RCEP — A Miraculous Feat amid Deglobalization

Prof. Heiwai Tang

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On 15 November 2020, the Regional Comprehensive Economic Partnership (RCEP) Agreement was signed by 15 countries, i.e. 10 members of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, Korea, Australia, and New Zealand. After being ratified by the national parliaments of the signatories at a later stage, the RCEP will become the world's largest-ever free trade pact signed by countries representing one third of both the world's population (approximately 2.3 billion) and global gross domestic product (GDP). By 2030, its share in global GDP is even expected to reach 50%.

Against the backdrop of the raging COVID-19 and deglobalization, the signing of the RCEP is not only a landmark breakthrough but also the most encouraging international event in recent years. As projected by research studies, various RCEP members will even serve as important engines of global recovery and long-term growth after the pandemic. Two of the member countries – China and Vietnam – were among the handful of countries which managed to maintain economic growth amid the serious threat to public health during the past year.

Apart from overshadowing the scale of the North American Free Trade Agreement (NAFTA) signed by the US, Canada, and Mexico, the RCEP will also mark the most significant consumption hub, taking up 50% of the global middle-income population (with an annual income of US$15,000 or above for a three-member family). As per the Chinese Government's objective, its 400-million middle-income population is expected to double by 2035 while that in the ASEAN region, currently amounting to 140 million, is also estimated to increase more than twofold to 330 million by 2030.

RCEP highlights

The RCEP Agreement runs to 500-plus pages divided into 20 chapters, eight of which are directly related to trade. Similar to traditional multilateral trade agreements, such as the World Trade Organization (WTO) Agreement, the RCEP provisions focus on phasing out tariffs and non-tariff barriers, with a plan to eliminate all tariffs for 92% of goods within a decade. However, free trade has already been practised among ASEAN countries and China has signed bilateral free trade agreements with various ASEAN members. Even China, Japan, and Korea, among which no bilateral free trade agreement had been in force before the inception the RCEP Agreement, have each maintained low tariffs. Therefore, lowering trade barriers in itself will probably have limited effect on trade in the region.

In terms of trade in goods, the focal point is Chapter 3: Rules of Origin. Similar to existing free trade agreements, e.g. NAFTA, goods with a certain value-added portion (around 40% in general) in the RCEP region are eligible for preferential tariff and other policy treatments jointly formulated by all the participating economies. Prior to the signing of the RCEP Agreement, as international bilateral trade policies had to comply with the respective origin requirements of different countries, trading companies have to ensure a sufficient value-added percentage provided by the exporting country. Consequently they often fail to perfect the production chain or may even engage in tax-evasion behaviour detrimental to social benefits, resulting in reduction of production rate. Hence, the redefinitions of originating goods specified in the RCEP Agreement are conducive to optimizing the reorganization of the regional supply chains, raising productivity, and encouraging companies to make the best use of intermediate input products and raw materials, thus minimizing reliance on economies beyond the region.

The remaining 12 chapters of the RCEP Agreement are meant to take conventional trade policies in goods to the next level. Examples include trade in services, which covers liberalization of financial services (Chapter 8); facilitation of and legal protection for cross-border investment (Chapter 10); optimizing and harmonising protections for the standard suite of intellectual property rights (Chapter 11); and adoption of a legal framework for the promotion and protection of a tariff-free environment for e-commerce (Chapter 12). All these are innovative provisions that not only go beyond the WTO and other regional free trade agreements but are also more in line with the 21st century worldwide trade environment driven by the digital economy and trade in services.

Given that 65% of trade in services in the region will be free from trade barriers within 10 years, the economies of developed countries in the region have long been powered by the service industry, and China has also been shifting from industry orientation to service orientation, liberation of trade in services promulgated by the RCEP will, more than that of industrial trade, most likely enhance cross-border investment and the sustainable economic development of member states. This will serve as reference for other regional free trade agreements in future.

Impact on the global economy

In contrast to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP, formerly TPP), the RCEP is generally less demanding in terms of reform requirements on member states. However, just as importantly, because there is greater respect for various political and economic situations of participating countries as well as an emphasis on integration and complementarity of economic development, the RCEP will be instrumental in boosting the economic recovery badly needed after the pandemic. The standardizing and synergizing work of a legal framework advocated in the Agreement, especially in relation to the coordination of property rights systems, can also generate positive reform momentum for countries with relatively-backward economic systems in the region.

While readers may be concerned that regional trade agreements (RTAs) could breed regionalism, economists have yet to reach a consensus on this issue. On the contrary, some research literature indicates that RTAs will increase opportunities to reach multilateral trade agreements (see Note). In their research around 10 years ago, authoritative trade economists Pol Antras and Fritz Foley at Harvard University conducted micro-data analysis of foreign direct investment by the US. Their findings reveal that during the 1990s, which saw the continuous expansion of ASEAN, falling production and sales costs in the region led to rapid increase of American investment in East Asia. Hence it can be seen that RTAs do not have an exclusive effect. Nevertheless, times have changed — the US has been practising unilateralism in the last few years. Hopefully, after Joe Biden becomes president next week, the American economic policy will gradually return to normal and investment in the region will be back on growth track.

