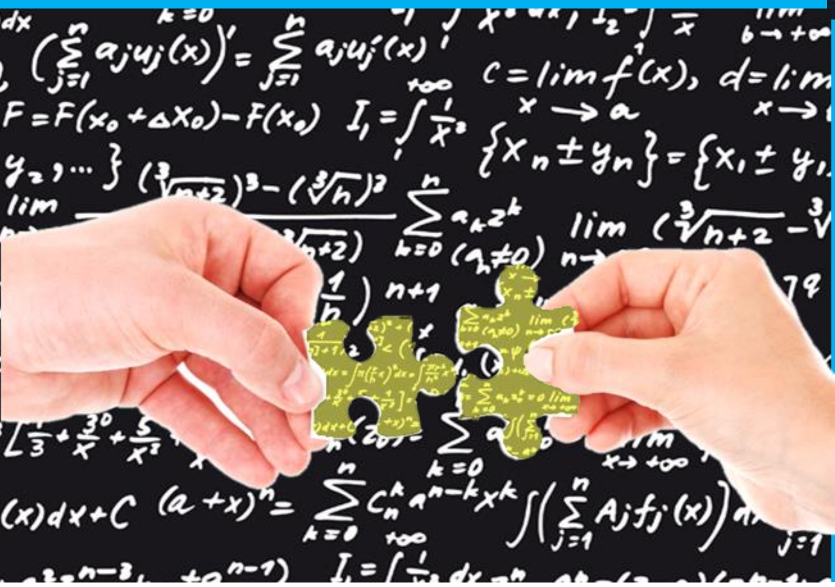
What does RCEP mean for insiders and outsiders?

The Experiences of India and Sri Lanka



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WORKING PAPER

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Abstract

This paper explores the economic implications of the Regional Comprehensive Economic Partnership (RCEP) – Asia's largest trade agreement - on India and Sri Lanka. The findings from existing model-based studies suggest that India, as an insider economy, will potentially gain from the RCEP while outsider economy Sri Lanka will likely loose. India faces challenges in the RCEP negotiations in liberalizing goods and services trade and adopting new intellectual property rules. Building business competitiveness and policy reforms can mitigate these challenges. Sri Lanka is banking on its recent FTA with Singapore as a stepping stone to the RCEP. But both Singapore and Sri Lanka need to do more to ensure that the benefits flow to Sri Lanka. Key issues include Singaporean support for Sri Lanka to join the RCEP, increasing ASEAN FDI to Sri Lanka, addressing the bilateral trade deficit and improving stakeholder consultations on FTAs in Sri Lanka.

Key Words: Free Trade Agreements**,** The RCEP, India, Sri Lanka

JEL Codes: F14, F15, F17

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1. Introduction

There is growing academic interest in the potential economic impacts of mega free trade agreements (FTAs) - such as the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Pacific Partnership (TPP) - on economies inside and outside such agreements. Several model-based studies of mega FTAs exist (e.g. Gilbert *et al.,* 2016; Petri *et al.,* 2017), but little research exists on South Asian economies, either using models or country case studies. The few South Asian model-based studies include Mohanty and Prohit (2007), Rahman and Ara (2015), and Mathur, Arora and Bhardwaj (2016).

India and Sri Lanka have employed different strategies towards free trade agreements (FTA) with East Asia in recent decades. As a part of its 1991 Look East Policy, India has pursued FTAs in a bid to expand economic ties with dynamic East Asia. India is participating in the RCEP negotiations which covers about three billion people across 16 Asian economies making it the world's most populous FTA[1]. India also has bilateral FTAs with ASEAN, Republic of Korea and Japan. Sri Lanka - a classic small open economy - has historically not sought FTAs with East Asia with the exception of membership of the Asia-Pacific Trade Agreement (APTA). A desire to accelerate trade-led growth since the end of 30-year civil war led the new national government to emphasize FTAs in 2015. One outcome was the conclusion of the comprehensive Sri Lanka-Singapore FTA in 2018. However, Sri Lanka lacks a formal East Asia policy and is presently excluded from the RCEP talks.

This paper seeks to contribute to the sparse literature on South Asia's FTAs by exploring the economic implications of the RCEP on India (an insider economy) and Sri Lanka (an outsider economy). It undertakes three tasks. First, as background, it reviews the aims of the RCEP and progress in the negotiations. Second, it reports the findings particularly for South Asian economies from existing computable general equilibrium (CGE) model-based studies of the RCEP. Third, it explores the national-level economic implications of the RCEP through case studies of India and Sri Lanka. There is a view among some RCEP members that India is a stumbling block to the

[1] The RCEP economies accounted for 32.3% of the world's population in 2016 compared with 6.9% for the European Union (EU), 6.7% for the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP or TPP-11) and 6.5% for the North American Free Trade Agreement (NAFTA). The RCEP economies also had 32.2% of world GDP in 2016 which is a larger world share than the other groupings. See Wignaraja (forthcoming).

RCEP negotiations. Accordingly, the Indian case focuses on its hesitancy in liberalizing its trade further and ensuring regulatory coherence with RCEP members. The Sri Lankan case explores the potential costs of being omitted from the RCEP, the benefits of future membership and ways of leveraging the bilateral FTA with Singapore.

2. Progress in RCEP negotiations

The RCEP was launched at the East Asia Summit in November 2012 in Phnom Penh, Cambodia. While the partnership would expand ASEAN's role in coordinating regional trade, the RCEP's key aim is to reconcile two long-standing proposals into a large, region-wide trade agreement. The two proposals being joined are: (1) the East Asian Free Trade Agreement (or ASEAN+3), which includes the 10 ASEAN members, China, Japan, and Republic of Korea; and (2) the Comprehensive Economic Partnership (or ASEAN+6), which has added Australia, New Zealand, and India. The first was backed by China, and the second by Japan. The RCEP neatly bridges the two proposals by adopting an open accession scheme so that any party that meets the template can join. Furthermore, ASEAN is accorded the coordinating role for the RCEP process, which means better inclusion of the interests of smaller ASEAN economies (and aligns with ASEAN's centrality principle).

