
Mizuho Economic Outlook & Analysis

November 18, 2019

RCEP comes to a crossroads

Even though an agreement in principle is reached among 15 nations, India suggests that it may withdraw

< Summary >

- ◆ The decision has been made to extend the RCEP (Regional Comprehensive Economic Partnership) negotiations, initially targeted for conclusion by the yearend, into the coming year. The fifteen parties excluding India have achieved substantial progress in the talks and produced what is equivalent to an agreement in principle.
- ◆ India faces strong objections from its domestic sectors about joining RCEP and is taking a particularly negative stance on opening its trade in goods market (reduction and elimination of customs duties, etc.). Under such circumstances, it seems unlikely that all sixteen nations including India will come to an agreement in the near future.
- ◆ As India's withdrawal from RCEP would lessens its significance, efforts to conclude a final agreement by the sixteen nations should carry on. However, we believe the fifteen countries may take the option to sign the RCEP agreement ahead of India's participation with a view to prompting India to join at a later date.

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1. While the RCEP member countries aim to sign an agreement in 2020, India has hinted at withdrawing from the talks

Seven years have passed since the launch of negotiations was announced on November 20, 2012, and RCEP (Regional Comprehensive Economic Partnership) has come to a major crossroads with India pondering its withdrawal from the RCEP talks.

The Joint Leaders' Statement on RCEP held on November 4, 2019 declared that the fifteen RCEP participating countries, excluding India, "have concluded text-based negotiations for all 20 chapters and essentially all market access issues." It went on to remark that legal scrubbing is the only task remaining in order to commence the signing in 2020, and we can evaluate that the fifteen parties have reached a so-called "agreement in principle."¹

The joint statement, also agreed to by India, stated that "India has significant outstanding issues that remain unresolved. All RCEP participating countries will work together to resolve these outstanding issues in a mutually satisfactory way. India's final decision will depend on a satisfactory resolution of these issues." On the other hand, after the RCEP Summit was concluded, India expressed its intention not to participate in future negotiations. This suggests the difficulty for India and the remaining fifteen nations to reach a "mutually satisfactory" compromise for all sixteen parties to sign the agreement next year.

2. The details of the fifteen nations' agreement are unclear, but the contents seem comprehensive

Regarding the contents of the agreement reached by the fifteen nations, the participating countries have only revealed the structure of the 20 chapters, and the details of the actual articles and market access agreement have not been unveiled.

If we look at the structure of the RCEP chapters, the agreement seems comprehensive with its coverage ranging from Trade in Goods, Trade in Services, and Investment to Government Procurement, Intellectual Property, and Electronic Commerce (**Chart 1**). Nonetheless, compared with the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), RCEP lacks independent chapters for such areas as state-owned enterprises, regulatory coherence, environment and labor.

¹ The ASEAN Secretariat, "Joint Leaders' Statement on The Regional Comprehensive Economic Partnership (RCEP)", 4 November 2019, Bangkok, Thailand.

Chart 1: Structure of the RCEP Agreement

1. Initial Provisions and General Definitions	7. Trade Remedies	12. Electronic Commerce	18. Institutional Provisions
2. Trade in Goods	8. Trade in Services -Financial Services -Telecommunication Services -Professional Services	13. Competition	19. Dispute Settlement
3. Rules of Origin	9. Movement of Natural Persons	14. Small and Medium Enterprises	20. Final Provisions
4. Customs Procedures and Trade Facilitation	10. Investment	15. Economic and Technical Cooperation	
5. Sanitary and Phytosanitary Measures	11. Intellectual Property	16. Government Procurement	
6. Standards, Technical Regulations and Conformity Assessment Procedures		17. General Provisions and Exceptions	

Source: Made by MHRI based upon the Joint Leaders' Statement on the Regional Comprehensive Economic Partnership (RCEP), November 4, 2019.

The fifteen RCEP nations have declared the conclusion of text-based negotiations, but does the contents of the negotiations carry the “high quality” insisted upon by Japan? For the level of rules, a split in opinions between developed countries including Japan and emerging countries such as China was reported, and how this discord was settled is worth noting. During the summit this time, Japan’s Prime Minister Shinzo Abe said he was pleased that, as a result of approximately seven years of resolute efforts to establish a free and fair trading system, fixed rules will be established in such areas as e-commerce and intellectual property in the Indo-Pacific region that is undergoing rapid digitalization.²

For example, regarding government procurement, documents released by the Australian government state that “RCEP’s government procurement chapter will support improved transparency and cooperation among the RCEP parties on procurement by central governments.”³ Documents compiled by the New Zealand government also state that the commitments on government procurement are “modest (primarily transparency and cooperation).”⁴ These statements infer that while the government procurement chapter in RCEP defines the basic principle to ensure transparency in government procurement, commitments on the liberalization of the government procurement market remain limited. Of the countries participating in the RCEP negotiations, only Japan, New Zealand, Singapore and Australia also take part in the WTO Agreement on Government Procurement (GPA), with Vietnam, Brunei (not effective yet), and Malaysia (not effective yet) participating in the CPTPP, which defines the same level of rules as the WTO GPA, in addition to the other four countries mentioned. Therefore, for more than half the countries taking part in the RCEP talks, it was the first time to accept advanced rules on

² Ministry of Foreign Affairs of Japan, ‘3rd RCEP Summit’, November 4, 2019.

