

RCEP and the impact of India's participation: summary of a quantitative assessment

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A recent assessment of the impact of India's withdrawal from the negotiations for the Regional Comprehensive Economic Partnership trade and investment agreement (RCEP) has implications for all negotiating governments. This note is a summary of some of those implications.

It is based on the paper *A quantitative assessment of India's withdrawal from RCEP: Issues and Concerns* by Sachin Kumar Sharma, G Badri Narayanan, Adeet Dobhal and Raihan Akhter (Sharma et al., 2020: see references below), whom I refer to henceforth as 'SNDA'.² The paper's primary focus is on the impact on India itself, but the impact on ASEAN and other parties is also reported and discussed. The reader is referred to this paper for further background to the RCEP and details of the authors' assumptions and the model's outputs.

There have been other assessments of the possible economic impact of the RCEP (for example Cheong & Tongzon, 2013; ITS Global, 2014; Li et al., 2017; Petri & Plummer, 2018). Because the negotiations have yet to conclude, all are forced to make assumptions about likely outcomes and so are to an extent speculative. Equally important is that typically they are based on a particular type of economic model – a Computable General Equilibrium (CGE) model – which makes general assumptions that are highly likely to show small but positive outcomes of trade liberalisation. These assumptions include perfect competition, perfect information, fixed current account balance, and little or no costs of transition through the structural changes caused by liberalisation. Many assume no net impact on employment. Materially to the present agreement, they assume fully fledged market economies, in contrast to the high levels of subsistence agriculture in India and other RCEP parties. When these assumptions break down, the modelling may produce incorrect estimates of outcomes (see, for example, Ackerman & Gallagher, 2008; Coates et al., 2016; Nilsson, 2018).

Indeed, while SNDA relax these general assumptions only partially, they find that some countries do not necessarily gain from increased goods trade among RCEP countries and even to the extent that countries do gain as a whole, there are significant domestic social and economic impacts that risk worsening poverty for some of their citizens and damaging the development paths of some countries.

Even for those that gain the most from RCEP – all but one of the high-income regions – the gains in GDP are estimated to be very small: a few months' additional production gained over a period of years. For the others, they are substantially smaller. For ASEAN (without India in the agreement) and

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² This paper is based on a pre-publication version of the SNDA paper.

India (whether or not in the agreement), their nominal GDPs are estimated to fall. India's presence or withdrawal makes little difference to any RCEP party's GDP.

India has withdrawn from the negotiations out of concern about the agreement's domestic impacts and the constraints on its industry development policies. Other countries will need to decide whether the small (or even negative) one-off gains that SNDA find in their study will sufficiently compensate them for what they are giving away in policy space for their ongoing development.

This note proceeds as follows. I first summarise the methodology used. I then outline some of the main findings. I conclude by pointing out some implications for continuing negotiations in the RCEP agreement.

Methodology

SNDA use the standard GTAP (Global Trade Analysis Project)³ model, a CGE model which is widely used in trade analysis because it allows regional and sectoral analysis and the incorporation of tariff and other trade-related data. The model is a 'comparative static' one, which means that it simply compares scenarios – in this case, with and without the RCEP, the RCEP with and without India. It does not show the transition path between the status quo and a scenario which may involve shrinking of some industries and expansion of others, unemployment and changes in the distribution of income and wealth. Nor does it allow conclusions about long-term development paths: for example many East Asian countries have successfully used tariffs and other measures to protect growing industries ('infant industries') until they become internationally competitive, allowing them to industrialise and move the economy into higher productivity, higher value production than their initial comparative advantages would have allowed. While in the short term those tariffs may have meant gains from trade were foregone, in the long run the countries benefitted considerably more than they would have from those gains.

As noted above, the model also makes various assumptions that affect its conclusions, including perfect competition, constant return to scale, and rational economic agents with perfect information maximising profits or utility. The model's structure does not allow the impacts on income or wealth inequality to be investigated because it does not distinguish between different types of households. GTAP can allow for some unemployment, though not all studies do so (instead assuming full employment and no net impact on employment). SNDA allow for unemployment to appear among unskilled workers, but not among skilled workers. However, they do not report the impacts on employment in this paper.

SNDA assume that all tariffs will be removed immediately on conclusion of the RCEP. This is unrealistic because most countries will reserve some tariffs in sensitive sectors, and there is usually a phasing down of tariffs rather than instantaneous removal. SNDA reason that 'complete elimination of tariff may provide the opportunities and challenges for the various regions under the maximalist trade liberalisation in the RCEP... We consider this as a hypothetical case as the maximum possible liberalisation of trade based on tariffs.' (pp. 6-7). What is just as important is that the study looks only at the effects of tariff removal, which affects only goods trade and not international commerce in services, foreign investment, nor indeed other potential aspects of RCEP, such as increased

³ See <https://www.gtap.agecon.purdue.edu/models/current.asp>.

stringency of intellectual property rights and deregulation in the form of removal of ‘non-tariff measures’ that affect trade and e-commerce. By focusing only on goods trade, SNDA are both modelling the areas in which current techniques have the greatest validity, and omitting areas in which India has had the greatest ambitions (such as services) and high concerns (such as patent protection of medicines).

