

Economic & Political Implications of the Regional Comprehensive Economic Partnership (RCEP)

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Background

The Regional Comprehensive Economic Partnership (RCEP) was first discussed at the 19th ASEAN Summit in November 2011 in Bali, when leaders of the 10 ASEAN member states adopted a framework for the partnership, which sets out the general principles for broadening and deepening ASEAN's engagement with its free trade agreement (FTA) partners. At the 21st ASEAN Summit in Phnom Penh on Nov. 20, 2012, leaders from ASEAN countries and their six regional free trade partners agreed to start negotiations for the RCEP. The "Phnom Penh milestone" signaled ASEAN's determination to lead the way in assembling the emerging regional economic architecture. The existing FTAs between ASEAN and China, Japan, South Korea, India, Australia and New Zealand could eventually lead to the creation of an integrated market with a combined population of more than 3 billion, and a combined GDP of about \$19.78 trillion (based on 2011 figures). With the region accounting for more than half of the global market and about a third of global economic output, a successful RCEP would significantly boost global trade and investment. Potential trade and investment changes of such huge magnitude would definitely have tremendous regional economic and political implications. What is the likely prospect of a RCEP agreement?

The objective of launching RCEP negotiations is to achieve a modern, comprehensive, high quality and mutually beneficial economic partnership agreement among the ASEAN member states and its FTA partners. The RCEP will cover trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement and other issues. Having to negotiate such comprehensive and complex trade and investment issues will not be easy, considering the existence of multi-track sub-regional and bilateral FTAs in the region. The RCEP negotiations will likely be tedious and complex. To facilitate the negotiation process, ASEAN leaders endorsed the RCEP's Guiding Principles and Objectives for Negotiating adopted by their economic ministers in Siem Reap in August 2012. Based on these principles, the RCEP would allow the region to eventually draw other economic partners into the agreement.

The Way Forward for RCEP Negotiations

To conclude the RCEP negotiations by 2015 will not be an easy task given the objectives of attaining a comprehensive and high-quality economic partnership agreement that involves deeper

engagement than ASEAN's existing FTAs. The question then is how to move forward?

The negotiation process could be facilitated by identifying the major characteristics of the existing FTAs with ASEAN's six regional trade partners. Negotiations should be built on existing ASEAN+1 FTAs because starting from scratch would be too complex, but the process should eventually require the integration and liberalization of all ASEAN FTAs. On trade in goods, for example, ASEAN+6 countries use different tariff classifications for their tariff concessions, making it difficult to construct straightforward schedules. It is not only that different countries use different tariff schedules, but the same countries also use different schedules for their FTAs with different countries. In addition, tariff concessions from the same country differ depending on the FTA, and tariff elimination rates are different across the ASEAN+1 FTAs. It is possible, therefore, that a common concession approach on certain goods would be considered in RCEP negotiations, instead of a bundle of schedules or exclusion lists for every possible bilateral combination among the member countries.

To accelerate RCEP negotiations and to increase FTA utilization, a simplified approach to rules of origin (ROOs) involving harmonization, co-equality of rules and the cumulation of value contents could be adopted. Such an approach would be essential to improve production networks. At present, the utilization of ASEAN+1 FTAs is not high due to restrictive ROOs, especially those in the ASEAN-China FTA and the ASEAN-India FTA.

Agreements on trade in services and investments have not been included in all ASEAN+1 FTAs. Similarities do exist in the level of liberalization commitments between ASEAN+1 FTAs and the ASEAN Framework Agreement on Services, which indicates that the sectoral patterns of liberalization processes for trade in services under ASEAN+1 FTAs are similar. Therefore, consolidating these FTAs into one may be possible. An agreement on investment is included in the ASEAN-China, ASEAN-South Korea and ASEAN-Australia/New Zealand FTAs, but a comparison reveals several differences with respect to national treatment, performance requirements and market access. The RCEP's Guiding Principles and Objectives for Negotiating will aim to create a liberal and competitive investment environment in the region, and negotiations for investment will cover the four pillars of promotion, protection, facilitation and liberalization.

The progress and conclusion of RCEP negotiations are dependent on the timely conclusion of the ASEAN Economic Community Blueprint. The way forward for RCEP negotiations should be based on rationalization and flexibility in consolidating the existing ASEAN+1 FTAs to maximize benefits and lower the costs of doing

business. In enhancing market access, consideration should be given to different stages of economic development across the region through special and differential treatment. There should be an emphasis on providing time extensions rather than lowering the threshold level for negotiations.

