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India's Exclusion from RCEP & its Impact on India's Foreign trade with RCEP Nations

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ABSTRACT :

The Regional Comprehensive Economic Partnership (RCEP) is a significant trade agreement comprising 15 Asia-Pacific nations, accounting for approximately 30% of global GDP and trade. However, India opted out of the RCEP agreement in 2019 over concerns about its potential impact on domestic industries, particularly the agricultural and manufacturing sectors. This research paper aims to explore the consequences of India's exclusion from RCEP and its effects on India's foreign trade relations with RCEP member countries.

The paper will delve into the background of RCEP negotiations, India's decision-making process, and the factors influencing its stance on joining the trade pact. It will analyze the potential benefits and drawbacks of RCEP membership for India, considering aspects such as market access, tariff reductions, investment flows, and competitiveness in regional trade.

Furthermore, the research will examine the implications of India's absence from RCEP on trade dynamics, economic integration, and geopolitical relationships in the Asia-Pacific region. It will assess the impact on key industries, employment patterns, export-import trends, and supply chain networks involving RCEP nations.

INTRODUCTION:

In recent times, the significance of international trade and relations in the policymaking process has been prominent due to their impact on the economic prosperity, social development, and geopolitical connections of a nation with the rest of the world. A commonly utilized strategy by policymakers in foreign policy is the elimination or reduction of trade barriers, both tariff and non-tariff, through engagement in trade agreements with other countries. India, following its economic reforms in the 1990s, has actively participated in various bilateral and multi-regional trade pacts.

One notable example is the Association of South-East Asian Nations (ASEAN) regional trade agreement, which aimed to eliminate trade barriers among member countries through a Common Effective Preferential Tariff (CEPT) Scheme. To strengthen trade relations with ASEAN, India initiated the "Look East Policy" in 1991, gradually progressing from a dialogue partner to signing the Free Trade Agreement with ASEAN (AIFTA) in 2010 .

Despite the benefits, India's escalating trade deficit with ASEAN and other free trade agreement partners raised concerns among policymakers, leading to a cautious approach towards engaging in new trade agreements. This cautious stance was evident in India's withdrawal from the Regional Comprehensive Economic Partnership (RCEP), Asia's largest trade agreement encompassing 10 ASEAN nations and 5 FTA partners.

This study delves into India's trade dynamics with ASEAN nations from 1991 to 2020, examining how its trade performance with ASEAN influenced its participation in RCEP negotiations. The analysis encompasses India's trade trends with ASEAN as a whole and individual nations, evaluating comparative advantages, trade
determinants, and the impact of the ASEAN Free Trade Agreement on the global economy in terms of trade creation and diversion.

Furthermore, the paper extends its analysis to the economic implications of RCEP by exploring India's trade performance with its 5 FTA partners. A simulation exercise is conducted to assess the consequences of India implementing a 100% tariff cut against all RCEP members, analyzing the effects on trade, revenue, consumer surplus, and overall welfare in such a scenario.

The Regional Comprehensive Economic Partnership (RCEP) is a trade deal that was being negotiated between 16 countries.

They encompass the 10 member states of the Association of Southeast Asian Nations (ASEAN), namely Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam, along with six nations that have existing free trade agreements (FTAs) with the bloc: India, Australia, China, South Korea, Japan, and New Zealand.

The RCEP is recognized as one of the most extensive regional trading agreements to date. Participating countries represent nearly half of the world's population, contribute more than a quarter of global exports, and constitute approximately 30% of the global Gross Domestic Product

OBJECTIVES

1. To analyze the trading performance (exports, imports, and trade deficit) between India and the overall ASEAN group .

2. To investigate the trade patterns (exports, imports, and trade deficit) between India   and each ASEAN nation separately .

3. To evaluate India's export comparative advantage with each ASEAN nation.

4. To identify the factors influencing trade between India and each ASEAN nation and five trading patners.

5. To determine India's export comparative advantage with other members of RCEP.

6.To eximine the impact on india's trade relationship with RCEP nation .

