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RCEP-Countries Create Asia-Pacific Free Trade Zone

Trade Facilitation but No Integrated Bloc

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The signing of the Regional Comprehensive Economic Partnership (RCEP) on 15 November 2020 establishes the world's largest free trade area. The agreement was hailed as an important step forward for the international trade system: protectionism is no longer the only visible option for the third decade of the twenty-first century. But RCEP is a relatively weak instrument. It consolidates existing trade agreements in the region, but does not represent a breakthrough to a liberal economic space. It lacks the potential to make the Asia-Pacific region into a monolithic trading bloc, nor does it contribute to overcoming growing political tensions in the Indo-Pacific.

The process that led to RCEP began in 2012, and was initiated by the ASEAN states. The agreement includes that organisation's ten members (Brunei, Indonesia, Cambodia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) plus China, Japan, South Korea, Australia and New Zealand. One of the original motives for the ASEAN states was to create a counterweight to the Trans-Pacific Partnership (TPP). After US President Donald Trump withdrew from TPP in 2017, the smaller and rather less ambitious Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) was realised in its place. This did not represent a full substitute for RCEP because important ASEAN members remained outside, in particular Indonesia and Thailand.

RCEP does not in fact involve great change in trade relations between ASEAN and China, which have been governed by a free trade agreement since 2010. That agreement was an initiative of then Chinese Prime Minister Zhu Rongji rather than ASEAN.

Japan, China, South Korea

So an agreement involving ASEAN and China is nothing remarkable. The problem was bringing together Asia's two real economic and political heavyweights, China and Japan. Concluding RCEP despite political tensions in the region represents a notable success.

Tokyo's relations with Beijing are fraught. Alongside the United States, Australia and

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India, Japan is a member of the Quadrilateral Security Dialogue (Quad), a loose military alliance in the Indo-Pacific region. Although it has been a very weak formation to date, the Quad's principal objective is clear: to form a military counterweight to China.

While firmly in the camp taking a critical view of China's increasingly assertive foreign policy, Japan is also interested in expanding trade. In fact the rivalry between Tokyo and Beijing explains Japan's participation in RCEP: abandoning the agreement would have allowed China to further expand its influence on the rising Asian economies.

While Sino-Japanese rivalry has been simmering for decades — and occasionally coming to the boil — China's relationship with South Korea seldom makes waves. One exception was a conflict in 2017, when Chinese state media called for a boycott of South Korean consumer goods and movies after Seoul deployed a US missile defence system. The South Korean—owned Lotte supermarket chain was specifically targeted after providing land for the missile system, and responded by announcing it would withdraw from China.

The biggest benefit of RCEP is that it eases the application of existing trade agreements in the Asia-Pacific region. For years economists have been complaining that the region's multifarious trade agreements increase rather than reduce regulatory obstacles, limiting their economic benefits. Reducing tariffs in bilateral trade in fact increased the administrative costs for businesses, which had to deal with documenting origin. To be traded tariff-free under a free trade agreement, goods require valid certification of origin. In many cases the costs involved have neutralised the savings attributable to abolition of tariffs.

Simplifying Complex Rules

The economic effects of trade policy have to date been disappointing. According to a study for the Pacific Economic Cooperation Council in 2015, most businesses were not exploiting the opportunities offered by existing free trade agreements. Just 22 percent of Asia-Pacific trade (between countries with free trade agreements) made use of the agreed preferences. The other 78 percent was conducted under standard WTO rules and tariffs. In other words, the existing free trade agreements did not contribute a great deal to trade liberalisation in the Asia-Pacific region.

RCEP, on the other hand, will reduce administrative costs for importers and exporters. As soon as it comes into force uniform rules of origin will apply across all participating economies, although businesses will still have to compare the cost of certification of origin with the tariff they would otherwise have to pay. It would certainly appear plausible to expect the share of trade conducted under RCEP terms to be significantly higher than under many of the existing trade agreements.

Violation of Article 24

RCEP contributes to liberalising trade between the participating nations by reducing the costs of importing and exporting goods and services within the free trade zone. But it also contributes to the ongoing erosion of the multilateral trade system. Every free trade agreement represents an exception to Article 1 of the General Agreement on Tariffs and Trade (GATT), the fundamental "most-favoured-nation clause" under which all trade liberalisations must be granted to all WTO members. This is permitted under GATT Article 24, which stipulates that exempted free trade agreements must cover "substantially all the trade". RCEP does not satisfy that condition. Agriculture is largely excluded, as is fishing; the arrangements for trade in services are weak. But these deficits apply to almost all free trade agreements. The reason this state of affairs is tolerated is simple: a WTO member would have to lodge a complaint, and because they all violate Article 24 none of them have any interest in so doing.