In order to bring additional and real gains to ASEAN countries, the RCEP should aim at a higher level than the contents in the current ASEAN+1 FTAs in tariffs, ROOs, trade facilitation, services, investment and economic cooperation. Other issues such as intellectual property rights (IPR), protection and competition policy are increasingly important as ASEAN aims for greater regional and global production networks. To reduce the “noodle-bowl syndrome” (overlapping and complicated FTA agreements) under ASEAN’s existing FTAs, the RCEP regime should introduce as many convergent rules as possible. Such a regime should apply to all the chapters such as common concessions on tariff structure, clear definitions and approach on non-tariff barriers (NTBs), general rules on ROOs, region-wide approach on trade facilitation and economic cooperation, and the types of limitations in services regulation. Lastly, the timeline and speed of RCEP negotiations will also be important factors in moving forward.

Economic Implications of RCEP

ASEAN’s initiative for the RCEP is generally interpreted as aiming at improving the liberalization level of the current ASEAN+1 FTAs by integrating them and increasing their FTA utilization rate and strengthening “ASEAN centrality” in the regional trade architecture.

Instead of working with a pre-determined membership, the RCEP would be based on open accession, which would enable any of the ASEAN FTA partners to participate, either at the outset or at a later date. The arrangement is also open to any other external economic partner. Moreover, the RCEP is expected to help entrench ASEAN centrality which is challenged by alternative economic cooperation arrangements, particularly by the US-led Trans Pacific Partnership (TPP). Would the RCEP compete with the TPP?

In line with its pivot toward Asia, the United States has led the expansion of the TPP and encouraged other APEC member countries to join the negotiations. It argues that TPP negotiations should be broadened to include trade in goods and services, investment, IPR, environmental protection, labor, financial services, technical barriers

TABLE 1

Comparing regional initiatives

	GDP (nominal, US\$ trillion)		GDP (PPP, US\$ trillion)	Population (billion)		Total merchandise trade (US\$ trillion)
	2011	2015*	2011	2011	2015*	2011
RCEP	19.9 (28%)	26.2 (32%)	26.1 (33%)	3.4 (48%)	3.5 (48%)	10.1 (28%)
TPP	20.7 (29%)	24.4 (30%)	20.8 (26%)	0.66 (9.4%)	0.68 (9.4%)	7.8 (21%)
ASEAN	2.1 (3.1%)	3.1 (3.8%)	3.4 (4.2%)	0.60 (8.7%)	0.64 (8.8%)	2.4 (6.5%)
APT	16.5 (23%)	21.8 (26%)	20.7 (26%)	2.1 (31%)	2.2 (30%)	8.8 (24%)
CJK FTA	14.3 (20%)	18.7 (23%)	17.3 (22%)	1.5 (22%)	1.5 (21%)	6.4 (17%)
APEC	38.8 (56%)	48.5 (59%)	43.9 (56%)	2.7 (40%)	2.8 (39%)	17.6 (48%)
NAFTA	17.9 (26%)	21.1 (25%)	18.1 (23%)	0.46 (6.6%)	0.47 (6.5%)	5.4 (15%)
EU	17.6 (25%)	17.5 (21%)	15.8 (20%)	0.50 (7.2%)	0.50 (7.0%)	12.3 (33%)

Note: Numbers in parenthesis give the global percentage. *Implies IMF forecast.

Source: World Economic Outlook, IMF, October 2012 database; World Trade Organization database; Sanchita Basu Das

and other regulatory issues. The US would like to conclude the TPP negotiations by end of 2013. However, there are many important issues that it is difficult for other less-developed TPP negotiating countries to agree on. Many analysts believe that the TPP and RCEP would divide ASEAN and East Asia countries, as they would have to choose between two seemingly competing regional economic frameworks, and impede Asia-wide trade integration. In fact, competition created by the TPP process might tend to accelerate the process of convergence toward region-wide economic integration as China, South Korea, India and Japan are not TPP negotiating countries and they are strongly supporting the RCEP process.

The negotiation package will also have a critical implication for whether the RCEP would lead to Asia-wide convergence. If RCEP negotiations adopt a “goods first” approach rather than a single undertaking which includes services and investment, there will be no chance of creating a balance between goods and other chapters. As a result, any FTA partner which has a larger stake in services and investment will face a challenge in its participation in the goods-only framework. On the other hand, a single undertaking approach will enlarge the possibility of creating a balance between different chapters. The parallel process of the TPP could create a positive environment for the RCEP to achieve a comprehensive and high-quality region-wide FTA. Therefore, pursuing package-deal negotiations on trade in goods, services and investment is important to accommodate the different interests of the RCEP members.