The model uses 10 regions: possible RCEP members ASEAN (with no differentiation between its nine members excluding Myanmar), Australia, New Zealand, China, Japan, South Korea, and India; and non-members the USA, the European Union including the United Kingdom, and ‘Rest of world’. The focus is on the impacts on India by comparing two scenarios (the RCEP with and without India), but the modelling also shows the impacts on other regions.

Many of the participants in the RCEP negotiations are covered by existing agreements: for example New Zealand and Australia have agreements with all participants other than India. India has agreements with ASEAN, Japan and South Korea. All are members of the World Trade Organization. So the RCEP’s outcome is not on a blank slate and impacts on countries will differ due to their existing arrangements, their sectors of production and their level of development, among other factors.

Significant findings

The closest the report comes to modelling the overall impact of the RCEP is in its reporting on the changes in Gross Domestic Product (GDP – the total activity in the monetised economy). The weaknesses of GDP in measuring human well-being and environmental impacts are well known. In addition, in economies with large subsistence sectors, GDP may poorly measure or omit correspondingly large economic impacts. For example, SNDA cite the 2019 Indian Agricultural Census in reporting that ‘More than 99.44 percent of Indian farmers are low income or resource poor farmers with an average landholding of less than 1.08 hectare, who are mainly engaged in subsistence farming’ (p. 11). Subsistence farming occurs in dairying, an important area of the RCEP negotiations, among other agriculture sectors. SNDA continue: ‘On the other hand, other RCEP members like Australia and New Zealand have an average landholding of 4331 and 252 hectares, respectively.’

The following table from SNDA shows the impact on GDP of the RCEP in the different regions according to their modelling, both without India (columns 2-5) and with India (columns 6-9). Negative values are in red.

The usual focus of modelling is on real values – that is, adjusted for price changes – which show changes in quantities of goods and services produced in an economy, affecting employment as well as other aspects of interest. In the table, real GDP is represented by the ‘GDP quantity index’, and that is our primary focus.

Without India, all RCEP regions are estimated to see an increase in GDP. All regions outside the RCEP have a reduction in GDP, including India. With the exception of New Zealand, the largest percentage increases go to the higher-income countries – South Korea’s real GDP rises by 1.38%, Japan’s by 0.39%, Australia’s by 0.39% (New Zealand’s is 0.15%). But ASEAN’s GDP rises by only 0.14% and China’s by 0.22%.

Table 11: Comparison of the impact of tariff elimination under two scenarios on GDP of different regions (US\$ million)

Regions	India not an RCEP member				India is an RCEP member			
	Change in GDP	Change in value of GDP	GDP quantity index	GDP price index	Change in GDP	Change in value of GDP	GDP quantity index	GDP price index
	Million US\$	%	%	%	Million US\$	%	%	%
1 ASEAN	-10,909	-0.44	0.14	-0.59	3,670	0.15	0.27	-0.12
2 Australia	19,866	1.37	0.39	0.97	22,369	1.54	0.41	1.12
3 New Zealand	2,435	1.22	0.15	1.06	2,347	1.17	0.14	1.03
4 China	29,120	0.28	0.22	0.06	41,096	0.40	0.28	0.12
5 Japan	146,921	3.20	0.39	2.80	150,426	3.27	0.40	2.87
6 S Korea	35,599	2.52	1.38	1.12	42,978	3.05	1.87	1.16
7 India	-10,354	-0.51	-0.05	-0.46	-13,796	-0.67	0.60	-1.27
8 USA	-98,076	-0.57	-0.04	-0.53	-113,058	-0.65	-0.05	-0.61
9 EU_28	-69,119	-0.37	-0.03	-0.34	-80,210	-0.43	-0.04	-0.40
10 Rest of World	-78,232	-0.39	-0.05	-0.35	-95,763	-0.48	-0.06	-0.42

It is remarkable that the GDP increase is very small in all cases. As international trade expert Paul Krugman put it, ‘Yet there is a dirty little secret in international trade analysis. The measurable costs of protectionist policies – the reductions in real income that can be attributed to tariffs and import quotas – are not all that large’ (Krugman, 1995). The largest increase is 1.38% for South Korea, about five months’ additional production⁴. Japan’s increase is about four months’ additional growth, Australia’s two months, ASEAN’s, China’s and New Zealand’s less than one month. These are once-off total increases, not a permanent increase in growth rates. Even then, the additional growth is likely to occur over a period of several years, and likely to be overestimated because it depends on full removal of tariffs which is almost certainly not going to occur.

Even if India joins, there is little change. ASEAN benefits to the extent that production rises slightly more but still by only 0.15%, about two weeks of additional growth for these generally high-growth countries.

The following table shows the differences in GDP growth between an RCEP with India in it, and without it.

