Opinion

THURSDAY, NOVEMBER 7, 2019

PEACE TRAILS

Union home minister Amit Shah

Kartarpur Sahib Corridor is a historic achievement that generations of devotees will remember ... It reflects Modi govt's commitment towards preserving our rich heritage

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Change promoters to fix real estate

Attract new loans to revive stressed real estate projects with easier NPA rules, but only if existing promoters are eased out

THE GOVERNMENT HAS been working on initiatives to resuscitate the real estate sector. It has proposed a ₹20,000 crore fund that would be used to complete projects that have not turned into NPAs yet and where 60% of the construction is complete. This sounds good, but can't help beyond a point because sound projects don't really need help.

The real problem lies in the hundreds of stressed projects—and the bankrupt developers—many of which have been funded by non-banking financial companies (NBFCs) and banks. It is these projects that need assistance. Indeed, we are already seeing collateral damage.

That is because, with limited liquidity and in the absence of refinancing options, many more developers could go bust, and many more projects remain incomplete; the fallout of developer defaults on lenders could be significant.

There could be a solution: Ask banks to fund stalled projects under certain strict conditions. In fact, some banks are believed to have indicated that they are willing to do so if they are allowed forbearance for their share of the exposure. In other words, they don't want their new exposure to be classified as a non-performing asset. They point out that if they have, say, just a tenth of the exposure, it is unfair to ask them to label it as an NPA. That is a perfectly valid demand. Indeed, the idea is a good one, and RBI could consider relaxing the rules, but only if there is a change in the ownership of the project, with new developers being roped in to complete it.

A project where just 20-25% of the work remains, but has been languishing for lack of funds—working capital perhaps—could easily be revived with a new lender joining the consortium, and new developers coming in. The idea could go a long way if banks are able to rope in strong corporate builders to take over stalled projects, and lending to these companies would be less risky. While forbearance for any reason is to be avoided because it sets a bad precedent, this time around, given how the real estate sector is in terrible shape and how it can catalyse growth, RBI may want to consider it.

However, it is important that this kind of last mile funding doesn't turn into a bailout for existing lenders. The projects need to be screened thoroughly to ensure they are viable and are only in trouble because of a shortage of a small quantity of funds. RBI could review an independent assessment of the requirement of funds and put a cap. Also, the existing promoters need to be sent packing. They can't be, in any way, linked to the project. The lenders with previous exposure to the project must continue to classify the account as an NPA. They can't get away from that; the forbearance should only be given to the new lenders.

> The government must make sure the process by which a new promoter takes over doesn't get mired in litigation. For instance, investigative agencies should not stall the process as happened in the NCLT

Critically, the government must make sure the process by which a new promoter takes over doesn't get mired in litigation. For instance, the investigative agencies should not stall the process as it has happened in the NCLT, where the corporate insolvency resolution process has been short-circuited by the SFIO, EoW, and so on. Such disruptions will put off the prospective buyer as also the lenders. Banks today are sitting on funds—the surplus liquidity is more than ₹2 lakh crore—but are unwilling to lend to poorly-rated companies for fear of further loan losses. That is understandable; so, they do need some support from the regulator and the government.

The total exposure—across banks, NBFCs, and HFCs—to the developer segment is estimated at around ₹6 lakh crore, with NBFCs and HFCs having an estimated 30%. Of this total exposure to developers, 40% comprises lease rental discounting (LRD), which carries less of a risk. The core developer book (net of LRD), is split more or less equally between banks and NBFCs. Some NBFCs, in their quest for high yields—17-18%—appear to have abandoned quality altogether; now, that money is stuck because the builders are broke, or going broke since they are unable to sell their stock. The total unsold residential inventory, at the end of September, was six lakh units. How much of this was complete at the time is not known.

Strapped for liquidity, some NBFCs are now trying to camouflage the bad loans by converting them into equity; at times, these are being converted into non-convertible debentures(NCD), and sold down to retail or even institutional investors, locally and overseas, in what are often junk bonds.

That is one reason an AQR or an asset quality review for NBFCs—of all shapes and sizes—needs to be carried out immediately. That will tell us the true quality of the real estate book at a time when it is becoming harder for them to access liquidity at an affordable cost. The other problem with real estate is that valuations, which are inflated to begin with, will soon start to fall as banks attempts to monetise their collateral. That, then, will drive down the value of collateral held by other lenders. It will, however, be good in the sense that prices will become real again.

