Economic Research Institute for ASEAN and East Asia

Policy Brief

NO. 2016-03, DECEMBER 2016 ISSN: 2086-8154

Implications of Mega Free Trade Agreements for Asian Regional Integration and RCEP Negotiation

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As mega free trade agreements (FTAs) are reshaping the rules of global governance, there is urgency for member states of the Association of Southeast Asian Nations (ASEAN) to take proper actions in response to the changing world economic order. On one hand, they should closely observe the progress of negotiations and follow up the issues that are under discussion in mega FTAs. On the other hand, they have to accelerate the pace in concluding the negotiations of the Regional Comprehensive Economic Partnership (RCEP).

Key Issues:

- *Mega FTAs were born to meet the needs of global value chains governance.*
- *It is important for Asian countries to get involved in levelling the playing field. However, it is recommended that they do sufficient 'homework' before making commitments.*
- *Mega FTAs require beyond-the-border actions. A gradual approach may lower the associated adjustment costs and smoothen the transition.*
- *Asian countries will benefit from RCEP. It is important for them to conclude a high-quality agreement as early as possible.*

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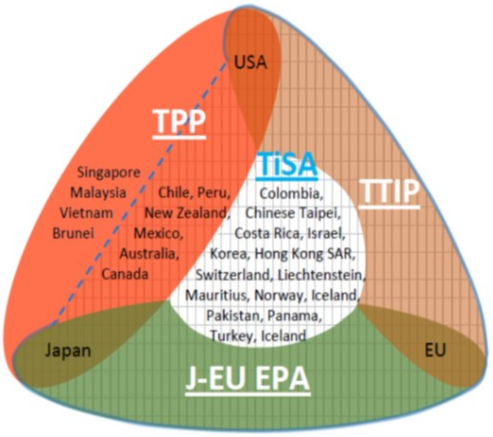
The Emergence of Mega FTAs

With the stalemate in multilateral trade negotiations, preferential trade agreements (PTAs), regional trade agreements (RTAs), and now mega FTAs are trying to fill the gap in global governance and reshape the world economic order. The TPP (Trans-Pacific Partnership) is one of such '21st century free trade agreements'. TPP negotiations were concluded in October 2015, and the agreement signed in February 2016. Four ASEAN member states – Brunei, Singapore, Malaysia, and Viet Nam – have already joined the TPP. Irrespective of whether the TPP will eventually be ratified by its signatories, what we can see so far is that the new rules and regulations that are already agreed or are still being discussed may change global economic governance and significantly impact individual economies.

The emergence of mega FTAs is not a random phenomenon, but part of the evolution of 21st century regionalism. It is closely connected to the 21st century trade that is composed of trade in goods, trade in services, trade in parts and components, and freer cross-border movement of factors. This is mainly driven by the international fragmentation of production, or the so-called second unbundling of globalisation, that is characterised by an increasingly complicated and widespread network of international production sharing. Global Value Chains (GVCs) have been a key concept in the world economy.

In parallel to the TPP that covers the Asia-Pacific region, the TTIP (Transatlantic Trade and Investment Partnership), the Japan–European Union economic partnership, and TiSA (Trade in Services Agreement) may also come into being in the near future (Figure 1).

Figure 1: A Triangle of Mega FTAs



Source: Authors.

To support the efficiency and sustainability of GVCs, we need to further develop a well-functioning system of international trade and investment governance. However, there are certain mismatches between what we need and what we have now.

On one side, the current multilateral framework of global trading system was constructed in the 20th century. There has not been much progress in the negotiations of the World Trade Organization (WTO) in the past decade(s). It seems that the current WTO rules in effect are not sophisticated enough to regulate the complex, multi-layered network of GVCs.

On the other side, although a large number of RTAs have been established and implemented to complement multilateralism, their influences are generally limited due to their small size compared to the wide extension and coverage of GVCs.

Simply put, the market is seeking a potential solution that is big enough in scope and sophisticated enough in content. This is how mega FTAs were born to fit in the world trading system. Typically, mega FTAs will include a large number of important trade partners and link up large economies together. For instance, the TPP has 12 members, including the USA and Japan whereas TiSA has 23, including most of the major industrial economies.

As a group, mega FTAs are big in terms of market potential, total output, trade and investment, etc. For instance, the 12 TPP countries as a group represent around 40 percent of world gross domestic product (GDP) and more than one quarter of world trade. In comparison, TTIP is even bigger. It covers almost half of global GDP and over 40 percent of world trade flows.