LITERATURE REVIEW

1. In his study titled "Trade and Investment Relations of India & ASEAN countries: Opportunities & Challenges," Ashok Sengupta utilizes the Export and Import Trade Intensity Index (TII) to examine the trading patterns between India and ASEAN. The research reveals that the Trade Intensity Index has been consistently increasing, with the Export Intensity Index (EII) nearly doubling while the Import Intensity Index (III) declined in 2015-16. Through econometric analysis, it was determined that 41% of India's export variations to the world are influenced by changes in total imports by ASEAN. Moreover, the study sheds light on the reasons behind India's advantageous trading prospects with ASEAN, highlighting the region's significance as a global center for consumer demand and its strategic position in global trade dynamics.

2. In his research article titled "An Econometric Examination of India's Trading Relationship with ASEAN," Amal Sarkar seeks to identify the factors influencing India's export levels to individual members of ASEAN. By focusing on individual countries within ASEAN, the study highlights significant variations in export demand elasticity based on their diverse economic development levels , shedding light on their importing behavior from India, a shared trade partner. The analysis of the trade model indicates a strong performance in terms of the direction and significance of the explanatory factors. Additionally, the findings offer valuable insights for policymakers, revealing a positive impact of expenditure on India's exports to ASEAN. Put simply, the demand for Indian exports is favorably affected by the growth of the ASEAN market. Furthermore, the study demonstrates that India's exports are competitively priced within the ASEAN market, suggesting that preferential trade agreements between India and ASEAN nations could enhance trade volume in the region.

3. B.P. Sarath Chandran (2018) employed the WITS-SMART simulation model to analyze the impact of RCEP on India. Through this simulation, it was revealed that India's imports from ASEAN plus countries would see a significant rise with the implementation of the FTA. China, which already maintains a considerable trade surplus with India, is expected to further enhance its trade performance and bolster the trade balance. India's strengths are anticipated to lie predominantly in the services sector, emphasizing the importance of finalizing a comprehensive trade agreement encompassing trade, services, and investment. Additionally, safeguarding sensitive product categories with increased Rules of Origin (RoO) support is deemed essential. Past encounters with existing FTAs have not been very promising for India, underlining the need to have its concerns addressed thoroughly before committing to the FTA .

4. Indira M. Hapsari and Carlos Mangunsong (2006) conducted a study on the factors influencing trade flows among AFTA members, exploring the effects of AFTA's establishment on both intra-regional and extra-regional trade. By examining trade patterns of AFTA countries in comparison to non-members, their analysis through econometric methods revealed that AFTA potentially leads to some trade diversion, redirecting trade from external countries to less efficient ones within the bloc. Additionally, the study confirmed that countries tend to trade more when their supply and demand are more complementary. As the export and import profiles of ASEAN members have become increasingly compatible over time, the opportunity for intra-regional trade among ASEAN nations has significantly expanded. Moreover, the research highlighted a positive correlation between similar export structures among ASEAN members and their bilateral export activity .

RESEARCH METHODOLOGY

The Regional Comprehensive Economic Partnership (RCEP) is an initiative for economic cooperation involving 10 ASEAN nations and five FTA partners: Australia, China, Japan, South Korea, and New Zealand. Despite this, India opted not to join RCEP. Consequently, the paper delves into the

potential economic ramifications of India's non-participation in this extensive trade agreement, particularly regarding tariff reductions that could have ensued if India had joined RCEP.

The paper also expands its analysis to examine India's trade dynamics with the aforementioned five FTA partners that did join RCEP, using a methodology akin to the previous analysis with the ASEAN nations. This descriptive analysis scrutinizes India's export trends, import patterns, and trade deficits with each of these countries individually for the period spanning 1991 to 2020, leveraging the same data sources. Lastly, the paper analysis the economic impact of the proposed RCEP agreement using WITS SMART Simulation Model.

Sampling Method :-

The t-test sampling method is chosen for its ability to assess the statistical significance of differences between two groups, which in this case are the periods before and after India's exclusion from RCEP. This method allows for a comparative analysis of trade metrics to determine if there is a significant impact attributable to India's non-participation in RCEP.

Hypothesis Formulation:-

- Null Hypothesis (H0): There is no significant impact of India's exclusion from RCEP on its foreign trade with RCEP nations.
- Alternative Hypothesis (H1): India's exclusion from RCEP has a significant impact on its foreign trade with RCEP nations.

Data Collection –

Data for the analysis includes key trade indicators such as export values, import values, trade balances, and sector-specific trade data between India and RCEP nations. The data covers the period from 1990 to 2020 to capture long-term trends and fluctuations in trade patterns.

