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Understanding the RCEP with Rajat Kathuria

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(Intro) Srinath Raghavan: Hello and welcome to interpreting India. I'm Srinath Raghavan and this is the podcast presented by Carnegie India. Every two weeks we bring to you voices from India and around the world as we unpack the role of technology, the economy and foreign policy in shaping India's relationship with the world.

Rajat, Welcome to Interpreting India. Thank you. So let's start by talking a little bit about the RCEP itself. What kind of a free trade agreement is it? Is it a standard free trade agreement or is it more ambitious than that?

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Rajat Kathuria: Yes, I think so. I mean RCEP, you know, goes beyond normal trade and services. It's also looking at investment. So in that sense it's what people have called an economic cooperation agreement. And I think the best way to look at RCEP is to look at a hedge that, you know, China had proposed, uh, sort of to counter the TPP when it was alive. So it's a counter to the growing, sort of hegemony of the United States. So that's the context in which we could look at RCEP. But it's a sort of more than just a trade agreement because as I said it looks at investments as well. But in terms of ambition, I think it's not as ambitious as let's say the TPP was because the TPP not only looked at trade liberalization and services liberalization, but TPP was also looking at standards across different sectors. But RCEP doesn't sort of go into standards as much. Maybe in the future it will, but it's essentially an economic cooperation agreement, which is looking at trade and goods, trade and services and investment cooperation.

Srinath Raghavan: And what do you think was the real driver behind this, given that there is an ASEAN free trade agreement and even countries like India have a free trade agreement with ASEAN. So what was the imperative to bring in these other six partners for the ASEAN countries? What was the vision?

Rajat Kathuria: So the vision is, I said, you know, it was to look at another alternative trading block to the TPP, uh, so that you could have, you don't have one sort of big power that is dictating what happens to global trade. And in hindsight, I think that's proven to be sort of correct in some sense because of the intransigence of the United States on trade or the growing protectionism within the United States in trade. United States, don't get me wrong, it's still very free and very open, but there are signs of growing protectionism. So if sort of you could engender you know freer movement of goods and services and investment, with a group of countries that constitute, uh, you know, 40% of, uh, trade and 30% of GDP and growing the center of gravity has clearly shifted towards, uh, you know, China, towards other, uh, East Asian countries and of course towards India.

So this is where hopefully the action, the young population, the growing GDP, uh, the growing investment flows. And of course, countering some of the age old institutions that have existed post Bretton Woods, some of them now have been created by China and I’m referring to the banks, AIIB and NDB. And so, so there is a movement of economic might towards

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reasons. I mean in the past when you had trade agreements, you were really looking at trade agreements to try and make trade as free as possible within a group of countries because it was becoming so difficult to negotiate in the multilateral framework, agreements with 160, 170 and now 190 countries. So it's becoming really difficult to do that. So, you know, as Professor Bhagwati once said, eh, this could be looked at stumbling blocks or building blocks.

So if you were to agree to the paradigm that this is a building block, then it is engendering, you know, freer movement of goods and services and hopefully from India's point of view of freer, movement of people as well. Uh, and also movement of investment because there'll be RCEP investment facilitation or economic cooperation as well. So I think there is a, a good reason for having the RCEP. And of course from India's point of view, I think there are several good reasons why we should be in there. But, uh, I think the political economy has, uh, sort of dictated what happens to global trade more often than not.

Srinath Raghavan: Right. And India of course was not even earlier invited to be a part of the Trans Pacific Partnership, which is the TPP. So in a sense, RCEP was possibly our only option. That's the only game in town so to speak.

Rajat Kathuria: Absolutely. And we were not definitely, definitely we were not ready for the TPP, although as academics had said, I mean, we should try and get into TPP because the opportunity cost of being out, uh, are uh, going to be high. And indeed I think, uh, the opportunity cost of being out of RCEP, um, will be high as well. Uh, we haven't done the math, but I think the opportunity cost of being out of RCEP will be very high. So you won't really be a part of the modified TPP, which is the CTTPP. Uh, and we are not a part, if we don't be a part of RCEP. Then we are really isolated in global trade. Uh, as far as agreements, like big agreements are concerned. We have agreements with Korea and Japan and you know, uh, partly with a preferential trade agreement with Sri Lanka. We have something with Malaysia and Thailand and Singapore. But you know, those agreements don't cover a large part of the trade that RCEP will cover and they don't cover China.

Srinath Raghavan: And also the whole WTO process seems to have slowed down almost to the point of being stalled hasn't it?