³ Department of Foreign Affairs and Trade, Australian Government, “RCEP Outcomes at a Glance”, November 5, 2019.

⁴ Ministry of Foreign Affairs and Trade of New Zealand, ‘Regional Comprehensive Economic Partnership (RCEP) / Key outcomes’.

government procurement. Meanwhile, as the documents released by the Australian government use the term “procurement by central governments,” procurement by sub-central and local governments may have been omitted from the RCEP provision. From this point also, we can speculate that the liberalization of the government procurement market may have made only limited progress.

With regards to e-commerce, basic rules on such issues as Electronic Signatures and Electronic Authentication, Paperless Trading, Unsolicited Commercial Electronic Messages, Online Consumer Protection and Personal Information Protection seem to have been included. Meanwhile, it is uncertain whether the basic rules contained in the CPTPP, such as Non-imposition of Customs Duties on Electronic Transmissions and Non-Discriminatory Treatment of Digital Products, have been included or not. Concerning Cross-Border Transfer of Information by Electronic Means and Location of Computing Facilities, a theme that divided opinions between developed and emerging countries, rules to allow businesses cross-border transferring necessary data and to prohibit governments requiring the installation and use of computer-related facilities in their territories seem to have been provided. However, there is a possibility that regulations on data localization, such as those provided by the Cyber Security Act in China, may have been recognized as an exception to these rules, or interpreted as exceptional cases to fulfill security and legitimate public policy objectives.

On the topic of investment, documents issued by the Australian government state that the investor-state dispute settlement (ISDS) procedure is not applied at the time of enacting the RCEP agreement and the RCEP parties “will discuss this question in the future.”

This fractional piece of information suggests that the RCEP provisions are the outcome of compromises reached between developed nations who want to raise the level of liberalization and rules in the RCEP agreement to the CPTPP level and emerging nations who want to the “moderate” level of liberalization and rules. But we can at least expect the contents of RCEP to be of “high quality” to a certain extent. Nonetheless, since our observation is based on unconfirmed information, we must refer to the finalized articles after the RCEP agreement is signed.

3. India faces strong domestic opposition to joining RCEP

As the talks made significant progress and came close to an agreement in principle, India was asked to decide whether or not it would participate in the agreement, just like the other RCEP parties. In the RCEP Summit held on November 4, India postponed the “final decision” and even suggested withdrawing from the talks. India’s Prime Minister Narendra Modi, who participated in the summit, stated that “the present form of the RCEP Agreement does not fully reflect the basic spirit and agreed guiding principles of RCEP. It

also does not address satisfactorily India's outstanding issues and concerns. In such a situation, it is not possible for India to join the RCEP Agreement.”⁵

Of “India’s outstanding issues and concerns,” two topics stand out as particularly divisive among the member countries: (1) limitations in opening India’s trade in goods market, and (2) promotion of service trade market liberalization in the other negotiating countries. As India suffers from a high level of existing customs tariff rates and a significant trade deficit with many of the RCEP parties, it takes an especially cautious stance on opening access to its trade in goods market through reducing and eliminating customs tariffs, and this has caused the RCEP negotiations to drag on. In contrast, in the arena of service trade where India boasts strong competitiveness as exemplified by its IT (Information Technology) services, India has always insisted on greater liberalization; but since the other emerging economies have adopted a prudent attitude on this topic, India’s dissatisfaction has only continued to grow.

Summarizing the media coverage, it seems that India is seeking to realize the following points regarding the trade in goods market: (1) to change the base year of customs tariffs reduction and elimination, (2) to set the tariff elimination rate at a lower level against China, (3) to implement an automatic trigger safeguard mechanism for many products, and (4) to introduce more stringent rules of origin.

As for point (1), India is said to be seeking to change the current base year of 2014 to 2019. With a view to stimulating India’s domestic manufacturing industries, the Modi administration launched the “Make in India” policy and has been raising customs tariffs for several years. According to the WTO (World Trade Organization), India’s simple average applied rate was 13.5% (agricultural goods: 33.4%, non-agricultural goods: 10.2%) in 2014, but the rate was raised to 17.1% (agricultural goods: 38.8%, non-agricultural goods: 13.6%) in 2018. In May this year, as India raised the tariff rate on smartphones and other items from 0% to 20%, Japan requested consultations with India regarding this tariff treatment based on the WTO dispute settlement mechanism.⁶ By making the newly raised tariff rate a base rate, India may be aiming to slow down the pace of tariff reduction and elimination.