So RCEP does not represent a return to the trade-liberalising spirit of the 1980s and 1990s. It tends to further weaken the multilateral trade system rather than strengthening it. It is advantageous for the participating nations, but not for the global economy. Even for its members the effects are marginal. A study by the Peterson Institute for International Economics (PIIE) suggests that the increase in aggregate annual GDP of member economies in 2030 will be just US$174 billion. Distributed among a population that already comprises 2.5 billion people the economic benefit at the individual level will be almost unmeasurable: annual per capita economic output will increase by about US$70. Nobody will be able to call that a significant gain.

Shallow Rules without Shared Standards

Despite fears in certain quarters, RCEP will not create a new Chinese-led economic bloc. Its regulatory ambition is explicitly modest: It contains no environmental rules at all and refrains from imposing uniform labour standards. Even more importantly, the agreement does not constrain the future trade policy of its signatories. In contrast to the European Union, whose customs union involves a common trade policy for all its members, RCEP permits its participants to continue to pursue their own trade policies. For example Australia can conclude a free trade agreement with the EU as and when it chooses. That would change if RCEP became a customs union. But in the current political climate it is almost inconceivable that countries like Australia or Japan would sign up for a customs union with China. In that sense RCEP creates very close ties to China but only in very limited dimensions. The agreement is not the beginning of an Asia-Pacific integration process. In fact, just two weeks after its signing the political tensions blocking broader integration in the Indo-Pacific region became very visible. The most prominent case is Australia, which has very close commercial ties to the People's Republic. In November 2020, Beijing's embassy in Canberra provided the Australian media with a short document detailing fourteen reasons for the rapid deterioration in relations, including criticism of statements by Australian politicians on Taiwan, Hong Kong, the South China Sea and Xinjiang.

Australia: Canary in the Coalmine

Australia is where the region's foreign policy tensions and contradictions are most apparent. It juggles close security ties with the United States with expanding economic cooperation with China. Canberra has become accustomed to fierce criticism from Beijing, for example over condemnation of human rights violations against the Uighurs in Xinjiang and the suppression of the protests in Hong Kong, or the exclusion of the Chinese technology firm Huawei from contracts for Australia's 5-G network. Now Beijing is testing how far it can go. In that sense, Australia is the canary in the Asia-Pacific coalmine.

The Australian situation is especially complex. The history goes back a long way, with Chinese immigrants contributing to Australia's development since the gold rush of the 1850s. Until the pandemic there were about 180,000 Chinese students in Australia, and 1.2 million annual visitors. Australia also has roughly that number of residents with Chinese roots.

No other country has profited so strongly from China's economic growth. China has been Australia's largest trade partner since 2007. In 2018/19 it was by far the biggest destination for Australian exports of goods, worth about 135 billion Australian dollars (AUD) — plus AUD 18 billion in service exports. Japan followed with AUD 59 billion. The sum of Australia's exports of goods and services to China is greater than its exports of goods and services to Japan, the United States, India and South Korea combined. At first glance Australia would appear susceptible to arm-twisting.

In fact Australian society is increasingly sceptical towards China. In 2019 half of

Australians held a positive opinion of the United States, despite all the difficulties with the US government and President Trump. But only about one-third thought positively of China even though Australia's prosperity depends heavily on resource exports to China and Chinese demand for educational and tourism services. The negative stance of many Australians has hardened further in 2020, with a full 94 percent now supporting their government's policy of reducing dependency on China.

In Australia we see how thin the sheen of modernity can be. Journalist Richard McGregor called it "a modern multicultural country with deep xenophobic roots". Australia's massive European immigration programmes after the Second World War were accompanied by a "yellow peril" scare. In the 1950s Australians feared Japan, today it is China.

Like the public, the government also struggles with ambivalent perceptions of China. When German Chancellor Angela Merkel visited Australia in 2014 she asked then Prime Minister Tony Abbott what factors influenced Australia's policy towards China. Abbott responded: "fear and greed". All that has changed since then is that the sense of threat has grown.

Today Beijing expects Australia to avoid any criticism of its internal affairs: the classical kowtow. RCEP will contribute absolutely nothing to lessening tensions. Australia has lodged complaints against Beijing's arbitrary punitive tariffs — not through the dispute settlement process in its existing bilateral free trade agreement with China, but through the WTO. The advantages of multilateral dispute mechanisms become especially clear when the going gets rough.

