Written by Administrator
Wednesday, 19 September 2018 16:39

RCEP as winning strategy: Why India must bring ongoing trade pact negotiations to a speedy conclusion

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The multilateral trade regime which saw trade flourish for seventy years following the Second World War faces an existential threat today. A trade war has broken out between the two largest economies, the United States and China. From being the principal architect of the system, the US has come to view itself a victim of it.

Therefore, in the medium run, we are likely to be left with regional trade agreements as the only game in town. This fact makes a successful conclusion of the Regional Comprehensive Economic Partnership (RCEP) agreement among its sixteen partner countries critically important. For reasons I explain below, India has much to gain from the agreement.

India is often criticised, even vilified, for its tough stance in trade negotiations. But all major nations with bargaining power negotiate hard to maximise access for their exports in return for the access they give to imports in their markets. The criticisms must therefore be heavily discounted.

This being said, India must not fear imports that would flow as a result of its reciprocal trade liberalisation. Conventionally, negotiators view imports as a cost and exports as a benefit. But in economic terms, true gains come from imports while exports represent the cost of obtaining those imports.

No nation would export its products to another nation if they did not allow it to import something more valuable in return. As Nobel laureate Milton Friedman once said, we can eat imports but not exports. Once shipped out, exports are no longer available to us.

One particular import-related fear that has shaped the actions of our RCEP negotiators is the prospect of an already large trade deficit with China turning yet larger. To be sure, it is a good negotiating tactic to use this bilateral trade deficit as a bargaining chip to maximise access for our exports to the Chinese market. But it is not good economics to let this fear determine the fate of the negotiations.

While there are good reasons for a country to care about its overall balance of trade in goods and services, the same is not true of bilateral trade deficit. A country must sell its exports to trading partners that offer it the highest prices for those exports. And it should buy its imports from partners that charge the lowest prices for them. When this is done, except by sheer coincidence, resulting trade flows would fail to balance bilaterally.

For instance, the US pays high prices for many products that India exports but it also charges high prices for many products that India imports. This leads India to sell a large volume of its exports to the US and to avoid buying an equally large volume of imports from it. Consequently, India runs a bilateral trade surplus with the US.

The situation with China is the reverse, leading India to run a bilateral trade deficit with it. But India maintains a healthy trade balance overall and thus avoids accumulating unduly large foreign currency debt.

In its negotiations, India must also pay particular attention to the benefits it can reap from membership in RCEP through a large-scale movement of multinational enterprises. It is a reasonable expectation that its large domestic market, large pool of labour and relatively low wages would combine to make India a progressively attractive production base for multinational enterprises. Membership in the large RCEP market would multiply this attractiveness manifold for two reasons.

First, the membership will give multinationals locating in India tariff-free access to the vast RCEP market. And second, movement of inputs without tariffs and other frictions across borders of sixteen member countries would make the multinationals doubly competitive.

Such movement is especially important in modern times because supply chain management requires inputs to cross international borders multiple times before being assembled into the final product. If tariff and friction characterise each crossing, costs multiply.

In the negotiations, India has made services liberalisation and freer movement of information technology workers a make or break issue. While India has strength in these areas, it must take two qualifications into consideration. One, our success in services exports to RCEP markets is likely to be limited due to language and cultural barriers that a free trade agreement cannot overcome. And second, preoccupation with services and freer movement of workers can result in underestimation of benefits India stands to reap in manufactures.

Given where India stands today in terms of its large pool of labour, low wages and reformed policy regime, past history is a poor guide to its future success in employment intensive manufactures. With half of India's farms less than half hectare in size, many of its farmers need decent jobs to escape poverty. Historically, labour intensive manufactures have been the principal engine of growth in such jobs in every successful country. RCEP offers India the same opportunity.

With a population of 3.5 billion, the volume of shirts, blouses, trousers, accessories, towels, bed sheets and pillowcases that RCEP membership would buy in the next several decades is beyond measure. Think of India as the dominant supplier of these labour intensive products and you have an irrefutable case for RCEP as a winning strategy.

Source: The Times of India