

ERIA Discussion Paper Series**No. 440****The Post COVID-19* and RCEP:
Pandemic Recovery in East Asia**Shandre M THANGAVELU[†]*Jeffrey Cheah Institute on Southeast Asia, Sunway University,
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Abstract: *The paper examines the impact of the Regional Comprehensive Economic Partnership (RCEP) on the COVID-19 pandemic recovery of the East Asian countries. Recent studies highlight the positive gains from the RCEP agreement for all 15 of its member countries (Itakura, 2022, Petri and Plummer, 2020; Park, 2022). However, the recovery will be not even across East Asia. The East Asian countries of China, Japan, and the Republic of Korea (CJK) are likely to have the largest gains, as these countries dominate the regional global value chain (GVC) activities. The ASEAN least developed countries of Cambodia, the Lao People's Democratic Republic (Lao PDR), and Myanmar also experience positive gains from RCEP, but need to undertake deeper structural reforms to fully benefit from the agreement. The RCEP framework has elements that will be crucial for the post-pandemic recovery and regional transformation: (i) accelerating and enhancing GVC activities through the single rule-of-origin framework for the 15 RCEP member countries and CJK (China, Japan, and Korea) effects; (ii) services liberalisation and digital transformation in the key services trade of e-commerce, financial, professional, and telecommunications services; (iii) economic cooperation amongst the 15 RCEP member countries to address key contingency issues such as mass vaccination and health infrastructure, protocols for the movement of people, and trade capacity building for ASEAN least developed countries; and (iv) the 'living' nature of the RCEP agreement will be able to create a wider regional integration agenda to address key contemporary issues such as environment and climate change, skills development, green transformation, and developing digital and smart urban centres. ASEAN centrality, as highlighted by the RCEP framework, is critical for the post-pandemic recovery and structural transformation of the region.*

Keywords: Free-trade Agreement; Global Production Value Chains; Structural Transformation; Pandemic Recovery.

JEL Classification: F15; F17

* COVID-19: Coronavirus Disease 2019 ([https://www.who.int/emergencies/diseases/novel-coronavirus-2019/technical-guidance/naming-the-coronavirus-disease-\(covid-2019\)-and-the-virus-that-causes-it](https://www.who.int/emergencies/diseases/novel-coronavirus-2019/technical-guidance/naming-the-coronavirus-disease-(covid-2019)-and-the-virus-that-causes-it))

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1. Introduction

The Regional Comprehensive Economic Partnership (RCEP), signed on 15 November 2020, is the largest free trade agreement (FTA) in the world. It comprises the 10 Association of Southeast Asian Nations (ASEAN) Member States (Brunei, Cambodia, Indonesia, Lao People's Democratic Republic (Lao PDR), Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam) and five countries in the region with which ASEAN has FTAs – Australia, China, Japan, the Republic of Korea (henceforth, Korea), and New Zealand.^{3,4} RCEP came into effect on 1 January 2022 with the ratification of six ASEAN Member States (Brunei, Cambodia, Lao PDR, Thailand, Singapore, and Viet Nam) and four non-ASEAN member countries (Australia, China, Japan, and New Zealand).

RCEP is the largest global trading bloc in the world, with a combined population of 2.2 billion (30% of the world population), total regional gross domestic product (GDP) of around \$38,813 billion (30% of global GDP in 2019), and nearly 28% of global trade. It sets an important agenda for trade and investment in global trade in terms of opening large domestic markets (demand), releasing huge resources for trade and investment, and creating dynamic regional and global value chain activities.

This paper examines the impact of the RCEP agreement on ASEAN and the ASEAN least developed countries (LDCs) in the post-pandemic (COVID-19) recovery. RCEP has elements that will be crucial for the post-pandemic recovery and regional transformation, such as (i) a single rule-of-origin framework for the 15 member countries, which could have an accelerating and enhancing impact on global value chains (GVCs) in the region; (ii) the key element of the China–Japan–Korea (CJK) effect, as the RCEP agreement is the first FTA for trade and investment amongst these countries; (iii) elements for digital transformation and services liberalisation in crucial services trade in e-commerce, financial,

³ India has opted out of the agreement, but the RCEP agreement allows for it to join in the future.