Rajat Kathuria: Precisely. I mean, that's the point I was making about if it's

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uh, if you go back to the old collective action public choice literature, you would see that, you know, negotiations within a small group of people with coherent interests are much more likely than a large number of diverse, uh, people or diverse groups where, you know, getting into an agreement becomes almost impossible. Similarly, in trade agreements, whether it's 16, whether it's 10 or you know, a fewer number, it becomes easy, easy, easier. It's not easy, RCEP is showing us that it's not really easy to arrive at an agreement, but definitely easier than the WTO and the multilateral framework to the extent that even the WTO is talking about plurilaterals that okay, if people don't want countries don't want to join, we can have a smaller group of countries agreeing on something that can then be extended to other countries on a multilateral basis. And whoever wants to join is free to join at any time. And that's a serious discussion within the WTO that is happening even as we speak. And there are other things that are happening within the WTO to try and ensure that the multilateral framework doesn't die. And that WTO, uh, as sort of a governor of global trade remains because it has significant achievements. But you know, as everything you have first generation, you have second generation, you have a third generation. I think, uh, you know, WTO's sort of benefits of WTO’s, you know, first and second generation if you will. Uh, they have happened. We've leveraged those. Now we are moving into territories where, uh, countries like India and China and other countries are becoming bigger. They are not going to take, uh, the agenda as it's been set by the developed block by the G 7. We want to become agenda setters. And that's, you know, creating a conflict between the existing powers as we knew them and the new power. So there has to be a realignment, uh, towards, you know, countries like India and China. And I think WTO will sort of reinvent itself.

Srinath Raghavan: Let's talk a little bit about India's position at the RCEP itself. You hinted upfront that it's been, let's say, not such an easy road for us and, uh, as, as the agreement looms, there is going to be a summit very soon. Uh, you know, um, there are news reports suggesting that India has been more or less told that, you know, you can take about 10 days and try and either convince everyone or we'll have to take some kind of a call on what is going to happen. And I think the appetite for continuing further discussion seems to be low. So what exactly are the kinds of big challenges that India has faced in acceding to RCEP and then to getting the agreement to shape, to reflect its own interests as well?

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trade agreement with China. We don't have a free trade agreement with China, but RCEP will make it a free trade agreement with China. So I think, uh, a lot of our energies have been directed towards what would happen, uh, if India enters the RCEP, uh, as if we were looking at only a free trade agreement with China. So I think that's really the challenge that India faces given our existing level of tariffs, where we are today, uh, with China and the existing levels of tariffs are sort of our average tariff is about 10% and some high, of course in some low, even at that tariff level, at the multilateral tariffs that China gets, we are running a $50 billion trade deficit roughly with China, right?

Uh, and our market access with China has not been very good, not been high. We export not that we don't export, pharmaceuticals, cotton, etc. But our imports from China are very very high and China is our largest trading partner. And therefore getting into a deal with a country where you're running a very large trade deficit then begins to raise questions and red flags. What would happen to industry? What would happen to jobs? What would happen to our local economy, especially at a time when growth has, has plummeted, right to 5%, it is the lowest. So growth has come down and then you're getting into a trade agreement. It's also a narrative that you're trying to build, uh, within the country, within the constituency.

People might say, turn back and tell the government that, you know, you're getting into a trade deal effectively with China, which is so much more competitive than us and we're running a huge deficit at a time when growth has declined. And there are challenges in the economy so that narrative, uh, the government has to try and address that narrative, which is what the minister is trying to do in Bangkok is try and get as many safeguards, delay the implementation of the agreement as much as possible. Get a phase in of 15 years, 20 years so that industry can sort of gear up and come up to speed and be able to compete with China.

Srinath Raghavan: Things which are at least I've heard some of the critics or people who are warning the government against moving towards an RCEP kind of an agreement has been to point out to the, what they call the negative and unforeseen consequences of the FTA with ASEAN in itself, which they say has in some ways provided a backdoor for Chinese manufacturing to actually come to India because China has a lot of investments and in terms of you know, companies and others which are

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happen. Do you think actually the data and the research supports that kind of a claim.

Rajat Kathuria: Well rules of origin and trade agreements are important. And you know, in NAFTA we saw a US was flooded with goods from Mexico that were not Mexican. Now you define what is Mexican or what is, you know, Chinese that will happen because, uh, you know, when you're getting into an agreement with 16 countries that already have an agreement. So there's already nested agreements within the group and, and China has been an overseas investors. So that will happen. It's just that in trade agreements, you will have to, you know, define very carefully what your rules of origin are. But that will remain, uh, uh, a risk that you will get Chinese good entering into India from ASEAN countries. And we've seen the history of that. So you actually see that in the data the extent of that.