BuyingTIME

Time-banks are a good idea if implemented well; otherwise, they would be akin to a ponzi scheme

A ROBINSON CRUSOE economy is a thought experiment that is often used in economics to explain difficult concepts with simplicity. One of the best examples is of consumption and pension. The example is of an island where there are only two categories of people, young and old. The young can climb trees and get coconuts, and they part with their earnings so that the old can survive. The example works well till the time the young keep tending to the old, as once the cycle breaks, there would be no older people left since future generations won't tend to the old. Social security schemes were designed on this idea. In recent times, the concept has found resonance with the emergence of time-banks. While the concept dates back to 1820, the first time such a bank was set up in the US was in 1995. As technology has allowed proliferation of apps to keep track of social credits, more countries are adopting this approach. Madhya Pradesh, last week, became the first state in India to implement such a concept.

Given that the state predicts that the 60-plus segment would account for 25% of its population in the next 30 years, it believes a time—or social—credit system would help people avail social security services based on these social credits. To illustrate, if a person were to give one hour to volunteer work at a shelter for the elderly, she could, in her sunset years, encash that one hour of work from another volunteer for her care. Although the approach is novel and, given the right technology, trackable, the idea would only work if the state can ensure that there are enough number of volunteers always. At present, the state claims to have the support of Rajya Anand Sansthan, which has a force of 50,000 volunteers. Social experiments like these do sound good, but without support, they often fail. Cuba is a good example. Che Guevara's videos of working on docks, and helping labourers as part of the moral incentive scheme did work wonders, but it failed once there was nobody whose example the masses could follow. Maybe the state's ministers can lead from the front to make the idea a success. Otherwise, it would sound as ludicrous as the ministry that launched it—*adhyatma* (spirituality).

RCEP

THE VISION OF MAKING INDIA A GLOBAL MANUFACTURING HUB DEPENDS ON GETTING ACCESS TO GLOBAL AND REGIONAL PRODUCTION NETWORKS. FOR THAT, IT NEEDS FTAs LIKE RCEP

No competition please, this is India

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Views are personal

INDIA'S BACKING OFF from RCEP is not surprising. What is surprising is that it took it so long to do so. As a reluctant participator, India hardly had a constructive strategy for the talks. For several years, and most of the early rounds, it relied on the old strategy of lingering the process. But, as other countries started piling up pressure for concluding talks from about a couple of years ago, India realised it was being pushed into a corner. The deal was to be concluded in the last ASEAN Summit itself, in 2018. But, India's general election, as well as those in other RCEP members like Indonesia, Thailand, and Australia, came to India's rescue. The group decided to defer the conclusion to this year's ASEAN Summit at Bangkok.

It is only during the last one year or so that India got serious about RCEP. Elaborate consultations took place in the past few months, along with extensive engagements with other members. The deal, though, was already at a substantially advanced stage. Other countries were not sympathetic to reopening discussions on India's 'core' demands: bringing up the base year for cutting tariffs to 2019 from 2014, automatic safeguard trigger for stopping surge in imports, and the insistence on greater market access for its professionals. At the end, India was left with little choice but to back out.

India's opportunity to return to RCEP remains. The joint statement of RCEP ministers mentions other members working with India for resolving outstanding issues. But, this would require India being realistic about its 'own terms,' and 'core demands'. It has been excessively reliant on its large economic size, and the hope that size matters so much that it can demand and obtain the impossible. It must note that RCEP is a multi-country, regional trade agreement, where interests of individual members can be accommodated only up to certain extents. It must also note that its paranoia over Chinese imports is not shared by other members. The rest are unlikely to be overtly sympathetic to India's insistence on special protection against Chinese imports.

Why is the Indian industry, and other stakeholders, so defensive on RCEP? It is interesting that the same defensiveness is hardly visible with respect to efforts of an FTA with the US. The answer is obvious. RCEP includes Southeast Asia, China, Japan, and Korea—countries that are miles ahead of Indian producers on competitiveness in manufacturing. The gaps are so much that even with high customs duties, Indian consumers, in many cases, prefer imports from these countries as opposed to domestic substitutes. The same lack of competitiveness prevents Indian exporters from penetrating deep in Asia-Pacific markets in spite of zero or low tariffs. Exports from Vietnam, Philippines, and Malaysia would be more competitive in larger RCEP consumer markets like Japan, Australia, and Korea, compared with those from India.