The good thing about the RCEP is that it is a step-by-step process, so any economy that meets the template can join. The parties have stated that their goal is to achieve a modern and comprehensive trade agreement, and the negotiations are supposed to be guided by several key principles (RCEP Ministers 2012), including:

- maintaining consistency with WTO rules, such as GATT Article XXIV and GATS Article V;
- providing improvements over existing ASEAN-Plus-One FTAs;
- reflecting different levels of development of participating economies, and allowing for special and differential treatment for least-developed countries (LDCs); and
- ensuring an open accession clause to enable participation of any ASEAN FTA partner, as well as other external economic partners, at a future date.

The core of the RCEP negotiating agenda will cover trade in goods, services trade, investment, intellectual property rights, economic and technical cooperation, and dispute settlement. More specifically, the RCEP seeks to achieve the following:

- gradually reduce tariff and nontariff barriers on most trade in goods to create a free trade area;
- largely eliminate restrictions and discriminatory measures on trade in services for all sectors and modes of services;

- create an open and facilitative climate for investment;
- address the special needs of less-developed ASEAN economies through early elimination of tariffs on products of interest to them, and through the provision of development assistance to narrow development gaps; and
- provide for a dispute settlement mechanism to effectively resolve trade disputes.

The ambitious three-year timeline for concluding the RCEP negotiations has slipped with the negotiations turning out to be more protracted than expected. During May 2013 to May 2018, 22 rounds of working-level RCEP talks were held. The 23rd round is expected to take place in July 2018 in Bangkok. Little official information is available on progress in the RCEP negotiations as these talks are being conducted secretly in keeping with a trend followed internationally.[2] Conflicting information can be gleaned from media reports. The China Daily reported already four years ago that the RCEP parties reached preliminary agreements on tariff reduction schedules, rules of origin, customs procedures, and other trade facilitation measures (see *China Daily,* 31 March 2014). However, the Straits Times recently reported that the RCEP agreement "consists of 18 chapters, of which just two have been concluded. These are in the areas of economic and technical cooperation and in small and medium enterprises" (*The Straits Times*, 1 July 2018).

The RCEP negotiations are likely to have been slow and contentious in the more difficult areas of barriers to services trade, investment rules and intellectual property rights. This reflects differences in levels of development of the parties, their negotiation positions, and the influence of domestic lobbies. The India case study below explores these issues.

Political pressure is being ratcheted up on trade negotiators amidst concerns about rising protectionism and an on-going trade war between the US and China. At present, the RCEP agreement is expected to be signed in November 2018 during the ASEAN Leaders Summit in Singapore. The joint leaders statement at the first ever RCEP Leaders summit in Manila in November 2017 instructed ministers and officials to

[2] However, some like the European Union (EU) attempt to keep their citizens more informed about FTA negotiations to reinforce public trust and accountability. Before launching negotiations, the European Commission (EC) conducts a comprehensive impact assessment and carries out a 3-month public consultation process. During the negotiations, the EC publishes online proposals for legal texts and progress reports after each negotiation round. At the end of the negotiations, the negotiated text is also published before full legal revision is undertaken. See https://www.oecd.org/tad/events/ec-trade-comms-statement.pdf

intensify work in 2018 to conclude the RCEP negotiations (RCEP Leaders, 2017). If this were to happen, under six years for concluding the RCEP seems reasonable by the standards of the TPP and the WTO Doha Round.[3]

[3] It would similar to the six-years it took to conclude the ambitious TPP agreement among 12 parties, dating from the formal start of negotiations in March 2010 to signing the TPP agreement in February 2016. However, the US withdrew from the TPP in January 2017 and the remaining 11 economies reached a partial agreement in November 2017, popularly termed the TPP-11. The WTO Doha Round began in November 2001 and has been virtually abandoned after over 15 years of talks, among 164 members.

3. Contribution to Asian Economic Integration

The RCEP comprises of a heterogeneous group of economies. A handful of commodity-rich economies (like Brunei Darussalam, Malaysia and Indonesia), co-exist among several largely resource-poor economies. As Table 1 shows disparities exist in world shares of GDP and trade as well as per capita income. RCEP includes some of the world's largest economies (e.g. China, Japan and Republic of Korea) as well as smaller ones (e.g. Brunei Darussalam, Lao People's Democratic Republic and Myanmar). Furthermore, the grouping includes a mix of high-income economies (Australia, Brunei Darussalam, Republic of Korea, Japan, New Zealand and Singapore), middle-income economies (China, Indonesia, Malaysia, the Philippines and Thailand), low-income economies (Cambodia, India, Lao People's Democratic Republic, Myanmar) and one low-middle income economy (Viet Nam).

Levels of trade opening and FTA strategies also vary (Table 1). Singapore has virtually no applied import tariffs, some have low average applied tariffs of less than 10% while others have average applied tariffs above 10%. Approaches to FTA-led integration differ, with very active economies with bilateral and regional FTAs (e.g. Singapore, Japan, China and Republic of Korea) alongside more passive economies (e.g. Cambodia, Lao People's Democratic Republic and Myanmar) which rely on ASEAN regional FTAs.

There are several a priori reasons why an RCEP agreement can contribute to Asian economic integration. First, the RCEP can help insure against rising protectionist sentiments in the global economy if the new regional rules align with WTO agreements on goods and services. Nontariff measures (NTMs) – e.g. import quotas, various government subsidies, arbitrary customs regulations, technical barriers to trade (TBT) and sanitary and psyto-sanitary regulations (SPS) – have been rising since the global financial crisis including in Asia. The Trump Administration's America First approach seems to be tilting the US towards isolationism and protectionist tendencies. Painstakingly collected data on NTM counts by Evenett and Fritz (2017) shows that the US administration's approach is becoming more discriminatory towards the G-20 (which includes 6 RCEP members) and that others are beginning to resort to murky trade distortions. At present, there is tit for tat protectionism involving the US, China, EU and India which could descend into a full-scale global trade war.