T-Test Formula for Impact Analysis

To assess the impact of India's exclusion from RCEP on its foreign trade with RCEP nations, the t-test will be used to compare the means of trade indicators before and after the exclusion. The formula for conducting the t-test is as follows:

Independent Samples T-Test Formula:

$$t = \frac{(\bar{x}_1 - \bar{x}_2)}{s_p\sqrt{1/n_1 + 1/n_2}}$$

Where ,

- Bar X1 is the mean of the trade indicator (e.g., export values, import values) before India's exclusion from RCEP.
- Bar X2 is the mean of the trade indicator after India's exclusion from RCEP.
- Sp is the pooled standard deviation,

  calculated as:

$$s_\rho = \sqrt{\frac{(n_1 - 1)\, s_1^2 + (n_2 - 1)\, s_2^2}{n_1 + n_2 - 2}}$$

Where,

- s21 and s22t are the variances of the trade indicators before and after exclusion, respectively.
- n1 is the sample size before exclusion.
- n 2 is the sample size after exclusion .
- t is the t-test statistic that measures the difference between the means relative to the variability in the data.

The t-test statistic t will be compared against the critical t-value at a specified significance level (e.g., 0.05) and degrees of freedom (calculated as n1 + n2 – 2) to determine the statistical significance of the impact of India's exclusion from RCEP on its foreign trade with RCEP nations.

WITS – SMART SIMULATION MODEL

The WITS SMART simulation model is a software tool integrated into WITS that facilitates data extraction and tariff simulation using databases such as UN COMTRADE and UNCTAD TRAINS. It enables users to estimate the partial equilibrium impact of tariff reductions by importing country for a specified group of exporting countries over a single period, particularly for simulating the effects of preferential trade agreements. The simulation model categorizes the impacts into four main effects:

1. Trade effects :

This assesses the impact of trade policy changes on trade flows (imports), distinguishing between trade creation and trade diversion, along with the price effect. Trade creation refers to the direct import increase due to tariff reduction on goods from a specific country. Trade diversion occurs when imports from other countries become relatively expensive due to preferential tariff reductions, leading to increased imports from the tariff-reduced country. The price effect signifies the global price increase resulting from increased demand following tariff reductions.

2. Welfare effect :

This measures the overall impact of trade policy changes on welfare, encompassing additional tariff revenue from increased imports and additional consumer surplus resulting from import growth.

3. Market View:

This indicates the impact of trade policy changes on changes in imports, tariff revenue changes, and consumer surplus. Tariff revenue change on an import flow is calculated as the ad-valorem tariff multiplied by the final import value minus the initial ad-valorem tariff multiplied by the initial import value.

4. Revenue effect:

This shows the impact of trade policy changes on total trade effects, trade value, and revenue effects. Total trade effect signifies the additional import increase due to tariff reductions.

In the simulation exercise for the study, bilateral trade data between India and RCEP members for 2020 was utilized. India's simulation involved a 100% tariff reduction across all products for all RCEP member countries, representing a comprehensive tariff cut affecting all products uniformly.

DATA ANALYSIS & INTEPERTATION

India's trade relations with ASEAN have strengthened over time, with ASEAN emerging as India's fourth-largest trading partner. The total trade volume between the two regions reached 78.9 billion USD in the fiscal year 2020-2021. During this period, India's exports to ASEAN were valued at 31.49 billion USD, while imports from ASEAN amounted to 47.42 billion USD.

The Table 1 shows that India runs huge trade deficit with 6 out of 10 ASEAN countries – Brunei, Indonesia, Malaysia, Singapore, Thailand and Vietnam in the year 2020, the highest with Indonesia and Singapore.

