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South Asia's Trade Policy: Adopt East Asian Approach

By Pradumna B. Rana

SYNOPSIS

South Asian countries must adopt the East Asian approach of signing free trade agreements (FTAs) to enhance market access and to link their economies to regional and global supply chains. Failure to do so, will adversely affect their relative comparative advantage in markets.

COMMENTARY

REGIONALISM DID not play a role in East Asia's dynamic growth story, until about two decades ago. With the stalling of the World Trade Organisation's (WTO) Doha Round, however, East Asian countries saw free trade agreements (FTAs) as an alternative approach to liberalising trade and sustaining economic growth in the region.

It was also felt that FTAs could promote deeper integration as compared to the shallower integration of the WTO which mainly tackles "on-the-border" barriers. FTAs could address "behind the border" issues such as rules for protecting investments, intellectual property, environment and labour rights, and regulations on product standards that were relevant to supply chain or "21st century" trade which now constitutes a bulk of global trade.

East Asia's Response to Trump's Protectionism

An important risk associated with FTAs is the so-called "spaghetti bowl" effect. This effect arises when overlapping FTAs create a web of trade agreements with different documentation and compliance costs for businesses and negotiation costs for governments.

Firm-level surveys conducted by the Asian Development Bank in six countries, however, found that concerns about the negative effects of the Asian spaghetti bowl were over-stated and that the Asian spaghetti bowl had not unduly affected small and medium-sized traders. There was, therefore, a surge in the number of FTAs signed by the East Asian countries since 2000.

More recently, ASEAN, China, the European Union (EU) and Japan have taken a stand against then President Trump's "America First" policy and his emphasis on "bilateral and reciprocal trade" and signed a large number of regional and inter-regional FTAs with other trading partners.

Soon after Trump's inauguration, the European Parliament gave its consent to the Canada-EU Comprehensive Economic and Trade Agreement. The Japan-EU Economic Partnership Agreement came in force on 1 February 2019. The EU approved the EU-Singapore trade pact in February 2019, signed the agreement with Vietnam in June 2019, and is negotiating with Indonesia, Australia, and New Zealand. The EU and China also signed the Comprehensive Agreement on Investment.

Japan has also played a key role in driving the 11-country Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTTP). Recently, China applied to join the CPTTP.

The ASEAN-led Regional Comprehensive Economic Partnership (RCEP), the largest and broadest — but not the deepest — FTA in the world, was also signed in November 2020. The RCEP was to be effective by end-2021 but this might not happen as COVID-19 has distracted the attention of national legislatures.

China has taken a complementary approach to regionalism, by focusing on infrastructure and physical connectivity. In this regard, President Xi Jinping's signature project, the Belt and Road Initiative (BRI), is the main game in town.

South Asian Hesitancy in Signing FTAs

While the East Asian countries are signing FTAs at a fast pace, South Asian countries, including India, have been hesitant to do so. A case in point is India's opting out of the RCEP literally at the eleventh hour.

This hesitancy is not appropriate as it reduces the relative comparative advantage of a concerned South Asian country vis-a-vis the East Asian member of an FTA whose export basket is similar to that of the South Asian country.

Let us take an example. Both Vietnam and India export apparel, leather goods, footwear, and fishery and pharmaceutical products to the EU, and the CPTTP and RCEP countries. Since Vietnam is a member of the regional groupings while India is not, its relative comparative advantage in the commodities mentioned increases while that of India declines.

Similarly, additional foreign direct investment could come in from the EU to the manufacturing and services sectors of Vietnam in order to access the huge RCEP

market. The same incentive could also push other RCEP members to invest in Vietnam to improve market access in the EU.

Thus, hesitancy in signing an FTA with the EU and not joining RCEP would have reduced India's relative comparative advantage vis-a-vis Vietnam in these markets to the detriment of India.

South Asia's New Trade Policy

Fuelled by the COVID-19 pandemic that has seriously affected their economies and concerns of being shut out of the global economy, several South Asian countries are now fast-tracking FTA negotiations with major trading partners. Two years after opting out of the RCEP, India is now negotiating nearly two dozen FTAs and early harvest deals including those with the United Arab Emirates (UAE), Australia, Canada, and the EU.

India is hoping to conclude an FTA with the UAE and an early harvest deal with Australia by the end of this year. Bangladesh is also negotiating FTAs with Thailand and Singapore.

The reversal of the past go-slow policy on FTA is welcome. But the question still remains on how, going forward, the Indian government will manage domestic concerns including political factionalism that have hamstrung economic reforms.

The RCEP did not happen because of the government's inability to address domestic concerns. Similarly, the government has been unable to implement the 2020 farm laws, which seeks to promote the much-needed competition in the agriculture sector, because of the strong opposition of the farmers.

Pradumna B. Rana is a Senior Fellow with the Centre for Multilateralism Studies (CMS) at the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University (NTU), Singapore.

S. Rajaratnam School of International Studies, NTU Singapore
Block S4, Level B3, 50 Nanyang Avenue, Singapore 639798
T: +65 6790 6982 | E: rsispublications@ntu.edu.sg | W: www.rsis.edu.sg