Second, the RCEP can help the spread of sophisticated global supply chains that make Asia the world's factory. If a comprehensive agreement can be reached, trade barriers impacting goods and services among RCEP members will fall. Rules governing the entry and operation of foreign firms should become more transparent and predictable. Market size will expand beyond national borders, and a larger regional market will facilitate the realization of economies of scale in production.

Third, in the area of investment rules—where there exists only a rather basic WTO agreement (the Trade Related Investment Measures, or TRIMs)—the RCEP promotes easier FDI flows and technology transfers by multinational corporations. Reducing barriers to investment and supporting a regional, rules-based FDI regime will further facilitate regional supply chain trade.

Fourth, by simplifying trade rules, the RCEP may reduce the overlap among Asian FTAs and the risk of an Asian "spaghetti bowl" of multiple trade rules (Bhagwati, 2008). Rules of origin, in particular, could be rationalized, made more flexible, and better administered through electronic means. This could reduce transaction costs for business including small- and medium-sized enterprises (SMEs). However, signals exist that this might not be achieved as none of the RCEP members have yet said that they would cancel any of the bilateral FTAs amongst themselves.

4. Quantifying economic impacts

Simulation modelling using computable general equilibrium (CGE) models are useful in quantifying the income effects of eliminating import tariffs on the trade in goods, and liberalizing cross-border trade in services through the formation of trade agreements. CGE models can trace economy-wide effects of policy changes and point to unintended economic consequences. CGE studies show that significant economic gains can arise from the RCEP.

Gilbert, Furusawa and Scollay (2016) provide long-run estimates of the gains from RCEP but assuming only full liberalization of import tariffs for goods in their CGE analysis. They show that full liberalization of goods trade under RCEP can result in significant income gains to the world economy of $127 billion. RCEP could also increase GDP in ASEAN's more dynamic economies - Malaysia, Singapore, Viet Nam and Thailand – of more than 1%. Republic of Korea sees even larger gains of over 4% of GDP. Interestingly, India (0.4%) gains more than China (0.2%) but less than Japan (0.8%). Mathur, Arora and Bhardwaj (2016) find that winners and losers are likely at sectoral level alongside overall Indian gains from RCEP. Thus, output are likely increases could occur in vegetables, textiles and clothing, footwear, chemicals and plastics, and services. Meanwhile, processed food, metals and transport could see output losses. However, these studies do not provide economic estimates for excluded South Asian economies.

Rahman and Ara (2015) studied the potential economic impact of tariff elimination on excluded South Asian economies under the RCEP. Their CGE analysis revealed that if the RCEP countries completely eliminate import tariffs with each other, excluded South Asian countries could face economic pressures of declines in exports and welfare. These are symptoms of trade diversion and loss of preferences. As India is a member of RCEP, it is likely to benefit from the agreement with its GDP increasing by 0.82%. In terms of real GDP, Nepal (-3.6%) could suffer the most in South Asia, followed by Sri Lanka (-1.27%), Pakistan (-0.81%) and Bangladesh (-0.62%). Indian exports could also increase by 6.6% while Nepal (-2.06%) and Bangladesh (0.06%) may experience a fall in exports.

Going beyond tariff elimination provides a different magnitude of gains. Using a slightly different regional unit of analysis, Mohanty and Pohit (2007) shows welfare gains for members of an ASEAN+3-India FTA ranging from $52 billion a simple FTA (involving only tariff liberalization) to $114 billion for a more comprehensive FTA (involving tariff liberalization as well as reducing barriers to investment and services).

Factoring in reducing import tariffs, services barriers and trade costs as well as Australia and New Zealand into a CGE model gives larger long-run estimates of the global gains from the RCEP. Kawai and Wignaraja (2014) show that such a comprehensive RCEP scenario can offer large income gains to the world economy, reaching $260 billion (or a 0.5% change from baseline income). Thailand (12.8%), Viet Nam (7.8%) and Singapore (5.4%) gain the most in ASEAN. Republic of Korea sees a 6.4% gain while that for Japan and China is under 2%. India sees a 2.4% gain but excluded South Asian economies experience losses.

Petri *et al.* (2017) use a CGE model with tariffs and non-tariff measures (NTMs) but are more pessimistic about the capacity of RCEP to deliver significant changes in openness and assume smaller non-discriminatory spillover effects of NTMs in the RCEP. They also report large global gains of $280 billion from the RCEP and suggest that this reflects a combination of the large economic scale of RCEP as well as the relative weakness of RCEP provisions. India could see a smaller long-term increase in income of only 1.0%.

However, fully realizing the gains from the RCEP will depend on addressing several risks during the negotiations and afterwards (Hiebert and Hanlon, 2012; Basu Das, 2016; Wignaraja, forthcoming). First are the twin risks arising from RCEP negotiating partners having different levels of development, global importance and interests. This brings the politically difficult challenging of respecting the central role of smaller ASEAN economies in driving the RCEP negotiations, amidst the presence of Japan and rising Asian economies (China, Republic of Korea, and India). The related economic challenge is that granting exclusions to protect sensitive sectors will ultimately limit the scope of preferential liberalization and gains from RCEP. This risk seems more likely if low-income members press for differential speeds of opening up sectors.

Second, like all forms of trade liberalization, implementing RCEP preferential liberalization will bring gains and losses at sector-level within members. The discussion of model-based studies below sheds light on potential gainers and losers from the RCEP. With wages and jobs at risk, adjustment costs may be higher than expected in declining economic sectors and new economic sectors may take time to emerge. The risk of significant losses in some sectors and economies could diminish public support for RCEP and prompt a backlash against Asian economic integration.