Impact on the Chinese economy

China, which accounts for half of the RCEP economy, will no doubt play a significant role in the future development under the Agreement. At the same time, it will in turn benefit from this by propelling its own economic growth.

One of the advantages is the opportunity to promote the internationalization of the Renminbi (RMB), which has hitherto been concentrated in trade. At present, over 20% of China's foreign trade is denominated in RMB. Through the RCEP, China is set to further expand its trade markets while the region is likely to reduce its import reliance on Europe and the US for raw materials and intermediate products, thus paving the way for the wider use of the RMB in the region.

Furthermore, owing to rising production costs over the years, the Chinese economy has moved from downstream / midstream sectors, e.g. labour-intensive processing exports, to near midstream / upstream sectors, e.g. high-value-added and research-and-development (R&D) intensive activities, of the global supply chain. Coupled with the tariff pressure and uncertainties imposed by the China-US trade war, the US has now dropped from the first place in 2019 to the third among China's trading partners while China is gradually shifting its trading focus to Southeast Asia, particularly Vietnam, Malaysia, and Indonesia.

With regard to ASEAN, which was ranked second after the European Union (EU) among China's trading partners in 2019, driven by semiconductors in particular, its export volume to China jumped 24% while China's export volume to the ASEAN countries rose even higher by 29%. After the signing of the RCEP Agreement, the overall regional productivity is poised to go up gradually. It is likely that ASEAN will surpass the EU to become China's largest trading partner as the reorganization of supply chains in the region further improves. Such a chain of developments will not only facilitate investments in the infrastructure and trade projects of the Belt and Road Initiative but will also provide a more effective response to the trade and technology wars launched by the US government. The RCEP also marks the first resounding success of the "outer circulation" of the "dual circulation" development pattern championed by the Chinese government. As for "inner circulation", its functions will be enhanced by establishing a more comprehensive local supply chain through reorganization of regional supply chains with the technologies and components in the leading domains of Japan and Korea.

The RCEP being a phenomenon of regionalism against the backdrop of deglobalization, Hong Kong's eventual participation in it has drawn much attention. Let me outline below the five preconditions the SAR must fulfil in order to reinforce its existing advantages and create a new edge.

Brand-new opportunities for Hong Kong

First, Hong Kong's four pillar industries (financial services, tourism, trading and logistics, as well as professional and producer services) have been going downhill year after year in terms of their share in both employment and GDP, with the financial services sector as the only exception. Thanks to its strategic location as the geographical hub among China, Japan, Korea, and ASEAN, Hong Kong is likely to revive its role as a trade and logistics intermediary. With the ongoing development of the Mainland's ports and airports, the SAR can no longer solely rely on infrastructure but should instead capitalize on its long-standing role as a super-connector, leveraging its own supply-chain management experience to provide logistics and trade financing, insurance, and management services for the RCEP free trade area.

Second, as a result of the liberalization of cross-border e-commerce and data storage under the RCEP Agreement, data storage will no longer be subject to geographical restrictions. Hong Kong is equipped with the world's most advanced telecommunications infrastructure and international bandwidth connection, making it an ideal location for data centres in the Asia-Pacific region, right after Singapore, Sydney, and Tokyo. The development of big-data industry chain in the region may well flourish through a further push by the Mainland and SAR Governments.

Third, I for one have long advocated the reindustrialization of Hong Kong to perfect the R&D and start-up ecosystem. On the basis of local scientific research and marketing experience, coupled with the high-end industrial production technologies in the Greater Bay Area, Hong Kong will be able to achieve reindustrialization and transformation of its economic structure through interaction among industry, academic, and research sectors as well as marketing. Additionally the SAR will be in a position to target the consumer markets in the RCEP member states.

Fourth, the RCEP is conducive to national efforts to further the internationalization of the RMB. As a prime global financial centre in the region, Hong Kong will be able to drive the digitization of the RMB by strengthening its capabilities as the top RMB offshore clearing centre and drawing on its fintech manpower and market network.

Finally, equipped with a sound legal system and well-trained legal practitioners, Hong Kong is well qualified to serve as a legal support base for corporate dispute litigation among RCEP countries and groom legal professionals for the region.

Note: Caroline Freund, Antoni Estevadeordal, and Emanuel Ornelas, "Does Regionalism Affect Trade Liberalization towards Non-Members?", *Quarterly Journal of Economics* 123(4), (2008): 1531-1575.