The starting of RCEP negotiations might dampen the scheduled trade talks for a China-Japan-Korea (CJK) FTA. There is competition between China and Japan in supporting different regional economic

integration frameworks. China clearly prefers the East Asia Free Trade Agreement, while Japan's preference is for the Comprehensive Economic Partnership Agreement. The RCEP offers a consolidated approach to a region-wide FTA. The start of CJK FTA talks would definitely facilitate RCEP negotiations as the three Northeast Asian nations constitute the overwhelming share of the region's economy. However, the competing territorial claims in the East China Sea between China and Japan and between Japan and South Korea would make it less likely that negotiations would start as scheduled in early 2013. TPP negotiations would make any Asian member a more open economy, and institutional competition with the RCEP could accelerate the process of forging region-wide economic integration as the four largest economies in Asia strongly support the RCEP process and should make maximum efforts to facilitate the RCEP negotiations expeditiously. Success in RCEP negotiations would contribute toward creating a friendly and cooperative framework among China, Japan, South Korea and India beyond the short-term objective of overlapping territorial claims. The benefits of long-term and sustainable economic prosperity in Asia far exceed the existing short-term national preoccupation with competing territorial issues.

There are four issues that are expected to be highly controversial in the TPP. These are a strict IPR regime, strong competition policy, investor-state arbitration, and labor standards. With the RCEP negotiation process, it is possible that these highly controversial issues that are strongly supported by the US in accordance with its strategic and economic objectives could put downward pressure on TPP negotiations. On the other hand, the TPP could apply upward pressure to elevate the level and quality of the RCEP talks. Therefore, the two processes are not mutually exclusive and potentially could be complementary, moving towards a certain convergence.

Another area in which the RCEP would have significant implications is trade facilitation programs. Trade facilitation is known to have larger positive economic impacts than tariff elimination. The current ASEAN+1 FTAs have only general provisions and lack specific work programs on trade facilitation, with the exception of the ASEAN-Australia/New Zealand FTA. It is more likely that trade facilitation programs would be more effective when large numbers of countries participate, rather than in a bilateral setting. Improvement in trade facilitation programs would have a more positive implication for FTA utilization. FTA utilization rates are affected by marginal tariff rates, costs of compliance with ROOs, and the administrative costs for understanding the FTA structure.

Closely related with trade facilitation, economic cooperation would be greatly promoted under the RCEP process. All the current ASEAN+1 FTAs have economic cooperation chapters except for the ASEAN-India FTA, although their contents vary. Trade in goods and

economic competitiveness are the two preferred areas of economic cooperation, while the coverage is weak in the flow of services, investment, capital and skilled labor. It is expected that the coordination mechanism between the existing ASEAN+1 FTAs would be given high priority in RCEP negotiations in contrast with TPP talks. In fact, there has been a good start for the deliberation of economic cooperation programs in the RCEP, as the ASEAN+6 countries have already discussed the issue under the ASEAN Plus Working Group on Economic Cooperation forum. Economic cooperation programs should expand to policy issues related to trade in services, investment, customs modernization, technical regulation and IPR.

Another important area of focus in the RCEP negotiations is the special and differential (S&D) treatment chapter. There are two important policy options for member countries to allow S&D treatment for certain countries. One is to set a lower threshold of tariff elimination, and the other is to allow a longer transition period. Most ASEAN+1 FTAs accept both measures for Cambodia, Laos, Myanmar and Vietnam. However, allowing a lower threshold on a permanent basis should be less a preferred option. It is much more efficient to allow for a longer transitional period as the distortion effect for consumers and producers would be less. The same principle applies to the liberalization of trade in services and investment. Similar to tariff elimination, a longer transitional period should be the main measure in trade in services and investment. Otherwise, the economic values of the RCEP will be limited if too much S&D treatment is allowed. Therefore, S&D treatment should be allowed only in limited areas, not in every content of the RCEP, as this would create a new regional noodle-bowl situation.

