Geopolitical Implications of Regional Comprehensive Economic Partnership (RCEP)

By:

Meredith Kolsky Lewis

February 11, 2021

On November 15, 2020, 15 nations signed the Regional Comprehensive Economic Partnership (RCEP) trade agreement. The signatories comprise the ten members of the Association of Southeast Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam) as well as Australia, China, Japan, New Zealand and South Korea. India participated in the negotiations for many years but withdrew shortly before the signing of the agreement. RCEP will come into force once it has been ratified by at least six of the ASEAN member countries and three of the non-ASEAN members. Once it comes into force, RCEP will be the world's largest trade bloc, comprising approximately 30 percent of the world's gross domestic product (GDP). RCEP has been criticized as less ambitious in breadth and depth in reducing trade barriers compared to some other free trade agreements (FTAs), and has been criticized at the extreme as being "platitudinous and ineffective." Notwithstanding these views, the Agreement has significant geostrategic importance. This post will highlight three significant aspects of the agreement: market access opportunities; increased opportunities for intra-agreement supply chains; and implications for the United States as a non-participant.

Market access

On first glance, the market access gains that will accrue from RCEP may appear to be limited. First, ASEAN already has free trade agreements in effect (FTAs) with each of the other partners. Second, seven of the RCEP signatories (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore and Vietnam) are also members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), an 11-country pact which came into force in 2018 and also includes Canada, Chile, Mexico and Peru, and thus these countries already have significant market access to each other's markets. Third, other pairings amongst the non-ASEAN members of the RCEP also already had bilateral FTAs, including Canada and Korea, Australia and China, and New Zealand and China. Notwithstanding all of the existing free trade agreements amongst RCEP members though, various of the non-ASEAN members did not already have FTAs between themselves. For example, while China and South Korea are already FTA partners, prior to RCEP, Japan did not have an FTA with either China or Korea, its largest and third-largest trading partners. RCEP will, therefore, lead to significant new market access between Japan and China and between Japan and South Korea, and will put Japan's exports on a more even footing with Korean exports in the Chinese market and with Chinese exports in the Korean market. Tariffs will be eliminated on an estimated 86 percent of industrial goods exported from Japan to China, as compared with a pre-agreement eight percent, and on 92 percent of goods exported from Japan to Korea, up from 19 percent.

Supply Chains

One of the most notable aspects of RCEP lies not in its market access via tariff reductions, but in a step, the signatories took that will make those tariff reductions more accessible. While a free trade agreement between countries A and B may provide for duty-free trade, this does not mean that every product shipped from A into B or from B into A will, in fact, be entitled to duty-free treatment. How can this be? The answer lies in an important but little-known set of rules called rules of origin, or ROO for short. The customs officials in country A need to have a mechanism for determining whether a product that arrives at the border is a product of country B and thus entitled to duty-free treatment. If an exporter from B is exporting an unprocessed agricultural product it is known to grow, such as corn, it may be relatively straightforward for A's customs officials to identify the corn as being from B and therefore entitled to duty-free entry. But this analysis becomes far more complicated if the exporter from B is exporting a manufactured product comprising inputs from multiple countries. For example, when an exporter from B exports a car to A that comprises an engine manufactured in country C, tires from country D, metal panels and seats from country B, and other components from countries E and F, is the car "from B" for tariff purposes? How is this determined? The answer is that every country has a method for determining the origin of a product. Some countries use a percentage by value test, whereby a product would need to comprise at least a designated percentage of content by value to qualify as being from a particular country. If A's ROO provide for a 40 percent by value test, B's car would need to comprise at least 40 percent content, by value, from B.

If ROO were not already complicated enough, across the world several different and inconsistent methodologies are used for determining origin. While the World Trade Organization (WTO) has identified an interest in harmonizing rules of origin, its rules neither state how origin should be calculated nor express a preference amongst the methodologies currently in use. When ROO are inconsistent across countries, it can be difficult to fully take advantage of preferential tariff treatment, as exporters may opt to default to the most-favored nation rates to which its products are entitled rather than to prepare different paperwork for each country to which it exports to demonstrate it meets the various different measures of origin being applied by its importers.