Srinath Raghavan: So, uh, the kinds of safeguards that India seems to be looking after, particularly on the sort of data front, trade front. Right. There seem to be three sets of things that India is looking for. So the first is we seem to be asking for the revision of what the base here for tariff cards is, because originally the agreement was pegging it at 2014, but the expectation then was that it would get completed by 2015. Uh, but I think now we are asking for it to be brought up to 2019. The second thing is this, uh, kind of a demand for some kind of an auto trigger in case there is a surge of ah, you know, imports from particularly like countries like China, New Zealand, also on the agrarian side. The third thing is about, uh, you know, India is seeking some kind of a carve out on the so-called ratchet principle, right? Which is that once you've agreed to cut tariffs on something, you cannot go back. And reverse those decisions.

Rajat Kathuria: These are the right set of vision and there's of course investment state dispute. Yeah. So, uh, I think these are the, the issues, the right issues that India is confronting. I mean the auto trigger mechanism is like going back to the quota, right? I mean I will allow you to import so much, but if it exceeds that amount, we'll have an auto trigger mechanism. It's really a safe gun for domestic industry, uh, so that they're able to compete. Now there are very good reasons why we should do that or why we, you know, think of asking for that. And I'll tell you the reason because mainly I think this is going to be effective with respect to China. I don't think they're going to be import surges to that extent from, from

But with China, yes, it could happen. It could happen in sector. It's already happening in electronics, we know that. It could happen in steel. So, uh, the good reasons for doing that is what the United States has been saying of China is that we don't know really how the system in China of state and business work together. i.e. is China a market economy or is it a non-market economy? And if there are non-market economy then the sort of ecosystem within China is not transparent and therefore we are not competing with them on a level playing field. And therefore there's one good reasons that in case there is a surge, then we could try and protect our domestic industry. And I protect our jobs. I mean I'm seeing that understanding that we need to become sort of really competitive because we can't go on, you know, in the 21st century, we can’t go on saying that, you know, we liberalized in 1991 and we still need time to become competitive.

We are going to delay it as much as possible. The tariff reductions, you know, over a 20 year period et cetera. So we will buy time in the agreement. But I think we should now begin to look at, you know, trying to compete, trying to improve our domestic environment. You know, ease of doing business is something which we desperately need to focus on and keep on improving. We moved 50 steps, 50 ranks, we need to improve a lot more.

You need to become competitive, you need to ease the costs of doing business. And I think these are steps in the direction of making industry to be able to compete. There's no reason why we can't compete with China. There is no reason, our labour costs are still 50% of China. Vietnam’s are even lower, but Vietnam will go up and so will we, but this is the time where we can actually attract a lot of investments that come out of China. So this agreement will change the way we approach manufacturing. That's and I hope that happens rather than saying, gee, you know, China will swamp our market with Ganesha’s, Diwali coming, you know with lights and so on. I think that's a misleading, we don't import so much consumer goods from China. I mean because it's so top of the mind. People talk about that. But our imports from China, if you look at our intermediate products, electronics $45 billion, we are assembling phones and selling them to other countries. I mean for all effective purposes, there are Chinese mobile phones which we brand ‘Made in India’ and sell not only in India but to rest of the world.

Srinath Raghavan: But I suppose that is true of value chains the way they means entirely a hundred percent produced in India.

Rajat Kathuria: Exactly. But the narrative, you know, the Make in Indian narrative I think is one where you are trying to sort of encourage more value addition in India, not for its own sake, but for the sake of trying to create more jobs. I think the jobs is sort of imperative in India or productive jobs imperative in India is guiding a lot of our sort of policy decision as it should.

Srinath Raghavan: But as you're suggesting, you know, an agreement like RCEP particularly coming on the back of steep reduction in corporate tax rates in India could also see a flow of a flow of investment into India. You know, in a sense it's not just about flow of goods and what we need to do to keep them out or regulate their quantum. But possibly there's also an opportunity to make India a much more attractive investment destination. And as you said, many of these economies are looking for alternatives to China, particularly in the context of the US-China trade war which is a bigger macro picture, but maybe we could end up benefiting from some of these countries.

Rajat Kathuria: The idea that we can build value chains, which is something that we've been lacking in sectors outside of automobiles and outside of pharmaceuticals. We haven't been able to create robust value chains in other sectors. And I mean, we could, we could create those in India and India could become a participant in the value chains, for example, in electronics. I mean, there's no reason why we can't become a provider to have handsets and tablets and computer better computers to the rest of the world. We have the skills, we have a known sort of competitive advantage in IT related skills and software.