Third is the risk that firms, particularly SMEs, may underuse RCEP tariff preferences due to a lack of international competitiveness and a poor understanding of its legal provisions (negotiated concessions). Unless SMEs could become subcontractors or suppliers to large firms, multinational corporations and large firms could gain disproportionately from the RCEP. Fourth, is the risk that the spread of mega-regional FTAs like RCEP and the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP or TPP-11) may exacerbate the divergence between regional and WTO trade rules, with the continuing erosion of WTO's central role in global trade governance.

5. India's experience of RCEP negotiations

India is regarded as the new frontier in Asia's economic miracle story. Already accounting for 3% of global GDP in 2016 (Table 1), the country has emerged as one of world's fastest growing economies with an increasing middle class in the post-global financial crisis era. The initiation of gradual trade and economic reforms by the government of Prime Minister Narasimha Rao in 1991 has resulted in a relatively open economy with simple average MFN applied tariffs falling to 13.4% in 2016.[4] However, agricultural goods (32.7%) enjoy significantly high tariff protection than industrial goods (10.2%). India's trade with RCEP members has increased significantly. The share of RCEP economies in India's global exports rose from 20% to 33% between 1990 and 2017 while their share in India's global imports increased from 28% to 46% (see Table 2). This reflects growing India-East Asia trade particularly with China and ASEAN.

Since 2013, India has been involved in the RCEP negotiations as an ASEAN dialogue partner. The country's involvement in building closer ties with East Asia dates to the Rao government's 1991 Look East Policy to develop strategic and economic relations with the economically important region. However, critics suggested that subsequent Indian governments emphasized forging strategic foreign policy partnerships and security cooperation with East Asian economies (particularly Japan and Viet Nam) at the expense of building economic relations. Eventually efforts at fostering closer economic relations bore fruit. During the 2000s India concluded several FTAs with East Asia including a regional FTA with ASEAN in 2010, as well as bilateral agreements with Singapore in 2005, Korea in 2010, Japan in 2011, and Malaysia in 2011. Bilateral FTA negotiations are also on-going with Australia, New Zealand, Indonesia and Thailand.

In 2014, Prime Minister Narendra Modi announced a new Act East Policy as a signature element of his government's economic strategy (Wignaraja, 2016). Modi's bold move signaled a more pro-active approach to strengthening economic ties with dynamic East Asia. This soon translated into intensified Indian engagement in the RCEP negotiations. The Modi government felt that RCEP would fill in critical, missing

[4] See https://www.wto.org/english/res_e/statis_e/statis_maps_e.htm

FTA links between India and RCEP members by providing for India-China trade and India–Australia/New Zealand trade. In turn, Indian business would have greater opportunities to access a larger Asian market, to exploit India's relative strength in services with its vast pool of qualified professionals (including from sectors such as information technology), and to better integrate Indian manufacturing into global supply chains centered on East Asia (including in automotive, electronics and consumer goods).

However, three challenging issues have emerged during the RCEP negotiations. First is liberalization of tariffs on goods trade. Relative to India, other RCEP members typically have a comparative advantage in key areas of goods trade. Several members have requested that import tariffs on agricultural and industrial goods be eliminated for more than 92% of tariff lines (Sen, 2017). Furthermore, some members have suggested reducing tariffs to 5% on an additional 7% of tariff lines taking total coverage of goods trade to as much as 99%. This implies gradually phasing out tariffs in India and exposing both agriculture and industry to competition from RCEP members. Australia and New Zealand have demanded that India lower tariffs on dairy and wheat in particular and that tariff elimination should occur on items of significant trade value rather than just a large number of items.

The major concern for India is virtually free goods trade with China, where cheap imports are thought to have adversely affected import substituting manufacturing sectors in India (Mishra, 2013). Some argue that, due to pervasive state-subsidies, Chinese firms have prices that few Indian firms can match. Concerns have also been expressed about opening up sensitive economic sectors and infrastructure to inward investment from China, particularly by state-owned enterprises that unfairly benefit from government subsidies.

India's counter offer was tariff elimination based on a three-tier system with 42.5% of tariff lines for China, Australia and New Zealand, 65% for Japan and Korea and 80% for ASEAN (Sen, 2017). However, other RCEP members rejected India's offer in favor of a single offer for all RCEP members. Despite fierce opposition from its farmers and industrialists, India made a new offer of eliminating tariffs on 70-75% of goods with some deviations for China, Australia and New Zealand which are not FTA partners. But this has not satisfied other RCEP members particularly Australia and New Zealand which are insisting on increased market access for dairy and wheat.

Agriculture remains a difficult area for RCEP negotiations as India wishes to protect the livelihoods of the rural poor who are electorally important. However, some Indian manufacturing exports have grown (including pharmaceuticals, the automotive sector, textiles, and food processing), and this trend is likely to continue under the RCEP. As discussed above, the CGE projections indicate that India can achieve potential income gains of 0.4% under a full tariff elimination scenario which can rise up to 2.4% under a more comprehensive RCEP scenario. Indian businesses should prepare for market opening under the RCEP by investing in price, quality, and delivery systems that meet international standards. Speeding up implementation of second-generation structural reforms will also help improve competitiveness. Furthermore, WTO-compatible trade remedies such as temporary safeguards and anti-dumping measures are available to tackle import surges from China.

Second, is liberalization of services trade. The RCEP offers inroads for Indian services to China and the rest of East Asia, where India has achieved a comparative advantage on world markets (Wignaraja, 2011; Mathur, Arora and Bhardwaj, 2016). These advantages include information technology, professional services, law, banking, and educational services. Moreover, India has seen increasing tourism arrivals from the Asia-Pacific region, and tourism services offer further opportunities for Indian businesses. India has been arguing for services trade liberalization in return for opening up of goods trade in the RCEP negotiations. In particular, India has been suggesting easing visa restrictions on the movement of skilled workers across RCEP boarder for short-term work (Arun, 2017).