⁴ The ASEAN Leaders adopted the ASEAN Framework for the RCEP during the 19th ASEAN Summit in November 2011 in Bali, Indonesia. The Joint Declaration of Ministers for launch of RCEP negotiations was made on 20 November 2012 during the 21st ASEAN Summit in Phnom Penh, Cambodia.

https://www.mofa.go.jp/mofaj/press/release/24/11/pdfs/20121120_03_01.pdf

professional, and telecommunications services; and (iv) ASEAN centrality, which is critical for the post-pandemic recovery and structural transformation of the region in terms of sustainable and inclusive growth.

The impact of RCEP on the East Asian region could be significant as the largest global trading bloc. Its impact in the post-pandemic recovery will be important in terms of strengthening the GVC (GVC activities) and creating structural transformation for ASEAN and its LDCs in the region. For example, RCEP has a new dimension in its rules of origin (ROOs) that will develop and expand the regional and global supply chain activities in East Asia (Sawada, 2020). The technical cooperation and capacity building elements of the RCEP agreement allow the ASEAN LDCs to implement key reforms and liberalisation policies to induce structural transformation in their respective economies to fully benefit from regional FTAs. The ‘special and differential treatment’ of ASEAN LDCs in the RCEP agreement allows the respective member countries sufficient flexibility to undertake the necessary and sufficient reform policies to fulfil the commitments in the FTA (Sawada, 2020; ADB, 2020; ASEAN, 2020a). As RCEP is a ‘living’ agreement, it will be able to address current and key issues for sustainable regional integration.

The paper is organised as follows. In section 2, we examine the challenges of regionalism and the importance of RCEP in managing regional integration. Section 3 highlights the importance of RCEP for the pandemic and post-pandemic (COVID-19) recovery. Section 4 provides policy discussion.

2. Challenges of Regionalism and Importance of RCEP

For the past decade, East Asia has been facing rising protectionism and anti-globalisation in regional and global trade, which will have a large impact on growth and development in the region (Rodrik, 2021). The United States (US)–China trade war tensions will have a significant impact on regional trade and investment in terms of the inward-looking policies and the decoupling effects of the GVC to more developed countries away from China and East Asia (Bown and Irwin, 2019; Evenett and Fritz, 2019).

2.1. Uneven Impact of Globalisation in Pre-COVID-19 Era

Several key factors account for the uneven impact of globalisation and trade.

- (i) The gains from trade are unevenly distributed and biased against the unskilled. UNCTAD (2013) showed an uneven distribution of gains from trade in India. Although trade increases the wages of unskilled workers, the study observed that 70% of the income generated from trade goes to the top two income groups. The study also highlighted that the impact of trade on wages depends on the export intensity of the industries. Firms that are less skilled and more labour-intensive, such as the garment and textiles and agricultural sectors, tend to experience less gains from trade in terms of wage increases for the unskilled and less educated (UNCTAD, 2013).
- (ii) As growth increases with trade in more open economies, these countries experience a widening wage gap (between skilled and unskilled workers) and polarisation of semi-skilled jobs (Thangavelu and Wang, 2021). In recent years, ASEAN Member States (AMS) have experienced a large decline in the share of semi-skilled jobs (mostly white-collar jobs) compared with unskilled and skilled jobs. This has a direct impact on the income and wealth of middle-income households.
- (iii) Although trade is increasing, we are also experiencing the rise of protectionist policies in East Asia (Thangavelu, 2021). For the past 2 decades, East Asia has been facing protectionist policy challenges from increasing anti-globalisation trends in regional and global trade. The rise in protectionist policies is reflected in the increasing trends of country-level new trade interventions since 2009, as shown by Global Trade Alert (Thangavelu, 2021). Harmful interventions, as defined by Global Trade Alert (n.d.), accounted for nearly 72% of the total state-level interventions from 2009 to 2021.⁵ As indicated in Figure A1 in the Annex, the peak of state-level new trade interventions by end of 2018, 1 year after President Trump was elected to office in the US (Annex, Figure A1).
- (iv) Over the past 2 decades, East Asia has experienced massive movement of skilled and unskilled workers, especially international mobility of unskilled workers. The impact of international labour mobility has a direct impact on the wages of unskilled workers and the vulnerability of the local people.