Japan

A free trade agreement is useful for China's eternal rival. Tokyo was able to join RCEP because the agreement serves its interests without incurring significant political costs.

RCEP permits Japanese businesses to further expand their regional manufacturing networks. Japanese firms were already very active in the ASEAN countries, playing a major role in turning Thailand into a significant manufacturing location for example. Euphoric observers were already calling Thailand "the Detroit of Asia". Simplifying the rules of origin will now allow Japanese carmakers to source more components from across the entire region.

The exclusion of agriculture is enormously politically helpful for Tokyo. Japan has always resisted liberalising agricultural trade, whether in the WTO or in bilateral and minilateral free trade agreements. Japanese agricultural products are expensive and cannot compete on price. Opening the Japanese rice market to imports from the region, for example, would have a high political price. Combining potentially considerable benefits for Japan's still very competitive manufacturing industries with ongoing protection for Japanese farmers, RCEP appears absolutely made-to-measure for Tokyo.

China

China stands to profit from the free trade zone in similar ways to Japan. Chinese enterprises will benefit from reduced trade bureaucracy and the possibility to regionalise their production networks. But the question is whether China is actually seeking such internationalisation. In November 2020 Communist Party General Secretary Xi Jinping presented his new economic strategy, which forms the backbone of the five-year plan for 2021 to 2025. Its essence is the idea of "dual circulation".

This involves partially decoupling China from the global economy. The share of exports in China's GDP has already fallen from 36 percent in 2006 to 18 percent in 2019, while the trade war with the United States reminded Beijing how dependent parts of its domestic economy are on imports. Almost two-thirds of all semiconductors used in China in 2019 were produced abroad (down from 80 percent in 2015). 16.6 percent of Chinese imports in 2019 were semiconductors and other electronic components, with a value of US$350 billion.

The list of the ten biggest semiconductor manufacturers in 2020 includes six from the United States, two from South Korea and one each from Taiwan and Japan, but none from China. Beijing aims to be 70 percent self-sufficient in semiconductors by 2025, but analysts regard that as overambitious.

It is too early to predict the consequences of the new policy of dual circulation. Xi has described the establishment of "fully domestic supply chains" as a matter of national security. Essentially, this represents a retread of the autarchy model of the 1930s. If China was serious about pursuing a new version of autocentric development, RCEP would be superfluous.

In fact the current leadership envisages China continuing to participate fully in international circulation. The goals of the new strategy include preserving the importance of the Chinese market for foreign companies. Continuing to import foreign-made goods such as luxury cars for example, could help deter foreign governments from criticising the Communist Party's new trade strategy too vigorously. As such, Beijing would be deliberately exploiting the motive of greed cited by Tony Abbott to preserve dependencies. German businesses, first and foremost the car industry, offer prime examples of such dependencies.

South Korea

South Korea's situation is similar to Japan's. South Korea has grown affluent without a free trade agreement with China. And like Japan, South Korea also shares a profound interest in protecting its agricultural sector.

But both nations learned hard lessons in the course of 2020, most prominently through production losses in their car industries early in the year when components failed to arrive from China. Hyundai and Kia had to suspend manufacturing altogether, while Honda and Nissan in Japan were forced to reduce production. In 2019 31.1 percent of car parts imported to South Korea came from China; for Japan the figure was 36.9 percent.

Many corporate leaders in South Korea and Japan experienced a painful realisation that sourcing components from China demands unfailing logistics. When the Covid crisis disrupted supply chains, entire production lines ground to a halt; cheap components suddenly cost businesses dearly. This experience will dampen the interest of East Asian manufacturers in sourcing more components from China and other South East Asian countries after RCEP comes into effect.

India Stands Aside

RCEP would have been a more significant development if India had joined. But the country has been wavering for years over its role in the global economy. On the one hand, Indian companies are very active abroad, in manufacturing as well as services. Significant parts of the British car industry today belong to the Indian Tata Group, for example (Jaguar, Land Rover). On the other hand Indian governments have consistently worked to slow and block the development of new rules for international trade. Before the beginning of the WTO Doha Round in 2001, New Delhi threw its weight behind the concerns of the developing countries and emerging economies. The sometimes exaggerated demands of this group contributed significantly to the failure of the Doha Round. Expectations that the election of Narendra Modi in 2014 would usher in a government with the courage to significantly liberalise India's trade policy have proved unfounded. India is entrenched in a position of scepticism towards globalisation and is focussing — like China in its new five-year plan — above all on domestic economic development.