The competitiveness problem doesn't arise for the US. Indian industry is confident of diving deep in the US market. The post-GSP scenario might be different though, since other GSP-receiving competitors from Asia and Africa are getting their act together by reducing business costs. The US imports also don't threaten Indian manufacturers, except in high-end pharma, and automobiles. The shock, though, will be in dairy and other agricultural products. If Indian dairy producers prefer being hit by American milk imports as opposed to those from Australia and New Zealand, then one needs to see what logic supports such preference!

> The logic of engaging in such FTAs only after domestic industry is competitive is fallacious. It will never be competitive unless exposed to competition, which it won't be

The overarching sentiment in pulling out of RCEP is Indian industry's fear of imports. But, will a longer phase-out period, and painfully slower cut in tariffs—as India is demanding—get rid of this fear? It won't. For most of Indian industry, the urge to become competitive doesn't exist as long as it is protected. Growth of exports requires being competitive and matching up to better quality standards. From an industry perspective, rather than export, it is better to focus on the protected domestic market, where the miserable Indian consumer will have to accept whatever is cheaply available, regardless of quality and price.

The vision of making India a global manufacturing hub depends on getting access to global and regional production networks. For that, it needs FTAs like RCEP. The logic of engaging in such FTAs only after domestic industry is competitive is fallacious. It will never be competitive unless exposed to competition, which it won't be.

RCEP members might concede more to India if they really value India's economic and geo-strategic might. There is talk of India pursuing bilateral FTAs with some RCEP members like Australia. Unfortunately, rubbing shoulders on the security platform of Quad won't guarantee special visas for Indian professionals through a bilateral FTA with Australia. The dairy sector would need to be stripped of protection, as would more of agriculture. That, though, might be more than a handful to handle. Getting shallow FTAs, as India has done in the past with Bhutan and Sri Lanka on geopolitical grounds, is very different from working out deep, modern, comprehensive FTAs with advanced economies. Even if India gets FTAs with the US and the EU, getting higher shares of these markets would mean competing with beneficiaries of deep non-reciprocal preferences like EBA. Competitiveness would matter there—a parameter where Indian producers would fall short.

The commerce minister's recent lament on FTAs not needing to create a fear psychosis is unlikely to serve its purpose. However supportive the government is, industry is unlikely to act towards becoming more competitive. Once protected, always protected. No wonder, the relief is so palpable after the pullout from RCEP!

The reforms that India needs now

Political control will be worthless if it is not used for decisive actions, with respect to the economy, which will both restore and accelerate growth

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THE CURRENT STATE of the Indian economy is bad enough to merit the description of being in a crisis. This is not the kind of crisis that triggered the economic reforms of 1991. At that time, India was facing the prospect of being unable to pay its bills to other countries whereas now, its problems are much more domestic, and, superficially, not as severe, with growth still at around 5%. The remedies now are also going to need to be very different. Removing controls, and cutting punitive import duties and tax rates is not where major reforms have to come, although trimming some tariff rates could help Indian firms that need to import equipment, or intermediate goods for efficient manufacturing.

The biggest problem, as has been said in this column multiple times, is in the financial sector. First banks, and then non-bank financial companies (NBFCs), have run into trouble, and credit has dried up in many key areas of the economy, with domino effects on real economic activity in those sectors. Cleaning up this mess will require major, concerted efforts if it is to be accomplished in a way that minimises the depth and length of the crisis. Bankruptcy and default situations involve renegotiating complex sets of claims by multiple creditors, and a poor resolution process can lead to an ongoing destruction of value as uncertainties are prolonged, and forward looking actions, such as new investments, are put on hold.

India's new bankruptcy code represented a significant step forward, but it has not yet been operationalised in the best way possible. Some of the problem lies with a judicial branch that is relatively inexperienced in such matters, perhaps to the point of lacking sufficient competence and expertise. Another large problem may be continued political interference. Political corruption and cronyism have been the bane of India's financial sector. Government bureaucrats and financial regulators also lack sufficient expertise and experience, along with a problem of bandwidth. This is one area where bringing in foreign know-how could be very valuable. It would be expensive, but with many billions of rupees of lost economic activity at stake, it would be an appropriate crisis response.