⁵ Global Trade Alert (n.d.) defines harmful measures (in terms of colour codes) as follows: (i) red colour code: the intervention almost certainly discriminates against foreign commercial interests; (ii) amber colour code: the intervention likely involves discrimination against foreign commercial interests; and (c) green colour code: the intervention liberalises on a non-discriminatory (i.e. most favoured nation) basis or improves the transparency of a relevant policy.

- (v) Trade has a more direct impact on the income and wealth of tradable sectors in urban centres compared with rural centres, creating a rural–urban divide and growth tensions between rural and urban populations.

The key to managing the uneven effects of globalisation and trade in East Asia is to recognise the real impacts of trade in the domestic economy and the region. Balancing the gains of trade with inclusive growth will be the key policy challenge for East Asia as the intensity of anti-trade populism increases in the region and the rest of the world.

2.2. Uneven Impact of the COVID-19 Pandemic in the Region

The coronavirus disease (COVID-19) pandemic shock will also increase and intensify the vulnerability of openness and induce more inward-looking policies. The uneven impact of the COVID-19 pandemic shock on unskilled workers and increasing digitalisation in the economy will widen the welfare gap between the skilled and unskilled in the economy (World Bank, 2021). The uneven impact of COVID-19 is also apparent within and between countries, especially as the negative impact is more severe in developing and LDCs that do not have sufficient fiscal resources to mitigate and cushion the economy and people from the pandemic shock.

The COVID-19 pandemic shock in early 2020 disrupted key economic activities within and between countries, as well as regional and global trade and investment. The key dimension of the COVID-19 pandemic shock is the diversion from open economic policies to more inward-looking policies (Kimura et al., 2020). The pandemic shock is likely to have long-term impacts on regional growth. The long-term impacts are expected to induce structural transformation in the region through (i) adopting more digital technology, (ii) intensifying technology adoption and streamlining the supply process in the GVC and to make the GVC more resilient to economic shocks, (iii) transforming human capital and skills via restructuring to a more technology-intensive and skills-based GVC, (iv) increasing the fragmentation of the production process across the countries participating in the GVC, (v) adopting and investing in communications technology to increase the agglomeration of manufacturing and services activities in the region, and (vi)

increasing investment in digital and communication infrastructure in the region. These structural transformations will have a significant impact on GVCs in the region and a direct impact on the production structures of ASEAN and its LDCs.

The structural transformation through digitalisation and innovation is expected to change both the consumption patterns as well as the production structures of the GVC in the region. The digitalisation of the GVC will change consumer behaviour and preferences by reducing the face-to-face costs of transactions and will shorten the average product delivery time to consumers. This will strengthen the consumer market and services activities in the region, increasing opportunities for small and medium-sized enterprises (SMEs).

The production structure is also expected to change with digitalisation, as investment in automation and artificial intelligence in the post-pandemic recovery to mitigate the risk of labour-intensive activities and exposure to future pandemic effects. This structural transformation of production is expected to affect industrial activities such as garments, clothing, and textiles; and also key services sectors such as logistics GVCs, thereby reducing the demand for labour.