Moreover, mega FTAs aim for higher standards and higher quality. They require not only
at-the-border liberalisation (such as free trade in goods, trade in services, and foreign investment) but also beyond-the-border economic reforms. They work on regulatory coherence in areas such as the enforcement of IPR (intellectual property rights) protection, the participation of SOEs (state-owned enterprises) in international trade and investment, and the administration on digital economy.

Accordingly, these agreements contain WTO plus and WTO extra provisions. WTO plus provisions refer to the deepening or extension of commitments that member states have already made at the multilateral level whereas WTO extra provisions refer to those new trade-related issues that are not yet covered or regulated by the WTO. Very often, those WTO plus and WTO extra provisions somehow overlap with each other. Horn, Mavroidis, and Sapir (2009) summarise the areas that the two groups of provisions cover based on the assessment on the articles of the PTAs

Table 1: WTO Plus and WTO Extra Areas

	Areas Covered
WTO Plus	FTA industrial goods; FTA agricultural goods; Customs administration; Export taxes; Sanitary and phytosanitary (SPS); measures; Technical barriers to trade (TBT); State trading enterprises (STE); Antidumping (AD); Countervailing measures (CVM); State aid; Public procurement; Trade-related investment measures (TRIMs); Trade in services agreement (GATS); Trade-related intellectual property rights (TRIPs).
WTO Extra	Anti-corruption; Competition policy; Consumer protection; Data protection; Environmental laws; Investment; Movement of capital; Labour market regulations; Intellectual Property Rights (IPR); Agriculture; Approximation of legislation; Audio visual; Civil protection; Innovation policies; Cultural cooperation; Economic policy dialogue; Education and training; Energy; Financial assistance; Health; Human rights; Illegal immigration; Illicit drugs; Industrial cooperation; Information society; Mining; Money laundering; Nuclear safety; Political dialogue; Public administration; Regional cooperation; Research and technology; Small and medium enterprises; Social matters; Statistics Taxation; Terrorism, visa, and asylum.

Source: Horn, Mavroidis, and Sapir (2009), Tables 2.2 and 2.3.

entered into by the European Union and the United States (US) (Table 1).

Mega FTAs are evidently trying to develop an extensive set of rules and regulations in global economic governance. Its impacts on individual countries and regions may vary due to their differences in the stages of development, the legal framework, the political system, and so on. This calls for more in-depth investigation on the related issues in the context of the general global tendency and each country's unique situation as well. At least, two points are sure. First, mega FTAs will affect both regional and global trade orders. Second, they tend to have deep impacts on both member and non-member states of the agreements.

Implications for Asian Regionalism

All in all, GVCs are the key to understanding 21st century trade. In addition to access to global market, the negotiations of a 21st trade agreement emphasise countries' connection to GVCs. Participation in GVCs provides an efficient way for developing countries to accelerate the catch-up process with developed economies. Fundamentally, the capability of invention, innovation, and creation determines a country's position in GVCs. There still exists a technology gap between developed and developing countries despite the latter's fast economic growth in the past decades.

As for mega FTAs, Asian countries should at least observe the progress of negotiations and implementation of the agreements and follow up the issues that are being discussed or 'in fashion', so to speak. For instance, reductions of non-tariff measures (NTMs) will be highlighted in the negotiations of mega FTAs. The issue of removing non-tariff barriers has been discussed in the WTO but did not witness much progress. Mega FTAs will put more effort in NTM reductions.

However, tariff cuts still matter, particularly with regard to agricultural products. Trade liberalisation in the agriculture sector is another unresolved issue in the WTO. Countries such as the US want to use mega FTAs to facilitate their food and agriculture exports. The TPP will help the US not only in increasing its exports to existing markets in Japan and Canada but also in exploring new markets in Viet Nam and Malaysia (Vetter, 2015).

In addition, it is evident in various aspects that trade in services is increasingly important in the global economy. Trade in services has been growing much faster than trade in goods since 2005. In the case of the US, 80 percent of its GDP came from the service sector. In 2015, US service exports reached US$716 billion, half as much as its total exports of goods. Despite the country's trade deficit in goods, there was over US$200 billion surplus in trade in services in that year. Rules and regulations on trade in services in mega FTAs may complement those of the General Agreement on Trade in Services (GATS).