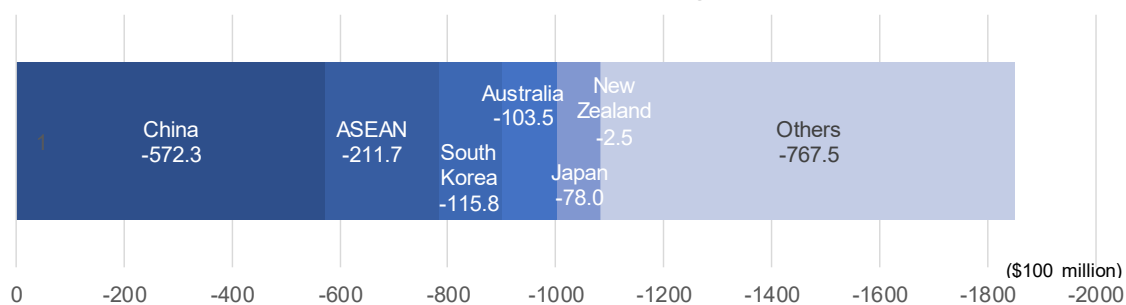
Point (2) has long been well known as India’s claim to lower the tariff elimination rate against China compared with other nations. Among the RCEP parties, India has a trade deficit with eleven nations, excluding the Philippines, Myanmar, Cambodia and Laos, and the value of its trade deficit against the RCEP nations accounts for 58.5% of India’s total trade deficit, which is approximately 185.1 billion dollars (2018 actual). Of these trade

⁵ ‘India decides to not join RCEP agreement, Modi says deal does not address our concerns’, *India Today*, November 5, 2019.

⁶ World Trade Organization, ‘India — Tariff Treatment on Certain Goods (DS584)’, 10 May 2019.

counterparts, China is the largest import counterparty and India’s trade deficit with China stands at about 57.2 billion dollars, accounting for 30.9% of the nation’s total trade deficit (**Chart 2**). For this reason, Indian industry is greatly concerned that India’s participation in RCEP will further increase imports from China and deal a significant blow to domestic industries. Furthermore, Indian dairy farmers have also expressed concerns about the potential increase of New Zealand imports, showing that the agricultural sector also opposes joining RCEP. Under such circumstances, while other RCEP parties aimed at achieving a tariff elimination rate above the 90% level, India has allegedly proposed setting the rate at 86% against Australia and New Zealand and at 74-80% against China over the next 25 years at maximum, albeit it has agreed to accept the rate of 90% for the ten ASEAN (Association of Southeast Asian Nations) members, Japan and South Korea as they have already entered into an FTA (Free Trade Agreement) with India. At first, India supposedly proposed a 40% level as the tariff elimination rate and tried to improve the contents of its proposal during the course of negotiations, but it seems that India could not come to terms with China and certain other nations.

Chart 2: Trade deficit of India (deficit amount against counterparties, 2018)



Source: Made by MHRI based upon UN Comtrade.

Although specific requests by India have not been revealed for point (3), the automatic trigger safeguard mechanism usually automatically increases a nation’s levies once imports cross a given threshold (regardless of whether damage is caused to domestic industries). This request seems to reflect voices from India’s domestic industrial and agricultural markets that are worried about surge of import from China and other countries, but India seems to have failed to reach an agreement with China and other certain nations on this issue as well.

On the rules of origin pertaining to point (4), as in the EPA with Japan, India probably wanted to adopt stricter rules of combined application of both the change in tariff classification rule and value-added rule. But in the RCEP talks, a system offering a choice between the change in tariff classification rule and the value-added rule was adopted in

principle, together with the accumulation rule. As the rules of origin have become more relaxed, we believe this has made it more difficult for India to concede points (1) through (3).

India's dissatisfaction with the reluctant attitude of the other emerging economies to liberalize their service trade also became apparent at the latest RCEP Summit. The "agreed guiding principles" pointed out by Prime Minister Modi as not being sufficiently reflected in the present agreement refers to the Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership compiled at the outset of the RCEP negotiations. These principles stipulate that "the negotiations on trade in goods, trade in services, investment and other areas will be conducted in parallel to ensure a comprehensive and balanced outcome." This seems to reflect Japan and India's insistence on not allowing the talks on trade in goods to precede the other topics. From India's point of view, if it fails to obtain sufficient benefits in the area of service trade liberalization while conceding to liberalization of trade in goods amid strong opposition from its domestic sectors, India cannot admit to having gained a "balanced outcome."