2.3. Rising Border and Behind-the-Border Trade Costs Due to Pandemic Shock

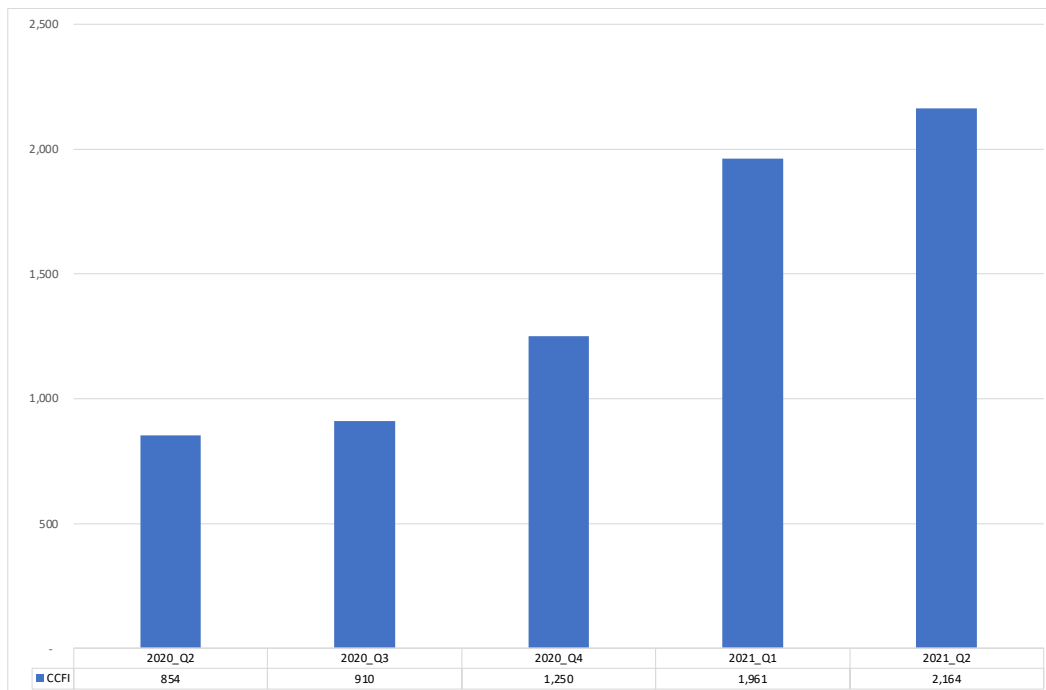
The pandemic shock has increased the cost of trade at the border and intensified behind-the-border issues – increasing barriers to trade in goods and services in ASEAN and East Asia. Rising trade costs at the border and behind-the-border issues directly affect trade in goods and services in East Asia and GVC activities (Baldwin and Evenett, 2020; World Bank, 2022).

Recent studies by UNCTAD (2021a, 2021b) have highlighted the rise in border and behind-the-border issues from the increasing logistics and maritime freight costs due to bottlenecks in the logistics supply chains, which directly affect goods and services trade in the GVC production activities. As indicated in Figure 1, the China Containerized Freight Index (CCFI)⁶ is given from 2018 to 2020. At the beginning of the pandemic shock, the CCFI stood at 854 points in the first

⁶ The CCFI tracks spot and contractual freight rates from Chinese container ports for 12 shipping routes across the globe, based on data from 22 international carriers.

quarter of 2020, and it surged beyond 2,164 points in the second quarter of 2021. The surge in rising freight costs in the second quarter of 2021 was due to increasing demand from the improvements in economic conditions from COVID-19, due to the pandemic policy of vaccinations and less border restrictions. The studies highlighted that the rising freight costs are also due to backlogs and longer waiting times – especially in the China–US trade lanes – leading to higher fees and surcharges. For example, the Shanghai Containerized Freight Index was only \$1,600 per 40-foot equivalent unit (FEU) in April 2020 but escalated to \$5,2000 per FEU in July 2021, although this routed capacity expanded by nearly 7% in the first quarter of 2021.

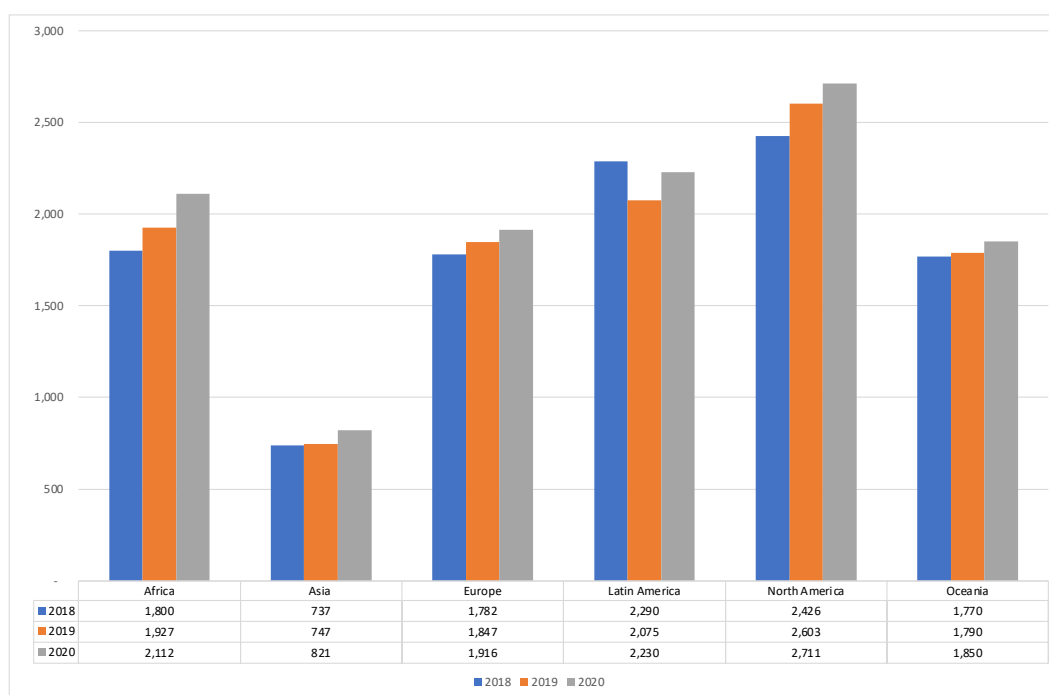
Figure 1: China Containerized Freight Index, 2020-Q2 to 2021-Q2