India has the greatest increase in GDP from its own participation, taking it from negative growth to positive – but only a 0.65 percentage point increase in production, equivalent to about one month’s additional growth. South Korea has a 0.49 percentage point increase and ASEAN a 0.13 percentage point increase. Changes for all other regions are less than 0.1 percentage points, and New Zealand is actually slightly better off without India in the RCEP.

⁴ At its average rate of growth over the decade to 2019, and similarly for the other regions quoted. Data source: IMF World Economic Outlook, April 2020.

Net effect of including India in RCEP: changes in GDP growth

	Change in growth			
	GDP	Value of GDP	GDP quantity index	GDP price Index
Regions	Million US\$	Percentage points		
1 ASEAN	14,579	0.59	0.13	0.47
2 Australia	2,503	0.17	0.02	0.15
3 New Zealand	-88	-0.05	-0.01	-0.03
4 China	11,976	0.12	0.06	0.06
5 Japan	3,505	0.07	0.01	0.07
6 S Korea	7,379	0.53	0.49	0.04
7 India	-3,442	-0.16	0.65	-0.81
8 USA	-14,982	-0.08	-0.01	-0.08
9 EU_28	-11,091	-0.06	-0.01	-0.06
10 Rest of World	-17,531	-0.09	-0.01	-0.07
The table entries are the growth that the model estimates would occur with India in RCEP less the growth that would occur if RCEP was concluded without India. Calculated by the author from Table 11 of the report.				

As SNDA point out, changes in real GDP do not tell the full story. Their modelling indicates relatively large changes in prices affecting the revenue producers are receiving, shown in the 'value of GDP' in the tables. With or without India, ASEAN's prices fall because of the influence of cheaper imports when tariffs are removed. That may possibly be good for consumers, but that assumes that there is sufficient competition for price falls to be passed on to them. But it is not good news for domestic producers including farmers if they receive less for their products. Possibly their fall in income will be offset by a fall in the prices of imported goods they use in production – but that depends on them using imported goods on which tariffs are reduced and on competitive conditions ensuring the reduction is passed on to them. For India, whether it joins the RCEP or not, it sees prices fall. On the other hand, the high-income countries see the reverse: higher prices under either scenario, and for all of them but South Korea, the price effect is much bigger than the weak increase in real GDP.

SDNA traverse concerns that if India joins the RCEP, domestic prices and production in the food-processing industry will fall, hurting the sensitive dairy and sugar sectors which sustain millions of farmers. India's trade deficit with China would increase substantially in manufactured goods, damaging India's manufacturing sector which it is trying to grow. India would increase its agricultural and food exports to South Korea, but at the expense of ASEAN countries.

Implications and conclusions

In assessing the implications of this study, we must return to the discussion of methodology and its assumptions. No model of this sort can tell the full story, and it lacks detail in many important areas such as the impacts on income inequality and on the future development paths of the countries

affected. There is no indication here of the impacts on employment and wages. For these and other reasons, the estimates of changes to the various regions' economies have an unwarranted precision to them: at best they should be seen as indicative.

The modelling SNDA have presented provides justification for India withdrawing from the RCEP negotiations if its principal concern was in trade in goods and it had little hope that it would obtain balancing gains in other areas of the agreement. It shows little effect on India's real GDP and a negative effect on its nominal GDP.

India's withdrawal raises the question for other negotiating parties as to whether it is worth continuing negotiations to conclude an agreement and, for individual countries, whether they should ratify it.

The first point to make is that India's withdrawal makes very little difference to that decision, at least as far as the goods trade is concerned. The RCEP without it makes little difference to any party's GDP.

As to whether individual parties should ratify the agreement, SNDA's study provides only a partial answer because it considers only goods trade. But goods trade is a significant part of the agreement so to that extent the study is useful. It indicates that any economic gains are likely to be at best very small. For ASEAN, without India it means a fall in nominal GDP and an insignificant rise in production.

Advocates for agreements like the RCEP will counter that the dynamic effects of trade – the impacts on the competitiveness and structure of the economy – brought about by liberalisation are more important than the very small direct gains. As discussed, like most modelling, that used by SNDA cannot measure dynamic effects so such claims would require separate validation for the RCEP agreement or be a matter of assertion. The counter is that active government involvement in industry development, such as through infant industry strategies, can be very effective in raising productivity and living standards (for example see Chang, 2002). There is strong evidence for this in many of the RCEP's own members, including Japan, South Korea, Malaysia, Singapore, China and Vietnam, whose active industry policies are or were crucial to their development. Yet many aspects of such policies are in conflict with the deregulatory provisions of agreements like the RCEP and others the negotiating parties are already members of.

It is also worth considering the impact of the COVID-19 pandemic which is having a major effect on many of the RCEP parties. Often, the economic impacts include a forced restructuring of sectors of their economies, particularly exposed sectors such as international tourism. It has exposed vulnerabilities such as lack of local supplies of medicines and medical equipment, and has reinforced concerns about food security for countries which have become dependent on food imports. Affected countries will need to use all the economic development tools available to address these impacts.

Like India, then, other countries will need to decide whether the small (or even negative) one-off gains that SNDA find in their study will sufficiently compensate them for what they are giving away in policy space for their ongoing development.

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