Unfortunately, the government has not seemed open to ideas and expertise from outside. A welcome trend of involving academics of Indian origin with stellar reputations has been reversed over the past few years. Even the warm glow of Abhijit Banerjee's Nobel prize only lasted a few days, as he became subject to ugly personal attacks by prominent ruling party members, annoyed by his gloomy, if realistic, assessment of the Indian economy. Right now, India needs more experts like him, who will speak their minds and provide unbiased analysis, as well as specialists who can manage, and accelerate, the process of financial restructuring.

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Another opportunity for "crisis driven" reform is in privatisation. In the long run, the GST will help India's government raise more revenue; and, as growth recovers, personal and corporate income taxes will also become more buoyant. But, for now, a series of well-structured, transparent privatisations, in areas such as the financial sector, telecom, and air transport, has the potential to raise revenue that the government needs to avoid a different (more traditional) kind of economic crisis. Privatisation will also have large long-run benefits as money-losing public sector enterprises are removed from the government's broader fiscal responsibility basket, and are forced to become more efficient and competitive. This kind of privatisation has to be whole-hearted, not just the sale of minority stakes that do nothing to force greater efficiency of operations. Again, experts who can design the mechanisms for structuring these privatisations, are needed, and the biggest challenge is whether the government is willing to recruit them from a global pool.

A complementary reform to privatisation is opening up entry in some areas of finance, in particular, but also, possibly, in telecom and other sectors where there is a shortage of supply, dominant players behaving as monopolists, possibilities for growth, or all of the above. Just repeating slogans about a $5 trillion economy will not bring it about, and not having a broad vision of where the growth will come, and how it can come about, will ensure that the goal remains unattainable. Having a concrete vision of what a robust economy, driven by competition and innovation, might look like in the next decade will also require expertise from around the world, including from people who do not necessarily agree with the government on everything—or indeed, on anything.

The ruling party has a solid national political mandate for the next five years. It will soon complete its project of extending that mandate to enough states so that political control of the Upper House of Parliament is also ensured. But, political control will be worthless if it is not used for decisive actions, with respect to the economy, which will restore growth, and even accelerate it to the East Asian-miracle levels that have remained a mirage for almost three decades. Making the right decisions will need openness to ideas, and drawing on global expertise in ways that have, so far, escaped the thinking of the current government.

LETTERS TO THE EDITOR

Police-lawyer face-off

The open confrontation between the police and the lawyers on the court and police station of the streets in Delhi has caused consternation among the general public. Obviously neither side is wholly to blame; both sides should share the blame in some measure despite a very one-sided picture presented by large sections of the media. There must have been a lot of simmering mutual mistrust and resentment for what started as a parking altercation to snowball into violent clashes. The instinctive territoriality of the lawyers and the police largely explains the scuffles that have broken out between them. Events have taken an ugly turn because of the perception of the encroachment of courts and police posts. Video clippings have shown police vandalising the chambers of lawyers, and lawyers ransacking police stations. The unprecedented protests by the lower rungs of the police joined by their kin with placards reading 'protectors need protection' and sloganeering 'we need justice', with which the media had a field day, were in violation of 'service rules' and defiance of 'superiors', and should not set a bad precedent. Slapping, thrashing or manhandling is wrong; it is a punishable crime, no matter who the perpetrators and the victims are. It is dehumanising; it not only causes physical hurt but also robs the victim of dignity. Getting physical at the slightest provocation is immature. The police should not do to ordinary people in custody or lock-up what it does not want the lawyers to do to them. As two indispensable pillars of the criminal justice system, the lawyers and law enforcers should nurture their interdependent relationship and complement each other in upholding the rule of law and serving justice. It is not necessary to draw a demarcation between them or portray them as villains and victims or vice versa. They are entitled to dignity of labour. As compatriots, they should now put "India First".