CCFI = China Containerized Freight Index, Q = quarter.
 Source: UNCTAD (2021a).

The UNCTAD (2021a) study highlighted that the impact of rising border and behind-the-border costs are also significant in East Asia. Figure 2 shows the contract freight rates (\$ per 40-foot container) by region from 2018 to 2020. Contract freight rates for containers rose by 7.5% from Asia to North America and Europe from 2018 to 2020; by nearly 4.1% from Asia to North America between 2019 and 2020; and by nearly 9.6% for Africa and 9.9% for Asia, respectively, from 2019 to 2020. The increase in the intra-regional contract freight cost for Asia of 9.9% reflects the rising cost of border and behind-the-border issues, which will have a direct impact on trade and economic recovery in the region (see Figure 2).

Figure 2: Contract Freight Rates from Asia to Other Regions, 2018–2020
(\$ per 40-foot container)



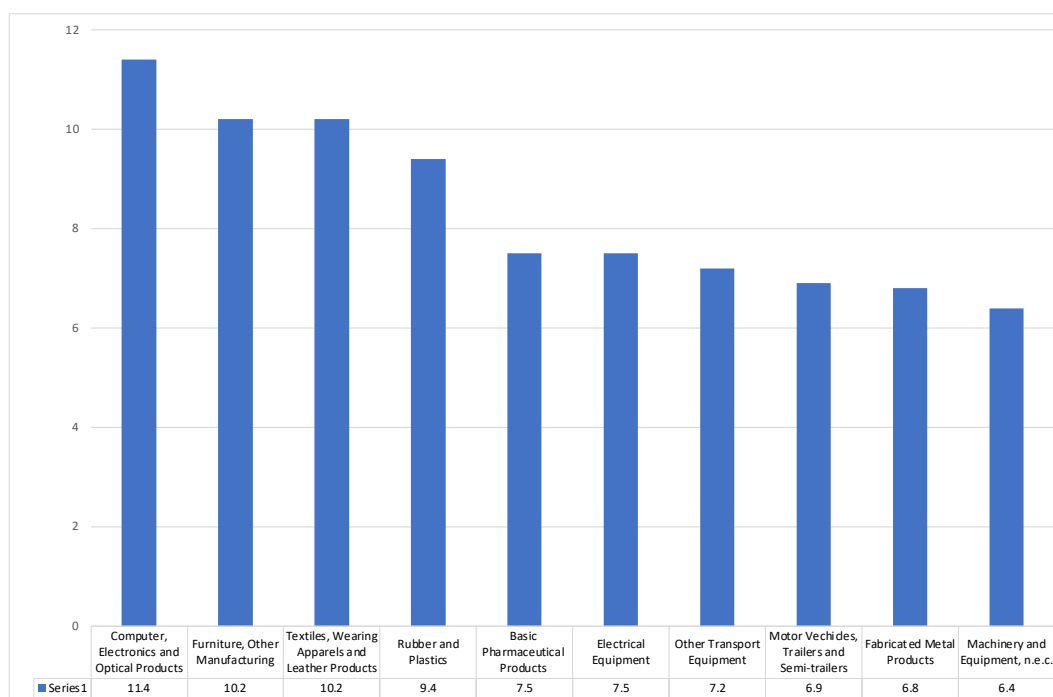
Source: UNCTAD (2021a).