A hardware should be the easier part. We've done the difficult part, which is the brainpower. So we should be able to do the hardware. I mean China didn't, you know, have to sort of, uh, they, they did this over a period of time, but they did it without having the, the sort of comparative advantage in IT services that we already enjoy. So I think it should be relatively easier for us to do that to a large extent. Um, getting investments in hardware into India, uh, eh is really the old story about, uh, you know, India is a difficult market to operate in. Its, you know, different States have different rules. I mean the, the uncertain, the policy uncertainty, the implementation uncertainty, the, the sort of infrastructure deficits of power, water, logistics, all of these are what is really a constraint to foreigners or to investors coming into India in the scales that they came into China.

Srinath Raghavan: So one particular sticking point as far as this investment side of RCEP is concerned is about this investor. Let me say that again. Investors state dispute settlement mechanisms and which is effectively provisions which allow private investors and private companies to sue national governments in other countries, not countries to which they belong. And these kinds of provisions have been problematic in many other trade agreements as well because they then go to a certain degree of regulatory harmonization, which all countries feel derogates from their national prerogatives to greater or lesser extent. And in the context of RCEP, I think India is a little uncomfortable with the fact that there is a consensus building saying that you know, these will kick in say two years from now, even if everyone doesn't agree, if there is a majority of those 16 countries end up agreeing, then you know, we can just go ahead with that. What exactly are the specific concerns, you know, which are motivating India beyond this kind of issue about saying, you know, should we really allow foreign private companies to be suing our national government?

Rajat Kathuria: So I think the main reason to my mind, uh, is our experience. One negative experience with typically Vodafone and Cairn. I think these are the two, you know, big ticket,adverse experiences that we've had. Uh, so I think we, we've been stung by the sort of Vodafone experience of taking the government, the sovereign to court, uh, in a third country because of the VIT. And I don't want think we want to repeat that mistake again. Having said that, I think there is no reason why, and here I'm much more sort of sympathetic to what, uh, India has been saying.

So what is a practical issue here? And an investor comes in, we've got a court process a domestic court process. I mean, you may, you may say that it gets delayed. We've got, you know, high court, we’ve got the Supreme court. Uh, you may say, you may criticize it to say that it gets delayed, but I don't think that they are biased. I mean, you have the agreement Tata Docomo for instance. I mean they were eventually allowed to take out their money and go back. Right? So it took long, but it did happen. And I think the court process, the judiciary has by far been an institution, of course, you know, we, we read about in the newspapers how the judiciary is also being maligned. But as far as you know unbiasedness for foreign investors is concerned I think, I don't think any

So delay, yes, I'm sympathetic then, but I think, uh, we have a whole lot of processes within the country. We are signatories to MIGA. I mean, there's no risk of expropriation of investment by the Indian government. We are not, not a banana Republic, you know, uh, expropriate these. So I think some of the concerns are unfounded, but so for India's point of view, we don't want to bind ourselves into something, we know it'll never happen. But at the same time, we don't want to bind ourselves into a company taking the sovereign, uh, to sort of quarantine a third country, so that I think and the experience stings us. And I think I would support the government, uh, in this aspect that we have a domestic process and we have a court process and you can always, uh, take recourse to that process if the case arises.

But I don't think the case will ever arise on expropriation grounds. Um, you know, the other experience. I had just come back to India and the Enron case, uh, was, was happened. And there was, I was quite surprised at the kind of media attention it got for, for the right reasons. I think, uh, in hindsight, you know, we were a power deficit country. And we bent over backwards to invite foreign investment. Not only did we give them things that seemed quite ridiculous, uh, you know, uh, 30 years down the line or 20 years down the line, they got a state guarantee and on top of the state guarantee they got a federal or a central guarantee of a 16% return on equity, on dollar return on investment.

So we were not only giving them a return on equity that was guaranteed, but we were also adding all the depreciation risk to uh, India. And that seemed quite outlandish to me, uh, at that time and why we were doing that. But, you know, we were desperate for foreign investment at that time. And so we sort of bent over backwards. We need foreign investment. I mean, it's no gainsaying the fact that India needs foreign investment because foreign investment comes with other benefits, but we don't have to bend over backwards to get, invite them to come to. They should come to India because India is an attractive market and the risk of appropriation is negligible if not non-existent.