— G David Milton, Maruthancode

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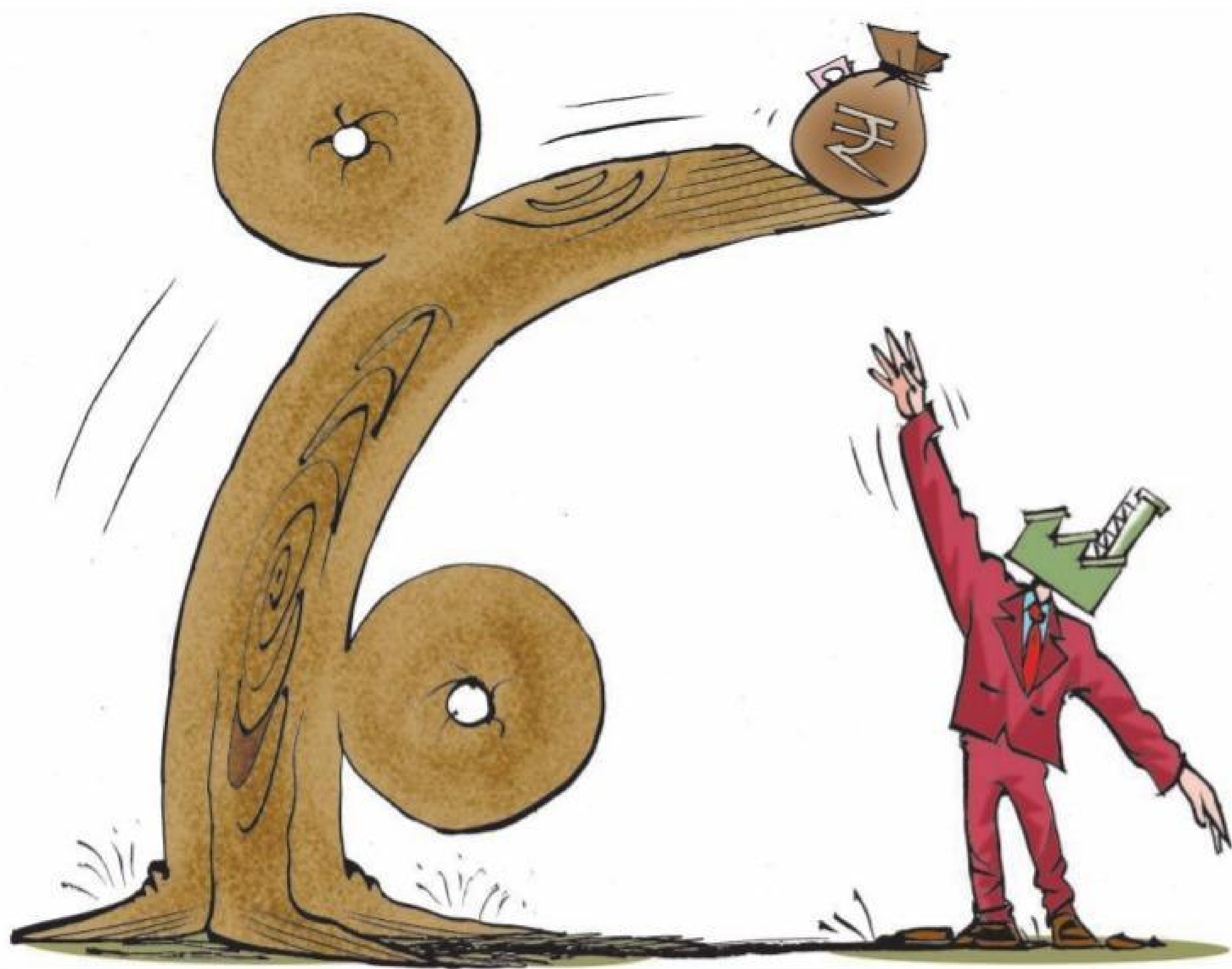

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GROWTH STRATEGY

Can fiscal stimulus revive growth?

Strong macroeconomic fundamentals, rising concerns on the economic downturn, and the urgency to close the infrastructure financing gap, have created room for a fiscal stimulus

MONETARY POLICY HAS taken the lead in this global downturn, with successive rounds of interest rate cuts in both developed and developing countries. Borrowing costs have been lowered to offset the headwinds of this synchronised global downturn. It looks like monetary policy is running out of ammunition, given that low rates are yet to deliver a growth stimulus. Most central banks are not a in a rush to further lower interest rates. Reviving growth in a world of low interest rates requires a fresh rethinking of macroeconomic policies, to prevent growth slowdown from becoming an economic stagnation.