2.4. Impact of Logistics and Transport Cost (Freight) on GVC Activities

The rising logistics and transport costs from freight charges will have a direct impact on the prices of imported goods and intermediate goods, which is expected to have a direct impact on the GVC activities in the region (UNCTAD, 2021a, 2021b).

The UNCTAD (2021a) study also imputed (simulated) the rising freight costs in relation to commodity prices and the cost of production. It is clear that rising border and behind-the-border costs will have a direct impact on GVC activities in the region. In Figure 3, the simulated cost of commodity prices shows that the largest increase will be in Computer, Electronics, and Optical products (11.4%); Furniture and Other Manufacturing (10.2%); Textiles, Wearing Apparels and Leather products (10.2%); Rubber and Plastics (9.4%); Pharmaceutical products (7.5%); Electrical Equipment (7.5%); Other Transport Equipment (7.2%); Motor Vehicles, Trailers, and Semi-trailers (6.9%); and Machinery and Equipment (6.4%). According to Figure 4, the simulated results of rising freight costs show that the production cost will increase by 1.4%, intermediate goods will rise by 3.1%, and imports will climb by 11.9%. The rising cost of production and imports of intermediate inputs will directly affect the supply-side activities of the GVC in the region.

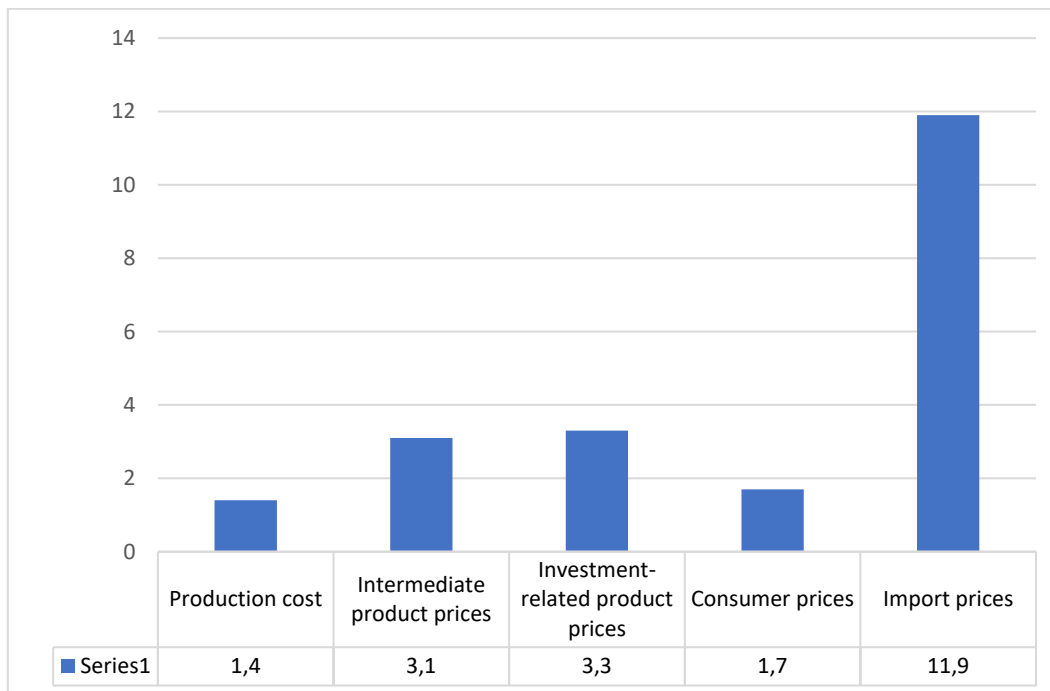
Figure 3: Simulated Impact of Rising Freight Charges on Commodity Prices (%)



n.e.c. = not elsewhere classified.

Source: UNCTAD (2021a).

Figure 4: Simulated Impact of Rising Freight Cost on the Cost of Production Activities



Source: UNCTAD (2021a).

3. Significance of RCEP for Managing Regional Integration

It is important to highlight the key role of RCEP in balancing the uneven impact of the trade and pandemic shocks in East Asia. In the subsequent sections, we discuss the importance of RCEP for the pandemic recovery and for creating sustainable growth in East Asia.