RCEP remedies the inefficiencies caused by inconsistent ROO by harmonizing ROO across the agreement. Not only is the methodology for determining origin consistent but also the substantive requirements are quite easy to satisfy compared to other agreements. In order to be deemed a product of RCEP, at least 40 percent of the product's value added must come from within any country or combined countries within RCEP. The remaining 60 percent could be from a country or countries outside RCEP and the product would still qualify as an RCEP product. A single certificate of origin will be used across RCEP, thus simplifying paperwork Because companies will be able to ensure duty-free access to the entire RCEP market by building in at least 40 percent content by value from any place(s) within RCEP, this should lead to more RCEP producers being included in supply chains. Just as the formation of the North American Free Trade Agreement (NAFTA) in the early 1990s led many automotive and electronics manufacturers to set up factories in Mexico to take advantage of NAFTA's ROO and thereby duty-free access to the US market, RCEP's friendly ROO will likely lead companies based outside of RCEP to open manufacturing facilities within an RCEP country and/or intentionally purchase inputs from RCEP countries so as to be able to sell their products to, inter alia, China, Japan and South Korea on a duty-free basis.

Implications for the United States

When the RCEP negotiations began in 2011, another major Asia-Pacific plurilateral trade agreement, the Trans-Pacific Partnership (TPP), was already under negotiation. The TPP grew out of discussions amongst the four Trans-Pacific Strategic Economic Partnership countries of Brunei, Chile, New Zealand and Singapore to broaden the scope of their existing FTA. The United States expressed interest in joining, and quickly negotiations to form a new agreement, the TPP, grew to include Australia, Malaysia, Peru and Vietnam. Following the launch of the RCEP talks, Canada and Mexico joined the TPP negotiations in 2012 followed by Japan in 2013. The TPP was seen as a potential model to grow into an Asia-Pacific-wide agreement and unlike previous conceptualizations for an Asia-Pacific-wide FTA, notably included the United States and did not include China. It is likely the TPP negotiations spurred China to encourage movement towards an ASEAN + 6 agreement (ASEAN plus Australia, China, India, Japan, New Zealand and South Korea; the name for this grouping changed to RCEP once the negotiations commenced) which had been floated conceptually but not yet launched.

Although the negotiations shared seven members, the ambitions differed. The TPP members sought to negotiate a cutting-edge agreement and, in addition to nearly comprehensive market access commitments, included various obligations that went beyond the WTO framework, including binding provisions on labor, environment and state-owned enterprises. Countries on both sides of the Pacific expressed interest in joining TPP, which was seen as setting the rules of the future. In contrast, RCEP members, who span a wider range of development levels, did not have consensus to pursue as ambitious a scope as the TPP, and did not have a waiting list for entry. As expected, the TPP concluded its negotiations first, with signatures in February 2016. However, with US presidential elections scheduled for November 2016, President Obama recognized the Republican-led Congress was unlikely to give the Democrats a win prior to the election. It was in any case widely expected that the Democratic candidate, Hillary Clinton, would win the election and in due course (notwithstanding her campaign statements opposing the agreement) seek to have TPP approved by Congress. Of course, Clinton did not win the election, and incoming President Donald Trump, who had vowed to withdraw the US from the TPP, did just that a few days into his term. The remaining 11 members agreed to conclude a very similar agreement that the US could join easily in the future, and the CPTPP was signed in January 2018 and came into force in December 2018.

Now, with RCEP signed, not only is the US not at the helm of the more strategically important Asia-Pacific FTA as planned, but China also now heads the (currently) larger of the agreements and has stated it may seek to join CPTPP. The geopolitical dynamics have thus been turned on their head. Previously, the US had dictated various terms within TPP, and China would have had to capitulate to these to be accepted into the agreement; a prospect that seemed unlikely even were the US open to its entry – which was not at all assured. Now, the CPTPP has frozen the TPP’s US-centric provisions; China already has its market access to the Japanese market in place; the US sits outside both agreements; and China could, in theory, be a party in both. These developments place incoming US President Joe Biden in a challenging position. On the one hand, it seems to be in the US’s interest to respond to RCEP and China’s comments about the CPTPP by joining CPTPP as soon as possible. Biden, who was Barack Obama’s Vice President during the TPP negotiations, is a moderate and likely would be interested in joining the CPTPP (thus effectively rejoining the TPP), all things being equal. On the other hand, however, Trump’s rejection of the TPP and shift away from multi-party diplomacy, in general, proved very popular with a significant segment of the US population, and Biden’s supporters include many Democrats who approved of Trump’s populist approach to trade. The timing is difficult for Biden. The domestic mood remains leery towards the TPP/CPTPP, and the coronavirus and other domestic issues are likely to take center stage for the foreseeable future. And while the Democrats control both the House and Senate as well as the White House for the next two years, Democrats have been less receptive to trade deals for the past many years than have Republicans. Thus, even though the Administration may want to join the CPTPP, this may prove difficult if not impossible, given domestic political realities.

View online: Geopolitical Implications of Regional Comprehensive Economic Partnership (RCEP)

Provided by Afronomicslaw