What can India do? The country has already implemented several rounds of monetary easing, and implemented major structural reforms—bankruptcy reforms, recapitalisation of banks, reducing corporate tax rates, improving doing business indicators—to revive growth. There is a rising concern that this has not turned around the economic downturn, and more needs to be done to reverse the declining trend in investments rates.

Can a fiscal stimulus stimulate growth? There is strong empirical evidence that countries that have sustained high public investment have also attracted more private investment. India's investment in physical and human infrastructure is low as compared to other emerging market economies, and it is dismal when compared to China. A fiscal stimulus, aimed at scaling up investments in physical and human infrastructure, can enable India to accelerate economic growth, and create jobs for 10 million more people that join the labor force every year.

More than 500 districts in India suffer from low levels of investments in physical and human infrastructure. This has constrained the pace of economic growth and job creation. Most jobs are created by new firms, and less so by incumbent firms. Unfortunately, the entry of new firms in India remains low, despite improvements in ease of doing business indicators. A key barrier to the entry of new firms is poor physical and human infrastructure. This is much more important than doing business indicators (*bit.ly/2NLtUHb*).

Will a fiscal stimulus compromise India's macroeconomic stability? Compared to other countries, India's debt is substantially low as a percentage of world GDP. In India, private debt was 54.5% of GDP and the general government debt was 70.4% of GDP, with a total debt of about 125% of GDP in 2017. In comparison, China's debt was 247% of GDP. India's debt is well below the average of most advanced economies and emerging economies.

A fiscal stimulus will increase debt, but it will also generate substantial assets. India has a lot of room to raise its net worth—difference between assets and liabilities—through investments in infrastructure. Although we hear horror stories of countries defaulting on debt, and being forced to cut back much needed investments, to close budget deficit, India's macroeconomic policies remain on a strong footing.

India's physical infrastructure financing gap is huge, and it is growing exponentially. It is estimated that India's infrastructure financing gap is $1 billion a day. The biggest infrastructure financing gap is in the rural areas, where 60% of the population lives. The largest gap is in the transport sector, followed by power, water and sanitation, and telecommunications. India's infrastructure financing gap will double, if we add investments in education and health, which deserve the same attention as investments in physical infrastructure.

Innovative financing

How will investments be scaled up? A stimulus is not just about maximizing financing for development, but also changing the composition of financing, to increase the efficiency of investments. In the past, domestic banks and NBFIs have met 85% of infrastructure debt financing needs in India. In the future, India will need to also tap into the global markets.

Given the long-term nature of infrastructure projects, global institutional investors, and pension funds, can play a key role in meeting India's huge infrastructure financing needs. The traits of India's infrastructure projects, such as its market size, long-term steady revenue stream, and investment returns that exceed inflation, make them attractive for global institutional investors.

Although India has a long history in public private partnerships (PPP) in infrastructure investments, PPPs need to be brought up to global standards, to make infrastructure projects into an asset class, that can attract long-term investors. Problems of moral hazard and adverse selection, that have impeded private financing, can be overcome by reducing the opaque and diverse structures of projects, and providing information required by investors to assess the risk-structures. These problems can be resolved through governance and institutional reforms aimed at improving land acquisition, and improved contract and risk management. The future of PPPs lies in improving the preparation, design, and execution of projects, as well as better management of economic and social externalities. Project designs also need to give a bigger seat at the table to the gender agenda, as poor infrastructure adversely impacts women more than men. Given the rising concerns on climate change, more financial resources need to be allocated towards green infrastructure investments.

Policy makers will need to develop a comprehensive, collaborative, and a credible infrastructure investment plan and a capital market framework, to mobilise new funding. The framework needs to build a multi-year project pipeline, to attract and increase the availability of long-term finance, diversify the investor base, lower the cost of funding, and improve the risk-return profiles that match investors' return expectations and liability structures. The central bank can also play a role in meeting the infrastructure financing gap, not just by targeting sovereign bonds, but also by exploring opportunities to buy debt issued by development banks that finance infrastructure projects.

A fiscal stimulus in India is timely, as this can lock in the current low global interest rates for decades to come, and absorb the glut in global savings, that is looking for new opportunities, and long-run returns. Strong macroeconomic fundamentals, rising concerns on the economic downturn, and the urgency to close the infrastructure financing gap, have created room for a fiscal stimulus.