India is a special case in the contemporary international trade system, having no free trade agreement with any of the major economic spaces (East Asia, Europe, North America). For a long time Prime Minister Modi created the impression that he was determined to turn India into a modern and internationally competitive economy. He often criticised the protectionism of US President Trump, and was celebrated at the 2018 Davos World Economic Forum for his appeal to accept globalisation and strengthen international institutions like the WTO.

Even then observers were warning about the gap between the Indian government's words and deeds. Essentially Modi has always pursued a protectionist line. India ranked 120th in the Heritage Foundation's 2020 Index of Economic Freedom, well behind ASEAN members Malaysia (24th), Thailand (43rd) and Indonesia (54th).

India's relative economic dynamism in the early years of Modi's government and his pro-globalisation rhetoric sustained an impression that India would join RCEP. Participating would have allowed India to liberalise its trade relations with dynamic economies, simplify trade bureaucracy and probably receive a great economic boost.

An Indian economic opening should not be expected in the foreseeable future, for two reasons. Firstly, tensions between India and China worsened considerably in 2020, culminating in a military confrontation in the Himalayas. In response New Delhi has recalibrated its foreign policy and is today more willing to join the United States, Japan, Australia and other democratic states in challenging China. It is currently inconceivable that India would join a free trade agreement in which China was also involved.

The second reason is the renaissance of an economic policy that concentrates on the internal market and seeks to limit imports. "Atmanirbhar Bharat" seeks a high degree of economic autarchy. Today New Delhi is pursuing the strategy that John Maynard Keynes propagated in 1933 as "national self-sufficiency". At the end of November 2020, immediately after the signing of the RCEP agreement, Indian Foreign Minister Subrahmanyam Jaishankar railed against globalisation, asserting that India's industry had been seriously harmed by earlier liberalisation measures.

The Modi government thus cannot be expected to abandon its course and revert to a policy of economic opening. This trade policy reversal is especially unexpected because the Indian public has always responded very positively to the effects of globalisation.

Strong Support for Globalisation

It is conspicuous that RCEP encounters little or no political resistance in the participating nations. The main reason for the acquiescence of their civil societies is that RCEP involves a group of countries that one could call the "winners of globalisation". Support for trade liberalisation and a far-reaching international division of labour remains strong in the Asia-Pacific region. While the original proponents of globalisation, principally the majority of OECD countries, have become weary and mistrustful, many Asian nations articulate a remarkably clear desire for greater opening and connectivity. In surveys the populations of Vietnam and the Philippines consistently exhibit the greatest support for globalisation. People in most RCEP countries regard more international trade as an opportunity rather than a threat.

The consequences of globalisation are seen a great deal more critically in many OECD states today. The loss of employment through relocation of production to countries with lower wages and weaker environmental standards outweighs the consumer benefits of cheaper imported products. The widely heard assertion that the EU and the United States should be taking action to liberalise their own trade policies is therefore a misplaced and unpolitical demand. Donald Trump won the election in 2016 by emphasising the negative effects of globalisation for American workers. Support for trade protectionism has probably increased since then. President Biden did not win the 2020 election by promising free trade, which lacks popularity both within the Democratic Party and among the broader electorate.

Europe, on the other hand, often regards itself as the trailblazer of free trade. In fact of course the EU is just as protectionist as the United States, placing strict constraints on agricultural trade, as well as certain other sectors such as the car industry. When the Covid crisis is over, the EU will probably further tighten its trade policy, for example by introducing tariffs to promote low-carbon production processes. For developing countries and emerging economies such climate tariffs can rapidly become barriers, for example if emissions associated with transport are factored in. Cut flowers from African countries could then disappear from European shops. That kind of protectionism enjoys broad public support in Europe. But from the perspective of poorer countries climate-driven trade restrictions represent more a threat than a promise.

RCEP is a positive development, with a large group of nations continuing to support trade liberalisation. But it will not significantly alter the future of international trade. What it will do is provide the simplification of trade bureaucracy that businesses in the Asia-Pacific region urgently need, and facilitate trade in goods and services in the region. It will not, however, do anything to resolve the political conflicts that hinder or prevent broader economic and political integration in the Asia-Pacific region: Beijing's contested territorial claims in the South China Sea, its increasingly aggressive foreign policy and the still unresolved relationship between state-subsidised Chinese enterprises and trade partners subject to free-market processes.

At the same time it is conspicuous that the two most populous states in the Indo-Pacific region are turning away from the open trade paradigm. This will probably lead to a slowing of economic growth in both countries, and especially in India delay recovery from the consequences of the pandemic.

RCEP will likely mark the high-water mark of integration in the Asia-Pacific region, rather than the starting shot for regional economic and political union.

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