4. RCEP15 may be signed first by member countries without India

If India were to withdraw from the negotiations, it is crystal clear that the significance of RCEP will lessen. From the perspective of economic size, the GDP coverage of around 27.3 trillion dollars (32.2% of the global GDP in 2018, the same below) will be reduced to about 24.5 trillion dollars (29.0%), with the population coverage significantly decreasing from about 3.59 billion people (48.0%) to 2.25 billion (30.2%). The value of total trade between India and the other fifteen nations, amounting to approximately 240.8 billion dollars, will be outside RCEP's coverage. Optimization of regional value chains, including India, will also become difficult, and it will be impossible to strengthen ties with India through RCEP as a footstep to expand relations with the Middle East and Africa.

As for Japan, India's exit will substantially reduce RCEP's significance both strategically and economically. After the summit meeting, Japan's Minister of Economy, Trade and Industry Hiroshi Kajiyama said on November 8 that India's participation in RCEP carries great significance also from a geopolitical perspective for the purpose of realizing a free and open Indo-Pacific region. During the course of formulating a regional economic partnership in East Asia, while China and other countries promoted the framework of ASEAN+3 (Japan, China and South Korea), Japan initiated the same RCEP framework of ASEAN+6 (Japan, China, South Korea, India, Australia and New Zealand).⁷

⁷ Junichi Sugawara, "Japan's strategy on the regional economic integration of the Asia-Pacific region; its role as a bridge between the "Asia-Pacific" and the "East Asia", *Mizuho Research Paper*, No.32, Mizuho Research Institute, February 2013.

Faced with deadlocked talks and emerging ideas to exclude India and to switch to the framework of ASEAN+3, Japan allegedly took objection. It is only logical that some within the Japanese government would argue that RCEP including India is vital for Japan. Hence it is beyond question that Japan must play a leading role to realize RCEP consisting of sixteen parties that include India. But, how can this be realized?

The easiest way to prevent India from leaving RCEP is to accept India's requests that surfaced during the course of the negotiations, as mentioned earlier. Since the details of negotiations have not been disclosed, we are not sure how the other fifteen parties responded to India's requests. But given that the sixteen nations failed to reach an agreement, there must have been something in India's requests that was unpalatable to the other parties. Whether India and the other parties will be able to come to terms and whether India's participation in RCEP will not affect the existing agreement reached by the fifteen member countries are uncertain, so there is no alternative but to expect strong efforts to be made by the Japanese government.

However, there is also a limit to what the Japanese government can do. Japan has always granted technical assistance and other support measures to the emerging and developing countries participating in the negotiations in order to gain their understanding to make RCEP a "high-quality" partnership. Japan has also continued to deepen its cooperation with India and contributed to the "Make in India" policy as can be seen in the conclusion of the Memorandum of Cooperation on the Manufacturing Skills Transfer Promotion Programme in 2016.⁸ Therefore, it may not be easy for Japan to come up with more effective measures to disarm national opposition to joining RCEP.

In view of the strong opposition within India to joining RCEP, it is not easy for India to initiate a compromise. Given certain voices within the Japanese government that it is better not to sign RCEP if India is absent, we wonder whether Japan will maintain its target of signing the agreement with the sixteen parties even though negotiations will certainly drag on. Six and a half years have already passed since the first round of RCEP negotiations was held in May 2013. Although the first targeted date to reach an agreement was set at the yearend of 2015, the sixteen parties have repeatedly pushed back the deadline to the following year. We want to avoid a situation where RCEP will repeat the same pattern as the FTA negotiations between India and the EU (European Union), which were launched in 2007 with no sign of a settlement today.

In light of these circumstances, if an agreement including India cannot be reached among the sixteen countries at an early date, we hold that the fifteen parties should consider signing and enacting the RCEP agreement without India (RCEP15), while offering an

⁸ Ministry of Foreign Affairs of Japan, "Japan-India Joint Statement", 11 November 2016.

alternative for India to join the agreement at a later date. It has been reported that some countries are already proposing that the agreement be concluded without India. If the agreement reached by the fifteen parties remains up in the air indefinitely, the existing agreement may simply collapse in the future. We can also expect the enactment of RCEP15 to prompt India to join RCEP at a later date as the disadvantages for India remaining outside the accord become apparent.

At any rate, we expect Japan will take the initiative as expressed in its determination “to continue to play a leading role in signing an RCEP agreement we can be proud of in 2020.”⁹ But we also believe that Japan should consider plan B, which is for the fifteen countries to sign the RCEP agreement before India expresses its willingness to join the agreement at a later timing.

⁹ Same as footnote 2.