Acting before the milk spills

RAKESH MOHAN JOSHI

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Modi's decision to opt out of RCEP reflects India's prudence on dairy trade

REALISING THE CONCERNS of farmers and industry, at large, India pulled out of the Regional Comprehensive Economic Partnership (RCEP) FTA. Contrary to earlier sentiments of the country's intelligentsia and bureaucracy, PM Modi took a conscious decision to opt out of RCEP. This will make millions of small farmers and industry stakeholders, especially the dairy farmers and their co-operatives alike happy.

India's ingenious strategy to organise and institutionalise milk production has become a matter of envy for the traditionally well-established dairy producing countries. Today, the traditionally robust milk producers are not fearful of the US, Europe or Oceania, but are afraid of the emanating challenge from the Indian dairy industry.

India is one of the largest milk producing nations with over 186 million metric tons of milk production a year. The country was a net importer of dairy products a few decades ago. Contrary to apprehensions of western dairy experts and erudite economists, both in India and abroad, over the last 60 years, India's milk production has grown at a CAGR of 4.5% compared to 1.8% in the US and 1.3% in EU and Australia.

India is credited to provide up to 70-80 % of the consumer price to dairy farmers compared to merely 25% in Australia, 33% in New Zealand and around 30-40% in most parts of Europe. Interestingly, 77% of milk production comes from small, marginal and landless farmers. Milk is the key source of liquidity and supplementary income for over 100 million farmers.

Today, India has reached self-sufficiency in milk production whereas the the US, Australia and New Zealand are largely milk surplus nations. Due to limited domestic market, countries like New Zealand and Australia are compelled to pro-actively explore markets for 93% and 25% of their milk production, respectively.

> India certainly needs technology, trade and investment in dairy sector. But the country under no circumstance can blindly follow the international model for dairying

India has about 100 million farmers dependent on dairy compared to merely 10,000 in New Zealand and 6,300 in Australia. Thus, the socio-economic impact of dairy sector is much more pronounced in India compared to any other major milk exporting country.

As per the NITI Aayog Working Group, India is estimated to produce 330 mmt milk by 2033, against an estimated domestic demand of 292 mmt. India's situation is likely to strengthen and the country is likely to have surplus. Therefore, the enviable balance of demand and supply in India's domestic market does not call for import of basic dairy commodities such as milk powder and milk fat.

Despite curb in production and export subsidies, major milk trading nations are actively using a variety of regulatory and non-tariff measures, complex enough for hard-core theorists and pseudo-intellectuals to understand and internalise into their assessment of world dairy order. Quantitative restrictions on milk-production and relative incentives used in a complex manner, coupled with a range of subsidies to depress milk prices, are the order of the day. A range of sanitary and phytosanitary barriers and issues related to quality assurance and cumbersome and exorbitantly expensive processes of certifications pose formidable hindrance for Indian dairy products to enter international markets, and it is unlikely that the scenario is going to change in near future.

In countries like New Zealand and Australia, pastures for cattle grazing, are available to farmers with little cost. Rearing of cattle and keeping dairy farming remunerative enough in time to come is the only challenge India needs to address. Ever rising cost of inputs in India need introspection.

India certainly needs technology, trade and investment in dairy sector. But the country under no circumstance can blindly follow the model for dairying or borrow the institutional mechanism that may be detrimental to the interests of domestic dairy industry and farmers in particular. Interestingly, the retail prices of milk and milk products in India is among the lowest in the world. Any imports on concessional tariff should be limited to production of exports. India needs to apply its own prudence while liberalising dairy trade.

RCEP

A sensible walk out

India's right in sticking to its terms and conditions

VK SARASWAT, PRACHI PRIYA & ANIRUDDHA GHOSH

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CITING "SIGNIFICANT OUTSTANDING issues, which remain unresolved", India decided to walk out of the proposed Regional Comprehensive Economic Partnership (RCEP) trade agreement. Had India joined, the trade bloc, comprising ASEAN, Australia, China, Japan, Korea and New Zealand, would have accounted for 25% of global GDP, 30% of global trade, 26% of FDI flows and 45% of the world population. RCEP countries account for almost 27% of India's total trade. Exports to RCEP account for about 15% of India's total exports, and imports from RCEP comprise 35% of India's total imports. Given, the magnitude of numbers involved, India's decision to not be a part of this deal is brave and warranted to a great extent. The deal has been under negotiation for the last eight years.

