New Asia-Pacific deal: Implications for the world's largest free trade agreement

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SUMMARY

- The Regional Comprehensive Economic Partnership (RCEP) is a new multilateral trade agreement involving 15 countries that collectively represent 30% of global output and population, and the largest trading bloc in the Asia-Pacific.
- This deal is a significant step to liberalizing trade rules, at a time when some countries have taken a more protectionist approach to trade policy. This is China's first major free trade agreement (FTA) in the region, which includes Japan and South Korea, among others. The United States had previously withdrawn in 2017 from another trade deal in the region called the Trans-Pacific Partnership, which is now the Comprehensive and Progressive Agreement for Trans-Pacific Partnership or CPTPP.
- RCEP builds upon and consolidates existing agreements between the Association of Southeast Asian Nations (ASEAN) states. Compared with some of Canada's major trade agreements, the Canada-United States-Mexico Agreement (CUSMA), Comprehensive Economic and Trade Agreement (CETA) and CPTPP, the trade liberalization initiatives through RCEP are somewhat less ambitious. Indeed, only about 17% of trade value covered in this agreement is new, relative to previous deals. Nonetheless, RCEP will, after a lengthy transition period, remove up to 90% of tariff lines among its members, although chapters on investor-state dispute settlement (ISDS) and state-owned enterprises (SOEs) are absent.
- The near-term implications for Canadian companies are relatively modest, given that Canada already has more ambitious trade agreements with several RCEP members via CPTPP or bilaterally (Japan, South Korea, and Singapore). However, RCEP may have additional benefits for a small sub-section of Canadian exporters that could eventually operate in an RCEP country, which is also a CPTPP member (e.g. Vietnam).

AT ISSUE

After eight years of negotiation, the RCEP was signed on Nov. 15, 2020, at a four-day virtual ASEAN summit hosted by Vietnam. This comprehensive trade agreement encompasses 15 members[1] states in areas, including trade in goods and service, e-commerce, investment, intellectual property rights, and standards. It establishes the world's largest trading bloc in the Asia-Pacific—larger than CUSMA, CPTPP, or the European Union (EU)—with the collective output of its member states accounting for 30% of global output and population.

[1] RCEP signing members are: Australia, New Zealand, China, South Korea, Japan, Vietnam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Brunei.

RCEP is expected to raise global national annual income in 2030 by $186 billion USD and add an additional $428 billion in trade for its members.[2]

Some media headlines characterized the agreement as "China-led." However, RCEP was largely driven by the ASEAN member countries, a group of countries with different economies and political systems whose diversity further highlights the significance of the accomplishment. Nevertheless, it's estimated that North Asian countries are likely to benefit the most from this pact, as they are the new members in the group. This is the first trade agreement including China, Japan and South Korea. A prominent absence in the group is India. Despite its earlier involvement in the negotiations, India has withdrawn, and is unlikely to rejoin the group soon, given domestic concerns about the ability of its industry to compete with China.

RCEP builds upon and consolidates existing agreements between ASEAN states. This agreement reduces tariffs for an additional 17% of trade value that is not currently covered by agreements. One of the most significant gains is the unification of the rules of origin, with a relatively low regional content threshold of 40%. In other words, a good manufactured in an RCEP country will be considered to "originate" from within the RCEP region if 40% of its inputs or its transformed value are from within the bloc. Once a product meets the RCEP originating criteria, it qualifies for the applicable tariff reductions set out in the agreement. Some caveat that RCEP is a relatively shallow agreement compared to CPTPP, because the tariff reduction schedule is staggered over the next two decades and many exceptions are present. Only an average of 90% of tariffs are slated for removal as compared to the modern trade agreement standard of closer to 99%. Further, highly contentious but important issues such as chapters on investor-state dispute settlement and state-owned enterprises are absent.

Next steps include ratification by all members, a process which could take several years, but has been speculated as early as January 2022. The deal only comes into effect once six ASEAN countries and three non-ASEAN signatories ratify. RCEP's political significance is as noteworthy as its economic benefit. The agreement signals that most Asian countries are looking to liberalize trade despite an anti-globalization/anti-trade climate in some parts of the world. RCEP recognizes the economic benefit of further trade integration for the region; and it signals how Asian countries want to balance their relationships with China and the U.S. This is the first multilateral FTA for China.

[2] Peterson Institute for International Economics, East Asia decouples from the United States: Trade war, COVID-19, and East Asia's new trade blocs. https://www.piie.com/system/files/documents/wp20-9.pdf

GLOBAL CONTEXT AND OUTLOOK

By securing a position in RCEP, China may be viewed as the agreement's biggest winner. Not only does China signal that it's willing to work with partners in Asia, but it gains a foothold into one of the most dynamic economic regions of the world, where it can help establish rules and standards. On the other hand, the U.S.'s historical role as a significant economic force in Asia, whether as a source of demand for exports, or as the main rule writer and standard setter, may decline without more outreach.

While limited in scope compared to other FTAs, the agreement is likely to strengthen intra-Asian trade and capital flows and to make supply chains in Asia more China-centric. While still immature, not covering rules of competition or state-owned enterprises, RCEP may very well encourage the further development of Asian supply chains at the expense of non-members. This follows a developing trend of regional retrenchment begun by way of the China-U.S. trade dispute. Notably, such a trend doesn't necessarily support improvements for all.

Indeed, a recent paper notes that the trade dispute costs China $35.2 billion, or 0.29% GDP, costs US$15.6 billion, or 0.08% GDP.[3] Ultimately, however, aggregate impacts of RCEP and CPTPP may offset these individual country losses.

The big question is whether the agreement will inspire the U.S. to renew its interest in the region.

IMPLICATIONS FOR CANADA

The impact of RCEP will likely have only a modest impact on Canadian companies whose goods and services will be competing against those of RCEP partners. Top Canadian exports to Asia include agricultural commodities, advanced manufactured goods, fertilizer, wood and pulp and paper.

The extent to which Canada's competitors in the region will gain additional market share depends on product-specific factors and on how great the tariff reductions are in practice compared to the pre-RCEP context. In many cases, RCEP won't alter the tariff landscape significantly, as Canada holds a deeper agreement through CPTPP and bilateral FTAs with several RCEP members. For example, CPTPP signatories (e.g. Japan, Vietnam and Singapore and Canada) have a bilateral FTA with South Korea.

For a small sub-section of Canadian exporters, RCEP may have additional benefits. Canadian manufacturers that are present in Asia or plan to set up operations there, could conceivably set up operations in an RCEP country, which is also a CPTPP member (e.g. Vietnam). They could then optimize their exports for both free trade agreements, importing inputs from signatory countries or integrating their products into regional supply chains in way that takes advantage of the rules of origin of the agreements and minimizes tariff costs as well as administrative burdens.

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[3] Zhou, Yang. "The U.S.-China Trade War and Global Value Chains." University of Minnesota, Working Paper, November 2020.

ABOUT THIS REPORT

This report is written by EDC Economics staff. The views expressed in this report are those of the authors and shouldn't be attributed to Export Development Canada or its Board of Directors.

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