More importantly, those new trade issues, either WTO plus or WTO extra, such as IPR, SOEs, and digital economy, need to draw more attention. Mega FTAs try to establish new rules in these areas, which could probably later become the global standards in GVC governance. Asian economies should be encouraged to get deeply involved in the process of new rules setting. This is probably the best way for developing countries to defend their interests and negotiate for better terms. The region has enough reasons to be confident in its roles in or its contributions to global governance. On one side, Asia is already the 'world factory' of manufacturing goods. Its contribution to the efficiency of GVCs and the global economy should not be neglected. On the other side, the region hosts the world's largest potential market. It is predicted that, by 2030, over two-thirds of the world's middle class will be in Asia, and the region will account for over 60 percent of the world's total middle class consumption as well.

This does not mean that Asian countries should eagerly join the TPP or other mega FTAs. It is indeed highly recommended for them to do sufficient 'homework', such as conducting pre-stage investigations, assessments, and simulations, before committing to enter the pact. Above all, two groups of factors are worthy of concern.

First, the government should consider the consequent impacts not only at the macro level (such as gross output, trade, and investment) but also at the micro level (such as the well-being of households and consumers, efficiency of small and medium enterprises, and inequality). The beyond-the-border measures will be associated with social and economic adjustment costs. This will be sourced from the cross-border regulatory harmonisation and/or the mutual reorganisation of standards, and connect to the issue of current account balancing, public budget balancing, job displacement, and others.

This effective policy intervention calls for the collaboration between the administration and legislation agencies as well as the cooperation among different government branches, particularly between foreign affairs department(s) and those in charge of domestic market regulation.

One option is to conduct some experiments or stress tests in some selected sectors and special economic zones. If a country feels uncomfortable to take the whole package of reform, it may start by voluntarily liberalising some areas that are relatively easy to move in first. This will smoothen the transition and give space and time for that country to accumulate experience.

Second, Asian countries still need to be careful to avoid economic marginalisation. From an economic viewpoint, it does matter whether countries will participate in global governance as individual countries or as a group which, taken together, constitutes one of the three main pillars of the world economy. In the long run, it seems that a multipolar international system may provide larger space and more options of development for both small economies and big actors such as Japan and China.

In this regard, RCEP has a special meaning for Asia. It is misleading to consider RCEP as a counterpart of the TPP. Indeed, the two initiatives need not compete with each other, neither do they have to complement each other. RCEP is part of the efforts of Asian countries to explore avenues of collaborative regional governance. It should be seen as the extension of an integrated ASEAN community, providing a platform for the region to act as a group and to collaboratively play a pivotal role in global economy. ASEAN stays at the core of this process and takes the role of a functional hub.

Of course, an RCEP agreement with 'high-quality' provisions would be welcomed. But it is not necessary at this stage to aim for the same high standards that may be contained in the TPP or other mega FTAs. The negotiators need to realise that RCEP involves many developing and least-developed countries in the region. It will be a significant achievement in itself to conclude a regional arrangement among 16 countries that covers almost half of the world population, one quarter of world GDP, and around 40 percent of world trade.

It does not really matter whether RCEP is only a '20th-century-type' RTA as long as it is effective in deepening regional integration and enhancing cooperation. Rather than embarking on an ambitious mission that may take a long time to complete, why not take a pragmatic step-by-step approach to achieving progress? How about aiming to conclude 'RCEP 1.0' first and upgrade it to 'RCEP x.0' later?

Indeed, it seems more realistic to prioritise three aspects of RCEP. First is setting a high target of tariff removal ratios at around 90–95 percent. Most ASEAN+1 FTAs have already achieved these. Those countries that may find this difficult to achieve or are reluctant to do so could negotiate for longer adjustment periods rather than lowering tariff removal ratios. Second is the high degree of utilisation that will make RCEP really meaningful. One key issue is how to effectively implement the agreement and improve FTA utilisation. Third, RCEP seems to be an arrangement not only for regional integration but also for regional cooperation. Infrastructure building, especially in the transport sector and the information and communications technology sector, should be included in the list of priorities.

In brief, there is urgency for Asia to take proper actions to respond to the changing world economic order as mega FTAs relevel the playing field. RCEP tends to buy all member states a double insurance plan for them to be inclusive and beneficial in this process.

Meanwhile, it is important for Asian countries to keep updated on their understanding of issues, such as what are the new rules and regulations that mega FTAs ask for, what is the 'gap' between the countries' current legal/market situation, and what kind of standards mega FTAs are trying to enforce. ■

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