Reciprocity is the key to FTAs. The biggest driver for trading partner countries to sign an FTA with India is access to a big and booming consumer market. So, it was quite logical for India to assess returns from the deal. Many pain points compelled the country to walk out of the China-led trade deal, and rightly so.

First, to start with India's trade deficit with the RCEP bloc of over $100 billion is almost 64% of its total trade deficit, of which China alone accounts for over 60%. China's manufacturing overcapacity and dumping of goods has compelled countries across the world to take action against its imports. As a result, China is the recipient of the highest number of ADD measures in the world with almost a 1,000 ADD (Anti-Dumping Duty) measures against it since 1995, this amounts to almost a quarter of all ADD measures globally. China's penetration in the Indian market dominates both in terms of value-added import items as well as labour-intensive industry imports. Overall, India has almost 20% of its non-oil imports from China. Almost 60% of India's electric machinery imports, 36% of machinery and equipment imports, and 37% of organic chemical imports are from China. Due to its massive overcapacity and financial and non-financial government support, China is able to create a significant edge over its trading partners.

Second, appropriate framework against circumvention of rules of origin is still lacking when it comes to trade deals. Under invoicing of imported goods to show higher value addition, re-routing through other FTA partner countries to gain preferential access is quite common. India's demand for stricter value addition norms in the RCEP received a lot of backlash during negotiations. Lax rules of origin norms would have led to a surge in imports from various trading partners into India. India's concerns in this regard were not addressed by member nations.

Third, India's concerns on non-tariff barriers were also not delved into during the negotiations. NTBs like complex product certification process, labelling standards, customs clearance, pre-shipment inspection and import licensing have hindered India's access to other markets. Dealing with NTBs is costly and negates the impact of duty reduction under FTAs. This happens, especially with respect to China, as market access in the country is restricted despite low duty rates. Despite a promised 92% preferential access by China into its market under RCEP, India wouldn't have really gained access into it.

Fourth, as per media reports there have been various other concerns such as lack of appropriate safeguard clauses in case of impact on the domestic market, insignificant attention to the services chapter and reluctance of trading partners to move the base year for MFN from 2014 to a recent one so that recent duty changes could be incorporated.

Lastly, India's not-so-remarkable performance with respect to its previously signed FTAs has also been an eye opener for the policymakers. A NITI Aayog note on Free Trade Agreements and Their Costs, 2018 details that the combined trade deficit with FTA partners like ASEAN, Japan and South Korea has doubled in the last eight years, while the quality of trade has also deteriorated. A case in point is the India-ASEAN FTA where India's trade balance has worsened (deficit increased or surplus reduced) for 13 out of 21 sectors including value-added sectors like—chemicals and allied, plastics and rubber, minerals, leather, textiles, gems and jewellery, metals, vehicles, medical instruments and miscellaneous manufactured items. These account for approximately 75% of India's exports to ASEAN. The paper concludes that joining the RCEP could be disastrous for India.

Thus, in terms of reciprocity in an FTA, Indian policymakers have rightly assessed that the Indian manufacturing sector will not be able to gain reciprocal access in other markets, specially China due to significant overcapacity, use of NTBs, and other financial and non-financial support available to its domestic industry. As for other RCEP trading partner countries India already has FTAs either in force or under negotiation. However, to be clear, it wasn't the presence of China that led to India's walkout from the deal, but the lack of safeguards and reciprocity built in RCEP as well as the current state of the manufacturing industry in the country.

Despite India's commitment to free trade and a more connected world, the decision is right. For the time being, we do miss out on being part of this mega trade block, but the costs of being part of such an agreement could potentially have been disastrous. This also gives us a chance now to concentrate our energies and synergies on propping up the economy. This is the right time to set things in motion with a New Industrial Policy that creates the necessary incentives for MSMEs to be an active part of this process. Going forward, these are necessary complements for ensuring maximum leverage out of our trade deals like RCEP. The doors to trade deals are still open and a New India will be a part of it, but on its own terms and conditions.