Emulating the APEC Business Travel Card, it has proposed an RCEP Travel Card to facilitate visa-free travel for movement of skilled workers in areas such as information technology, engineering, training and investment banking. However, there have been few offers from RCEP members in this area (Sen, 2017). ASEAN members have refused to offer even the limited level of openness that exists among the ten members of the grouping. ASEAN members are concerned that temporary movement of Indian skilled workers could become permanent with a loss of local jobs. Discussions are continuing over this issue.

Third is intellectual property rights rules. India has an internationally competitive pharmaceutical sector with strengths in manufacturing cheap generic drugs. It is also a global leader in using the WTO Agreement on Trade-Related Aspects of Intellectual

Property Rights (TRIPS) safeguards to balance the rights of inventors with the health rights of the population. Leaked text from a 2015 draft of the RCEP agreement showed that Japan and Republic of Korea were seeking strengthened protection for intellectual property raising concerns about reduced access to cheap generic drugs, high prices for non-generic drugs and adverse consequences for public health in low-income RCEP members (Amin, 2017). Civil society groups in India argue that the so-called TRIPS plus standards in RCEP would increase protection for patent monopolies of multinational corporations and enforcement mechanisms while simultaneously removing the ability of RCEP members including India to use TRIPS health safeguards.

In spite of various challenges, India appears committed to supporting closer Asian economic integration through RCEP. There seem two options for the way forward for the RCEP negotiations. One is to take the best features of existing ASEAN+1 FTAs[5] (e.g. on flexible rules of origin) and to use them as a basis for negotiations to maximize the quality of an RCEP agreement and to observe the end 2018 for concluding the talks. Another is to treat India similarly to the CLMV economies within ASEAN and give it some time to adjust to trade opening.[6] If the end 2018 deadline for concluding the RCEP is missed, the second option could be explored in the RCEP talks.

The RCEP can be achieved for India because it has the more ambitious India-Japan and India–Republic of Korea FTAs. Indian businesses, then, should embrace the RCEP, as it includes all the ASEAN economies, as well as others. The Modi's government has implemented a flurry of pro-growth measures since 2014 including investment climate reforms, a "Make in India" initiative, and fiscal reforms, and has boosted public sector accountability and increased public infrastructure investment. It has upset some parts of business with two other measures -- demonetizing large currency notes to fight corruption and introducing a general sales tax. But the economy is recovering from these shocks and the sales tax lays the basis for healthier future public finances.

Gradual and systematic domestic reforms over the next few years will make it easier for India to lock in the gains from trade by concluding an RCEP agreement. Afterwards,

[5] See Fukunaga and Isono (2013) for a painstaking mapping of the features of the five ASEAN+1 FTAs.
[6] I am grateful to Masahiro Kawai for this point.

significant business support services would be needed for SMEs to improve their international competitiveness and lower the costs of using the RCEP. Enhancing domestic structural reforms, investing in cross-border infrastructure, and streamlining trade facilitation would also help elicit a private sector response to the RCEP. Furthermore, adjustment assistance and social safety nets can help mitigate the negative effects of trade liberalization under RCEP on affected sectors and jobs.

6. Leveraging Singapore for Sri Lanka's participation in RCEP

Sri Lanka was South Asia's earliest to embark on a gradual economic reform programme in 1977 and is probably its most open economy today. In 2015, the country's simple average MFN applied tariffs were 9.3% with agricultural tariffs of 23.7% and industrial tariffs of 6.9%.[7] Trade with RCEP economies particularly China have grown rapidly during the 2000s and account for an increasing share of Sri Lanka's trade. The share of RCEP economies in Sri Lanka's global exports increased from 25% to 30% between 2010 and 2017 while their share of global imports rose from 81% to 84% (Table 3). Until recently, Sri Lanka did not express interest in joining the RCEP, but this is changing as policy makers are becoming concerned about the economic effects (e.g. trade diversion and preference erosion) of being left out of the large Asian integration group.

Since 2015 a national government led by President Maithripala Sirisena and Prime Minister Ranil Wickremasinghe adopted a new macroeconomic stabilization and structural reform strategy to tackle a high level of external debt, an anti-export bias in the trade regime and other residual economic distortions. An important element of the new strategy was a more active FTA policy targeting East Asia and India to increase market access and to attract export-oriented FDI aiming to position Sri Lanka as a trading hub in the Indian Ocean.[8] A flurry of activity has followed with some success. FTA negotiations are currently on-going with China, Thailand and India. FTAs with Indonesia and Malaysia were raised during visits by their heads of states to Sri Lanka in 2018. In more concrete terms, a bilateral FTA with Singapore was swiftly concluded in 2018 and Sri Lanka's Ministry of Economic Development and International Trade said that

[7] See https://www.wto.org/english/res_e/statis_e/statis_maps_e.htm

[8] In his Economic Policy Statement in October 2017, Prime Minister Wickremasinghe reiterated "We have obtained good results from the steps we have taken to stabilise the economy. Therefore, we should now focus on adopting an export-led economic growth strategy and policies by providing high-value and diversified products and services. A key part of this policy will be entering into Free Trade Agreements with partner countries around the world. We are making great progress towards mutually beneficial Free Trade Agreements with Singapore, China, and India. These deals will give our economy a massive boost by opening huge new markets to our entrepreneurs". (Wickremasinghe, 2017, p. 6).

