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Revisiting RCEP's Trade Implications

What are the implications of RCEP for trade? The second of a four-part series looks at the agreement's impact on trade.

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Since its conclusion last November, the trade implications of the Regional Comprehensive Economic Partnership (RCEP) have attracted

immense attention. This is not surprising given its terms, the trade emphasis of most free trade agreements (FTAs), and the fact that the volume of foreign direct investment flows (FDI) within the Association of Southeast Asian Nations (ASEAN) and between ASEAN states and other RCEP signatories such as China and Japan pales in comparison to inward FDI flows from outside the RCEP area. The consensus uniformly is that RCEP will dramatically bolster trade volumes within and outside the RCEP area, especially because it constitutes the first trade pact involving China, Japan, and South Korea.

As we showed in our first piece in this series which reconsidered the effect of RCEP on FDI, however, RCEP's future implications are not so clear-cut. Furthermore, commentators routinely ignore many other important issues like the ramifications of RCEP for specific signatory countries and RCEP'S effects on specific sectors like finance, manufacturing, e-commerce, and technology.

The optimist case is built upon some of RCEP's trade reforms, which we already mentioned in our first piece in this series: tariff eliminations and/or reductions, quota reforms, an enhanced environment for trade in services, reductions of complex and costly rules of origin (ROOs), and the consolidation of multiple, existing bilateral trade agreements. In addition, it is believed that RCEP trade reforms such as standards harmonization, less burdensome sanitary and phytosanitary measures, as well as simplified customs procedures and faster customs clearance requirements will boost trade.

Those positive about RCEP further note that various agreement provisions, like improved dissemination of information on RCEP, will aid small- and medium-sized enterprises (SMEs) in

joining or participating more extensively in the RCEP zone's trade activities. They argue, too, that the pro-globalization tenor of RCEP may have value not only in sending a positive message at a time of increased protectionism and populism in many international economic areas, but also in laying a basis for more creatively designed and/or development-friendly economic agreements.

The defects of the optimist case, however, are that RCEP tariff and quota reforms are not that impressive (especially since many RCEP signatories already have agreements with other signatories and/or have committed to higher levels of trade liberalization through CPTPP), have very long implementation timeframes, many trade liberalization exemptions or uncertainties, and ignore or downplay China's unparalleled supply chain advantages (which will constrain the relocation of value chains) and the lack of a level-playing field resulting from the pervasiveness of Chinese state-owned enterprises. Besides this, limits on trade flowing from government industrial policies will bound potential gains. Finally, Cambodia, Myanmar, Laos, and Thailand will face challenges in profiting from RCEP given their political problems, poor state capacity, and inadequate infrastructure. Dr. Deborah Elms, a top expert on trade in the Asia-Pacific, wisely quipped about existing calculations of RCEP's benefits: "Economic models that claim to do so with authority should be taken with a large handful of salt."

Naysayers deride the conclusion of RCEP for diverse reasons, some mentioned above. Aside from these shortcomings, RCEP does not

mandate substantive reforms regarding the agriculture and service sectors to address issues relating to competition and state-owned enterprises, or deal well with e-commerce issues. As many have stressed, RCEP also has nothing to say about environmental or labor issues.

Some assessments of RCEP's trade effects seem to indicate merely that many countries such as Australia, Myanmar, and New Zealand will only become greater agricultural and raw material suppliers to China, Japan, and South Korea. These gains are certainly meaningful, but hardly point to RCEP transforming the composition of trade or catalyzing the relocation of supply chains as some have conjectured. Relatedly, trade deficits may balloon given that China, with its outsized economy, is well positioned to play the trade game while many developing RCEP signatories are not, even if they ultimately receive dynamic gains from trade.

In addition, it is far from clear RCEP will generate the anticipated benefits in the service sector. The Australian government touts that the "gates will open for the export of services, resulting in Australia gaining crucial new access across financial, banking, health care, education, and many other types of other serviced-related industries." The reality, though, is that the foreign service providers in these and areas like air transport and professional and engineering services will face significant challenges in China, Japan, and South Korea because of extant government policies and the entrenched position of domestic players in these service sectors. RCEP's long implementation timeframes, bounded tariff and quota reductions, and omissions and inadequacies are legitimate concerns.

The reality, though, is that RCEP does entail positive changes and ultimately *will* result in a RCEP zone encompassing more market access, fewer trade barriers, and new export opportunities, even if more bounded than the optimists opine.

While we do not have the space herein to address the distributional or sectoral consequences of RCEP, a few words are in order. First, it is clear that China, Japan, and South Korea will gain the most from RCEP for reasons ranging from cost advantages to their capable multinational corporations (MNCs), from their outsized role in trade within and outside the RCEP zone to the fact that China-Japan and Japan-South Korea do not already have standing FTAs. Second, countries such as Indonesia, Malaysia, and Vietnam will experience gains, despite intensified competition from each other and other RCEP members, if they embrace the requisite economic and political policies. Third, less developed countries like Cambodia, Laos, and Myanmar will find it challenging to profit fully from RCEP in the absence of improvements to their competitiveness, infrastructure, and/or political environments. Fourth, turning to sectoral effects, a J.P. Morgan Private Bank assessment conjectured that automobiles, electronics, and industrial machinery will benefit notably from RCEP, with it and others believing there will be increased trade in consumer goods, plastics, and raw materials due to changes in tariffs, quotas, and ROOs. Lastly, the service sector may witness the increasing prominence of MNCs from countries like Australia, New Zealand, and Singapore given these countries' strengths in services.

One ramification of our analysis is that businesses and policymakers should not be

overly optimistic or pessimistic about RCEP's trade implications. A second is that government and political leaders should expect the regional economic pecking order to remain largely the same, though Indonesia, Malaysia, and Vietnam may move notably up the ranks. A third is that all RCEP signatories must adopt, among other things, suitable fiscal, education, infrastructure, FDI, tax, and trade policies, so they and their companies can maximize RCEP's benefits. RCEP will not deliver benefits automatically. A fourth is that, in many cases, MNCs would do well to focus on first- or second-tier economic players because that is where the action is and will be. Finally, businesses should not assume the changes, harmonization, and simplifications flowing from RCEP mean their analytical work will be less necessary. Indeed, the challenges and opportunities associated with RCEP may increase the time needed to properly assess where to go and what to do in the new trade environment created by the trade pact.

In our next piece, we will focus on the political ramification of RCEP for China, Japan, and South Korea and supply chain restructuring.

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