INDIA'S TRADE PATTERN: COUNTRY-WISE (IN 1000 USD)- 2020			
ASEAN COUNTRY	**Exports**	**Imports**	**Trade Deficit**
Brunei	60050.926	422894.374	-362843.448
Indonesia	4363741.9	12020794.5	-7657052.636
Cambodia	144042.578	38186.46	105856.118
Lao PDR	27873.503	2074.905	25798.598
Myanmar	837624.366	575594.224	262030.142
Malaysia	6194006.085	7378040.61	-1184034.524

Philippines	1416026.273	505658.19	910368.083
Singapore	8295020.166	12306747	-4011726.812
Thailand	3777064.296	5223761.79	-1446697.494
Vietnam	4500548.684	5564634.47	-1064085.783

Table 1

Figure 1 and Figure 2 import with each of ASEAN major Export points are Thailand, while India's top are Singapore, Indonesia and Malaysia for the year 2020 . presents , India's export and countries. India's top three Vietnam , Singapore, and three major import sources

Figure1   **Figure2**
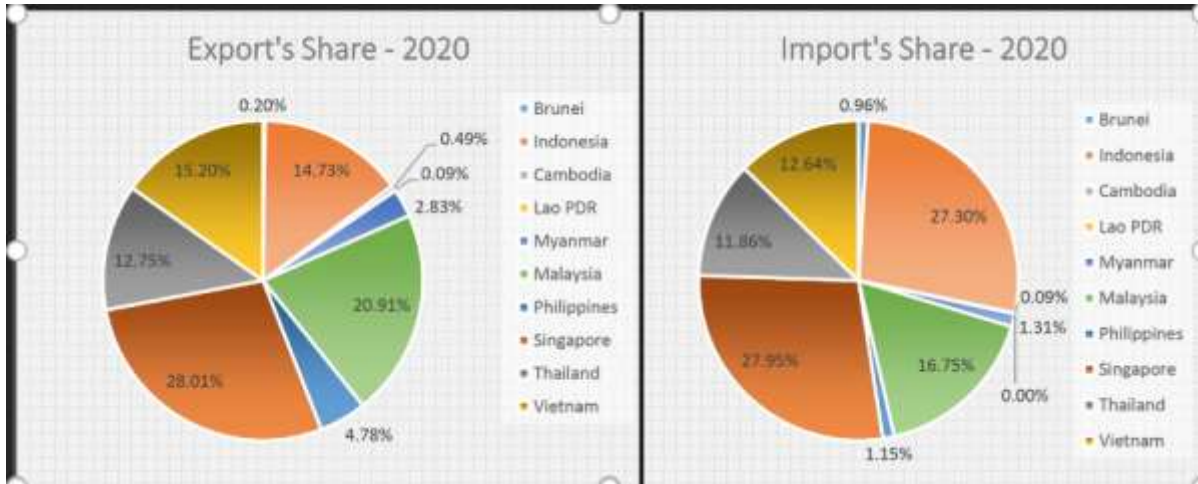

Additionally, Figure 3 presents India's trade with ASEAN, showcasing the trends in exports and imports from 1991 to 2020. Until 2005-06, India's exports and imports to ASEAN were relatively balanced. However, starting from 2006-07, imports exceeded exports, resulting in a trade deficit for India with ASEAN. This shift can be attributed to India's higher tariffs compared to its partner countries, leading to a more pronounced reduction in tariffs for partner countries and subsequently causing imports to outpace exports.

The trade deficit has continued to widen since 2010-11, the year India entered into an agreement with ASEAN, further exacerbating India's trade imbalance with the region.

Figure 4 provides insights into India's exports and imports to ASEAN by product category. It reveals that India's exports of goods such as textile clothing, footwear, food products, and minerals, where India holds a competitive advantage, do not feature prominently in ASEAN's imports. Instead, ASEAN shows a greater reliance on essential commodities like vegetables, fuels, chemicals, and metals from India.

Figure3   **Figure 4**
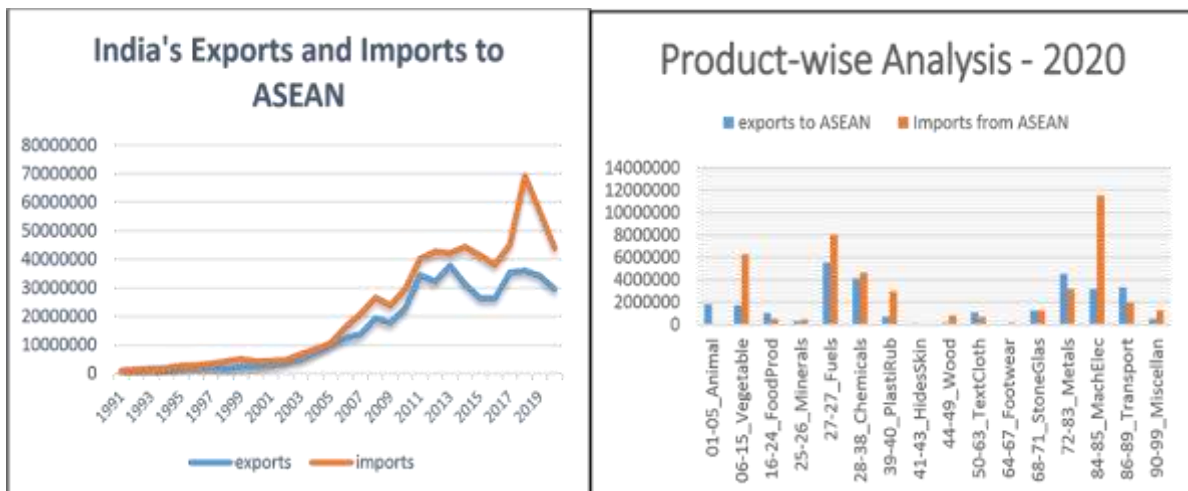
DESCRIPTIVE ANALYSIS India – RCEP:

The RCEP agreement is negotiated between ASEAN countries and their FTA partners which are Australia, China, Japan, South Korea and New Zealand. The Table 2 shows India's trade value with each of the other 5 countries for the period 1991 to 2020. It can be observed that India runs huge

trade deficit with 4 out of 5 countries with the highest recorded with China followed by South Korea and Japan. However, India recorded trade surplus with New Zealand.

INDIA'S TRADE PATTERN: COUNTRY-WISE (IN 1000USD) 2020			
Partner Countries	**Exports**	**Imports**	**Trade Deficit**
Australia	3471126.903	7263295.691	-3792168.788
China	19008266.74	58798824.68	-39790557.94
Japan	4043285.123	10206851.07	-6163565.944
South Korea	4516495.886	12168869	-7652373.118
New Zealand	439100.806	410837.552	28263.254

Table 2

FINDINGS

The paper reveals that India's trade deficit with ASEAN nations has been steadily increasing from 1991 to 2020. This trend intensified after the Free Trade Agreement with ASEAN in 2010, resulting in a significant gap between India's exports and imports. The paper also identifies specific product categories where India has a comparative advantage but low trade volume with ASEAN, suggesting an opportunity to address the trade deficit by focusing on exporting these categories to markets where they have a comparative advantage.

Furthermore, the paper concludes that the ASEAN Free Trade Agreement (AFTA) primarily led to trade diversion rather than creation. India also faced substantial trade deficits with five other Free Trade Agreement partners during the same period. The simulation model indicates that a 100% tariff reduction by India would significantly increase imports, reduce tariff revenue, enhance consumer surplus, and boost trade flows. These findings support India's decision to opt out of RCEP negotiations, considering its current trade dynamics and past experiences with existing trade agreements.

CONCLUSION

India has encountered a significant challenge with its Free Trade Agreements (FTAs) . This escalating trade deficit is concerning for India as it implies the need for foreign currency payments and reserves, potentially leading to a balance of payment (BOP) crisis if not managed. While the complete costs and benefits of India's participation in RCEP remain uncertain, the current trade deficit levels are unsustainable. India should focus on reducing deficits with its various trade partners.

A more gradual and sustainable integration into trade agreements like RCEP would have been preferable for India. With India's absence from RCEP, there's a pressing need to initiate long-overdue reforms in the domestic sector, executed meticulously and with a sense of urgency. India's export portfolio primarily comprises lower-stage manufacturing goods. To leverage tariff reductions effectively, India must ascend the value chain. High-value goods exhibit greater resilience as they are influenced more by demand and supply dynamics than income factors.

One of the reasons India hasn't fully benefited from past FTAs is the low utilization rate, ranging from 5 to 25 percent . India should assess existing FTAs to identify sector-specific constraints contributing to these low utilization rates. The government's decision not to join RCEP was influenced by industry pressures aiming to shield the economy from external shocks. Internal reforms are crucial to enhance the competitiveness of India's manufacturing sector and optimize the benefits of existing FTAs.

In the long term, India should actively engage in the global value chain and trade framework, assuming a leadership role in shaping trade relations and cooperation among nations. As India gears up to renegotiate FTAs with Japan and ASEAN, it must delve into the root causes of its trade deficits and devise sector-specific strategies to capitalize on future trade agreements.

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