"…we envisage this as a first step towards closer integration with ASEAN and potentially be part of the RCEP – Regional Comprehensive Economic Partnership in the future".[9]

In spite of the two islands' decades of warm diplomatic relations, economic relations between Sri Lanka and Singapore are limited. Singapore comprised of 2.0% of Sri Lanka's global exports and 6.1% of global imports in 2017.[10] Singapore also only accounted for only 1.0% of foreign aid to Sri Lanka and 0.9% of inbound tourists. In a bid to strengthen economic relations, the Sri Lanka-Singapore FTA was signed on 23 January 2018 in under two years with just eight rounds of negotiations. The FTA entered into force on 1 May 2018.

The agreement underlines Singapore's serious search for trade and investment partners beyond East Asia, and it shows Singapore's recognition of Sri Lanka's potential as a trading hub in the fast-growing Indian Ocean region. The agreement is also an outcome of Sri Lanka's post-conflict trade policy to boost flagging growth and to strengthen ties with East Asia.

This is Sri Lanka's first FTA since 2005 and the most comprehensive among its handful thereof. It covers goods, services, investments, trade facilitation, intellectual property rights and government procurement.[11]

Market access to Singapore has not been a barrier for Sri Lanka, even before the FTA. Singapore is one of the world's most open economies, with 99% of all goods imports entering duty-free and few banned imports. Meanwhile, Sri Lanka will eliminate tariffs on 80% of goods over 15 years under the FTA – a relatively long adjustment period for firms in Sri Lanka.

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[9] The statement reported in January 2018 stated: "The Singapore-Sri Lanka FTA is part of a broader strategy of looking East to renew our trade relationships in the process of diversifying our markets towards Asia and focus on plugging in to Asian supply chains. This FTA is our first agreement with a South East Asian country – and we envisage this as a first step towards closer integration with ASEAN, and potentially be part of the RCEP – Regional Comprehensive Economic Partnership in the future" *Daily News* 24 January 2018. http://www.dailynews.lk/2018/01/24/local/140786/slsfta-renew-trade-relations-asia

[10] The data for trade, aid and tourists are from the UN COMTRADE Database, the Ministry of Finance Annual Report 2017 and the website of the Sri Lanka Tourism Development Authority.

[11] The full text can be found at: https://ie.enterprisesg.gov.sg/~/media/IE%20Singapore/Files/FTA/Existing%20FTA/Sri%20Lanka%20Singapore%20FTA/Sri-Lanka-Legal-Text-SLSFTA.

Somewhat usually perhaps, it seems that a joint feasibility study including a cost-benefit analysis was not undertaken for the agreement. *A priori* reasoning suggests that the FTA is likely benefit Sri Lanka through cheaper consumer goods and inputs, FDI, technology transfer and competition, and higher technical and quality standards. At the same time, opening up to Singapore may also mean adjustment costs to local industry caused by cheap imports and the entry of foreign firms. But the two countries should address several crucial areas in order to maximize the benefits flowing to Sri Lanka.[12] Otherwise, there is a risk that potentially affected parties in Sri Lanka may lobby to derail or even cancel the agreement.

First, Singapore – who will be the 2018 ASEAN chair – should be asked to support Sri Lanka's eventual participation in the RCEP. Joining the RCEP offers Sri Lanka the prize of simultaneous access to an enormous regional market and dynamic Asian FDI. Participating in RCEP is also arguably simpler for and less draining on Sri Lanka's scarce negotiating capacity than separately negotiating 16 bilateral FTAs. Sri Lanka has been a member of the 27-member ASEAN Regional Forum since 2007, but the Forum's main purpose is discussion on security issues, not on economic ones. Becoming a sectoral dialogue partner to ASEAN is the imperative next step and Sri Lanka is currently preparing its application. Further ahead is the difficult task for Sri Lanka to obtain ASEAN observer status.[13] Enhanced diplomatic engagement with Singapore and other ASEAN economies would help. Sri Lanka presently has embassies in seven ASEAN countries but not in Brunei, Cambodia, and Laos. Existing ambassadors to ASEAN countries should be given a clear mandate and resources to lobby for Sri Lanka's inclusion in the RCEP process. This should be followed by regular high-level policy dialogues at head of state-level.

[12] This analysis draws on Wignaraja and Hundlani (2018).

[13] ASEAN decided in 1983 that only countries geographically located in Southeast Asia are eligible for accession to ASEAN. The last three ASEAN members – Cambodia, Laos, Myanmar - began applying to join the grouping in the 1990s. Laos and Myanmar became members in July 1997 while Cambodia joined in April 1999. Papua New Guinea – currently the only ASEAN observer and located outside Southeast Asia - was granted observer status in 1976 but its accession seems stalled due to internal political instability. Sri Lanka is competing with Bangladesh and Pakistan to join ASEAN.

Second, increasing Singaporean FDI to Sri Lanka is a priority: only 5.3% of Sri Lanka's FDI during 2014–2017 came from Singapore and are concentrated in a few sectors.[14] The investment climate has improved for Singaporean firms: the FTA rightly includes safeguards against expropriation of and discrimination against Singaporean investments, Singaporean firms can bid for large government procurement projects in Sri Lanka and Sri Lanka's Board of Investment (SLBOI) is targeting Singaporean FDI in infrastructure, IT services, tourism and education. Despite these improvements, Sri Lanka's investment climate remains challenging. Opening a business in Sri Lanka in 2017 takes an average of nine days, compared to 2.5 days in Singapore.[15] Streamlining redundant colonial-era business regulations, speeding up the introduction of on-line systems for investors and demonstrating consistency in macroeconomic policy would help gain the confidence of risk-averse Singaporean investors. It will also lay the foundation for attracting inward investment from other RCEP economies.