The TPP is intended as an economic approach to regional economic architecture. However, it is also perceived by other countries, particularly by China, as a significant US policy instrument to strengthen its presence and strategic regional security arrangements. The net effect of the TPP agreement on regional economic integration is critically dependent on the possible structure of the TPP. There is an inherent conflict between the objectives of a high-quality TPP agreement and the inclusive region-wide FTA framework that provides policy space and flexibility to diverse economies of the region. China and other East Asian countries perceive the TPP talks as tending to focus on the first objective, at the expense of inclusive growth. Such policy orientation by the US is interpreted by East Asian countries principally as an instrument of US international economic and security policy, rather than a pathway for the eventual establishment of the Free Trade Area in the Asia-Pacific as envisaged by APEC.

Central TPP issues include industrial goods, services, IPR, competition policy, safety standards, labor and environment. These

are discussed in the context of “cross cutting” issues such as regulatory coherence, competitiveness, business facilitation, the promotion of SMEs, production and supply chain linkages. It seems the majority of the TPP provisions deal with “behind border” issues that tend to create disagreements, not so much in principle but in details. From developing countries’ perspectives, is preferable to have a TPP framework that is flexible by taking into account the interests of less developed countries.

With the starting of RCEP negotiations, there is a competitive interaction and competitive liberalization that could lay the foundation for a region-wide agreement. Such a convergence would enable major countries in the region, especially China and the US, to minimize the political and security overtones of the TPP talks that could gradually converge with those for the RCEP.

Political Implications of RCEP

How would the RCEP have any regional political and security impact? As an ASEAN initiative it would strengthen its position as the default hub of the East Asia regional architecture in trade and investment matters. If the RCEP is successfully concluded among ASEAN+6 members on a timely basis, it is plausible that an enhanced ASEAN centrality could have the effect of stabilizing China’s relations with the US and with Japan in the long term. ASEAN in its present structure is unlikely to exert any significant impact on political and security issues. It is therefore imperative that ASEAN should exhibit a strong leadership role to stabilize the potentially explosive issues in the South China Sea and other flash points in the region. However, such an outcome requires a strong and cohesive ASEAN to facilitate a dialogue and to provide a framework for conflict-resolution mechanisms. A successful and timely conclusion of the RCEP would create a region-wide high-quality FTA but it would also strengthen ASEAN’s position in regional security by creating a platform for consensus-building, crisis-prevention mechanisms and a framework for economic prosperity and regional security. A conscious effort should be made in both TPP and RCEP negotiations to make clear provisions as complimentary as possible, with a view to guiding the technical development and negotiations of each track toward a region-wide FTA convergence.

Based on various empirical studies in different parts of the world, economic cooperation and accompanying prosperity tend to create a conducive environment for the prevalence of peace and stability. It would increase the likelihood of peace and security when economic cooperation progresses towards economic integration. The classic case in point is in European economic integration, whereby the historical rivalry between Germany and France is gradually diminished as the scope and level of European economic integration

are adequately integrated. At the same time, historical evidence clearly indicates that economic integration and subsequent economic prosperity are necessary but not a sufficient condition to promote regional peace and security. It desperately requires a workable and effective regional architecture in terms of institution, modality and process to promote confidence-building and conflict resolution mechanisms. East Asia is desperately lacking in this respect. This is due to the fact that there is a serious deficit of trust among major countries in the region and the default concept of ASEAN centrality does not have the power to enforce the required elements for regional stability.

Furthermore, East Asia does not have a regional architecture to provide a platform for major countries to engage in dialogue to settle competing national interests. Security arrangements and protection are mainly conducted through bilateral structures and the US is the only superpower that has the capacity to project its national security interests and objectives in the region. Consequently, as long as there is no comprehensive regional security architecture and a regional balance of power, regional economic convergence through the leveraging elements of the TPP and RCEP would at most provide a “second best” solution to regional peace and security. The short-term benefits of pursuing a full course of overlapping territorial claims are far less compared to the long-term benefits of pursuing a full course of regional stability and prosperity through economic cooperation and integration. In addition, East Asia needs a workable multilateral regional security arrangement. In this context, ASEAN must exercise its default centrality not only in trade and investment but equally in the regional security sphere as well. In the initial measure, ASEAN must be able to move further from a Declaration on Conduct of Parties in the South China Sea, which was agreed in 2002, to a more binding code of conduct in negotiating a peaceful resolution of the overlapping claims in the South China Sea. As the RCEP process would require negotiating trade and investment agreements, overlapping territorial claims in East Asia will only be settled if the claimant states change their mindsets from one of sovereignty and sole ownership of resources to one of functional cooperation and cooperative management. Indeed, the RCEP process could potentially lead not only to enormous opportunities for regional economic cooperation and integration but to a peaceful and stable region through a coordinated effort to supply collective trust and confidence.

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