Srinath Raghavan: So just moving away from the economic and policy questions, uh, do you think the government's position is also sensitive to the politics surrounding RCEP itself? Uh, we've seen not just protests from, you know, the standards of trade union left, uh, parties which are opposed to globalization, free trade agreements of any kind. But we've also had a, in fact have ongoing protests by affiliates of the government

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have consistently had a different view on how the Indian economy should be opening itself up or you know, tying up with the rest of the world. And uh, they do have expressed serious reservations about, uh, some of these questions. Do you think the politics of it will also determine how the government will be looking on what terms to conclude an agreement?

Rajat Kathuria: I think so. I mean, I think politics is inextricably linked to economics. There is no question about, I don't think there is a, an economic policy that doesn't have, uh, either a trace or a significant amount of politics embedded in it. So the reality is political economy and government, going back to the globalization issue that you raised, and I still feel that, you know, free trade, uh, is what you read in textbooks. Free trade is good for all, uh, because nobody, you know, forces you to trade with somebody else. You do it because you gain. So countries gain, the problem with free trade or globalization has been the internal domestic policies of redistribution, sort of haven't worked and they're difficult to work. So trade is good. It increases the size of the pie in, in, you know, trade jargon. It increases the frontier a, it moves the production possibilities frontier out, uh, towards what is called the consumption possibility frontier.

And everybody is better off when you're looking at the unit as a nation. But within the nation, the redistribution has been abysmal. I mean, there have been gainers and there have been losers and the losers have not been compensated. So given that background, I think there are bodies, as I said, as you mentioned, and as I mentioned in my sort of remarks that, you know, there are some people who are not aware of trade agreements, whether they will affect them or not and how they will affect them. But there are losers, there's no gainsaying the fact that there would be no losers, there will be losers. And that's where the internal politics of redistribution becomes important. How do you compensate the losers? You know, trade benefits, the exporting industry, trade harms, the import competing industry. We know that through Samuelson.

We know that through our, you know, trade theories, but the compensation of the losers, uh, has been difficult in most countries. And so globalization gets a bad name because internal redistribution hasn't happened. So the, the visible sort of enemy becomes immigration in the United States for example, or in the UK. They are responsible for what's

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India. Uh, but I think the, where India is on its development cycle. Uh, if I could sort of look at the experience of history, at least in within the RCEP, China and before that Korea and before then Japan and then the newly industrialized economies, the smaller countries who we don't like to compare ourselves with, they've all benefited from globalization.

They wouldn't be where they are today without globalization. You know, even China couldn't take off to those 10% plus growth rates for 30 years. On the strength of the domestic market. So you had to have sort of globalization as a handmaiden in some sense for your growth. Unfortunately for India today, uh globalization is sort of receding in some sense, protectionism is taking over, but we need globalization today or we need open markets much more than we did in the past and as much as these countries before as it enjoyed the benefits of globalization. And the best way to be able to prize open foreign markets is through agreements like RCEP where you put your money where your mouth is, you want an open market, you will have to give some concessions as well. You and, and we should recognize that openness or globalization is going to benefit us, but we'll have to keep those safeguards in place. As I said, those internal redistribution has to happen otherwise, uh, there will be huge political protest and push back on it. But I think it makes sense for us to be in rather than out.

Srinath Raghavan: So I'm tempted to ask you, but I'm not going to ask you if you think actually whether we will end up there or not. We will know by the time this podcast goes live or close to thereabouts as to what the outcome is. Um, and in any case, I think you've given us enough context to understand whichever way this plays out. But I do want to finish by asking you if you could recommend anything to our listeners, uh, anything that you've read lately, uh, which would help them understand the larger context to which these things are happening, not particularly necessarily about the RCEP alone, but about globalization, about international trade, uh, and how it relates to India’s development.

Rajat Kathuria: Two of my favorite authors, uh, in international trade, uh, are Professor Jagdish Bhagwati and Paul Krugman and uh, I would encourage readers to, to look at their, they are both right in popular press as well, and they have their websites and Paul Krugman continues to write extensively. Professor Bhagwati has slowed down a bit, but his past readings are a delight to read. They're almost like you're reading

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Srinath Raghavan: That's great. And we'll put out some links to their work on the show notes to this show. Rajat Katuria, thank you so much for being with us today.

Rajat Kathuria: Thank you. Thank you. It's been a pleasure.

(Outro) Srinath Raghavan: Thank you for listening to this episode of interpreting India. A podcast presented every two weeks by Carnegie India. I'm Srinath Raghavan. For more information about the podcast and the production team, you can follow us on social media and visit our webpage.