Third, Sri Lanka should additionally seek Singaporean expertise on sustainable FDI-led development. Singapore's Economic Development Board (EDB) is famous for its network of well-staffed overseas offices of which the sole aim is to market Singapore as an investment destination. Tapping into its expertise to restructure Sri Lanka's Board of Investment (SLBOI) and to improve its investment promotion strategy including its selective use of FDI incentives in a highly competitive international environment for FDI flows. The EDB could assist the SLBOI to establish its first overseas office in Singapore, which would help the SLBOI to step away from managing export-processing zones and instead to refocus its capacity on investment promotion. Sri Lanka could also harness the 'know-how' of Singaporean firms in climate-friendly urban planning and transport, export-processing zones and logistics services. Improved investment promotion capabilities would also help to market Sri Lanka as an investment destination in other RCEP economies.

[14] This data is from the Central Bank of Sri Lanka. According to Wijayasiri and Hewage (2018), Singaporean FDI projects in Sri Lanka include: property development (Overseas Reality Ceylon Ltd), tourism (Shangri -La Hotels), food and beverage processing (Prima Ceylon, Asia Pacific Breweries), and telecommunications (Lanka Bell).

[15] World Bank's Doing Business Report. http://www.doingbusiness.org/reports/global-reports/doing-business-2018.

Fourth, Sri Lanka should also use this opportunity to address its substantial trade deficit with Singapore, amounting to $1.1 billion in 2017.[16] Sri Lanka's exports to Singapore are concentrated in gems, refined petroleum, textiles and boats; agriculture, fisheries and services exports are lagging. Sri Lankan business is concerned that the FTA will lead to 'round-tripping' of state-subsidized imports from ASEAN and China via Singapore. They hope that the agreement's rules of origin, which require at least 35% of value added to occur in Singapore, will be sufficient. In order to alleviate these and other concerns, Sri Lanka has strengthened laws for temporary trade remedies like WTO-compatible safeguards and anti-dumping policies. But rather than lobby for prolonged protection, Sri Lankan firms should improve their knowledge of standards and quality such that they can export to Singapore's high-income market. In mid-2018, the government also introduced a new National Export Strategy emphasizing improving logistical services for transshipment, national quality infrastructure and trade promotion as a part of an export push to Singapore and other FTA markets.

Fifth, the experience of the Sri Lanka-Singapore FTA suggests that better stakeholder consultations in Sri Lanka are crucial to success in implementing agreements including the RCEP. There have been protests from professional lobbies in Sri Lanka (including doctors, lawyers and engineers) against the Sri Lanka-Singapore FTA who falsely claim that the agreement allows for free movement of natural persons into Sri Lanka, i.e., skilled professionals from third countries. However, a careful reading of the text of the agreement[17] shows that it only provides for controlled entry of a few foreign managers and technical manpower per project which usually accompany FDI internationally. This FTA experience underlines the importance of building a strong pro-trade constituency for the RCEP to clarify issues and dispel myths. It is also essential to do the prior homework of assessing the benefits and costs of an RCEP agreement for Sri Lanka. To this end, think tanks in Sri Lanka can be commissioned to study the economic effects of RCEP on Sri Lanka and to disseminate the findings locally and in RCEP members including a Track 1.5 dialogue with think tanks and officials in RCEP members. The research findings need to be communicated to the

[16] Estimated from the UN COMTRADE Database.

[17] The full text can be found at https://ie.enterprisesg.gov.sg/~/media/IE%20Singapore/Files/FTA/Existing%20FTA/Sri%20Lanka%20Singapore%20FTA/Sri-Lanka-Legal-Text-SLSFTA

general public and fake news via social media countered through fact-based responses.

The Sri Lanka–Singapore FTA will undoubtedly bring economic benefits for Singapore. It could also be beneficial for Sri Lanka and act as a welcome step in improving the country's outward orientation and ties with East Asia — but the benefits will not automatically flow. Sri Lanka should take advantage of Singapore's influence to gain ASEAN observer status and eventual RCEP membership. Additionally, Sri Lanka should seek Singaporean expertise on investment promotion and sustainable development. This will ensure that the FTA delivers substantial long-term dividends for Sri Lanka's growth.

7. Conclusions

This paper examined the economic implications of the RCEP on insiders and outsiders focusing on the Indian and Sri Lankan cases. This is a difficult undertaking as patchy official information exits on the state of play in the RCEP talks. The timeline has slipped but trade negotiators being pressured to reach an RCEP agreement in late 2018.

The RCEP is globally important as a trading bloc, and CGE studies suggest that a comprehensive RCEP can potentially generate global economic gains. Accordingly, arguments for and moves toward RCEP are supported by CGE modelling. As a member, India is the only country in South Asia to potentially gain but the magnitude of its gains will depend on the depth of the final RCEP agreement. Excluded South Asian economies – Bangladesh, Nepal, Pakistan and Sri Lanka – will likely lose from the agreement. But realizing the benefits requires managing various risks.

India has long emphasized building closer economic ties with East Asia through a formal policy towards East Asia and the RCEP. But various challenges for India have emerged during the course of the RCEP talks including liberalizing goods and services trade and adopting new intellectual property rules. Closer review suggests that some of the concerns expressed in Indian business and policy circles seem overstated. India stands to gain from the RCEP owing to strengths in services and manufacturing and a large, rapidly growing domestic market. A renewed partnership between Indian businesses and government will help prepare for market opening under the RCEP.

As an outsider, post-conflict Sri Lanka risks losses from trade diversion and erosion of preferences from the advent of the RCEP. The country is forging closer economic ties with ASEAN and its recently concluded FTA with Singapore offers a stepping stone towards this end. RCEP membership is an eventual policy goal for the national government. But both Singapore and Sri Lanka need to do more to ensure that the benefits flow to Sri Lanka. Otherwise, there is a risk that potentially affected parties in Sri Lanka may lobby to derail the agreement. Key issues include asking Singapore to support Sri Lanka’s eventual participation in the RCEP, to help Sri Lanka increase FDI from Singapore and ASEAN, address the trade deficit with Singapore and improve stakeholder consultations on Sri Lanka’s FTAs including the RCEP.

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Table 1. Selected economic characteristics for RCEP members

	GDP per Capita (PPP, Current International $) 2016	Share of Global GDP % (2016)	Share of Global Trade % (2016)	MFN Tariffs, Simple Average Applied Rates[a]	No of FTA's as of 2018[b]
Northeast Asia					
Japan	41,470	6.54	7.60	4.0	15
China	15,535	14.82	20.20	9.9	16
Republic of Korea	35,751	1.87	5.34	13.9	16
ASEAN					
Brunei Darussalam	77,441	0.02	0.05	1.2	8
Cambodia	3,736	0.72	0.70	11.2	6
Indonesia	11,612	1.23	1.70	7.9	9
Lao PDR	6,186	0.02	0.05	8.5	8
Malaysia	27,681	0.39	1.85	5.8	14
Myanmar	5,773	0.09	0.14	5.6	6
Philippines	7,806	0.40	0.96	6.3	7
Singapore	87,856	0.39	4.60	0.0	21
Thailand	16,916	0.54	2.44	11.0	13
Viet Nam	6,424	0.27	1.82	9.6	10
Other					
India	6,572	3.00	4.39	13.4	13
Australia	46,790	1.59	2.35	2.5	12
New Zealand	39,059	0.24	0.47	2.0	11

Note: [a] MFN Tariffs are the most recent figures available, [b] FTA's that have been Signed and Enforced

Source: Authors calculations based on World Bank: World Development Indicators, https://data.worldbank.org/data-catalog/world-development-indicators; Asian Development Bank: Asia Regional Integration Centre, https://aric.adb.org/beta; World Trade Organisation: Tariff and Trade Map, https://www.wto.org/english/res_e/statis_e/statis_maps_e.htm. Accessed June 2018.

Table 2. India’s trade with RCEP economies

	Values (US$ Millions)								Member Shares (%)							
	Exports				Imports				Exports				Imports			
	1990	2000	2010	2017	1990	2000	2010	2017	1990	2000	2010	2017	1990	2000	2010	2017
China	18	758	17,519	12,579	173	1,569	40,880	68,143	1%	8%	24%	13%	3%	8%	27%	35%
Japan	1,656	1,767	4,813	4,512	1,711	2,488	9,052	8,853	46%	20%	7%	5%	27%	12%	6%	5%
Republic of Korea	164	457	3,641	4,467	436	1,326	11,435	14,822	5%	5%	5%	5%	7%	7%	8%	8%
ASEAN	760	2,749	23,015	35,288	1,771	6,849	37,049	45,131	21%	31%	31%	37%	28%	34%	25%	23%
Brunei Darussalam	0.3	3	21	54	-	0.1	495	541	0%	0%	0%	0%	0%	0%	0%	0%
Cambodia	1	8	61	124	-	0.1	8	25	0%	0%	0%	0%	0%	0%	0%	0%
Indonesia	92	386	4,572	3,684	60	1,151	9,915	14,084	3%	4%	6%	4%	1%	6%	7%	7%
Lao PDR	0	5	8	25	0.3	-	19	218	0%	0%	0%	0%	0%	0%	0%	0%
Malaysia	126	568	3,551	5,941	478	1,925	6,517	7,995	4%	6%	5%	6%	7%	10%	4%	4%
Myanmar	1	48	273	1,072	44	225	958	708	0%	1%	0%	1%	1%	1%	1%	0%
Philippines	21	188	804	1,620	2	64	410	509	1%	2%	1%	2%	0%	0%	0%	0%
Singapore	308	826	9,094	10,943	1,103	2,871	13,341	11,016	9%	9%	12%	11%	17%	14%	9%	6%
Thailand	201	510	2,145	3,646	63	566	4,395	6,414	6%	6%	3%	4%	1%	3%	3%	3%
Viet Nam	8	208	2,485	8,178	20	47	992	3,621	0%	2%	3%	8%	0%	0%	1%	2%
Australia	183	405	1,653	3,899	491	1,055	15,029	11,370	5%	5%	2%	4%	8%	5%	10%	6%
New Zealand	21	64	189	330	67	71	650	464	1%	1%	0%	0%	1%	0%	0%	0%
India’s RCEP Trade (total/as a % of world trade)	3,562	8,950	73,845	96,364	6,420	20,208	151,143	193,914	20%	21%	33%	33%	28%	36%	42%	46%

Source: IMF, Direction of Trade Database. Accessed June 2018

Table 3. Sri Lanka's trade with RCEP economies

	Values (US$ Millions)				Member Shares (%)			
	Exports		Imports		Exports		Imports	
	2010	2017	2010	2017	2010	2017	2010	2017
China	70	430	1,995	4,111	3%	12%	17%	24%
Japan	176	210	640	877	7%	6%	6%	5%
Republic of Korea	33	66	246	284	1%	2%	2%	2%
ASEAN	757	922	2,446	3,382	32%	26%	21%	20%
Brunei Darussalam	0	0	0	0	0%	0%	0%	0%
Cambodia	3	5	0	1	0%	0%	0%	0%
Indonesia	64	430	298	293	3%	12%	3%	2%
Lao PDR	0	0	0	0	0%	0%	0%	0%
Malaysia	72	56	465	575	3%	2%	4%	3%
Myanmar	0	3	1	14	0%	0%	0%	0%
Philippines	9	38	19	22	0%	1%	0%	0%
Singapore	513	234	1,199	1,828	21%	7%	10%	11%
Thailand	73	54	402	445	3%	2%	3%	3%
Viet Nam	22	102	62	204	1%	3%	1%	1%
India	474	790	3,314	4,380				
Australia	108	190	186	215	5%	5%	2%	1%
New Zealand	18	28	215	285	1%	1%	2%	2%
Sri Lanka's RCEP Trade (total/as a % of world trade)	2,392	3,557	11,489	16,916	25%	30%	81%	84%

Source: IMF, Direction of Trade Database. Access June 2018.

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