3.1. Significance of RCEP in Sustainable and Inclusive Growth in the Post-Pandemic Era

RCEP is a critical framework for global trade and regionalism, given the current context of uncertainty and inward-looking policies induced by COVID-19 pandemic and the US–China trade war. It provides the key impetus for global trade and investment and shifts the domestic and regional activities in East Asia to open regionalism and global trade and investment. RCEP is based on four key elements of regional integration: (i) rules-based trade and investment, (ii) market access, (iii) economic cooperation, and (iv) ASEAN centrality. These four key elements are

important for East Asia and ASEAN regional recovery in the post-pandemic era and to move the region to the next stage of inclusive and sustainable growth in regionalism and regional and global production value chain activities.

The impact of RCEP will be significant for ASEAN and its LDCs (Itakura, 2022; Park, Petri, and Plummer, 2021; Park, 2022). The dynamic Computable General Equilibrium (CGE) analysis by Itakura (2022) highlighted the positive impact of the RECP on GDP for all RCEP members throughout the 2030s, particularly for the scenario with deeper trade and investment facilitation and addressing behind-the-border issues (S4: tariff reduction, services liberalisation, logistic improvements, and investment facilitation). Cambodia, the Lao PDR, Myanmar, and Viet Nam (CLMV) are particularly likely to have significant positive gains, given their young populations and GVC effects from the CJK effects. This is significant for Cambodia and Viet Nam, which are at a critical stage – shifting to the next stage of growth in the regional and global production value chain activities. For example, ASEAN LDCs such as Cambodia are positioning themselves for higher GVC activities and emerging as an important focal point for regional and global value chain activities in ASEAN and East Asia. Park (2022) highlighted that RCEP will generate more significant gains than the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) for RCEP member countries.

RCEP also provides a new regional integration framework for trade and investment that builds on bilateral FTAs to form multilateral FTAs such as the ASEAN+1 FTAs (Table 1): ASEAN–China, ASEAN–Korea, ASEAN–Japan, and ASEAN–Australia–New Zealand FTA initiated in early 2000.

Table 1: Building Blocks for Regional FTAs – ASEAN + 1 FTAs

ASEAN + 1 FTAs	Date in effect
ASEAN–China FTA	July 2003
ASEAN–Korea FTA	June 2010
ASEAN–Japan FTA	December 2008
ASEAN–Australia–New Zealand FTA	January 2010
ASEAN–India FTA	January 2011

ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement.

Source: Enterprise Singapore (n.d.).

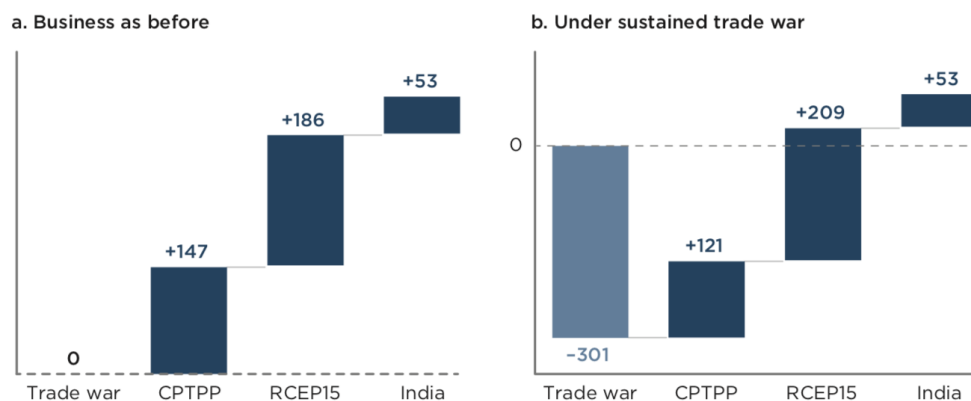
RCEP provides a greater platform for regional integration in terms of opening up the domestic and regional markets for further trade and investment integration. The key element of RCEP is to drive deeper regional integration for Asia from the existing ASEAN+1 FTAs, to eliminate more than 65% in tariffs and quotas in goods trade upon its entry into force, in addition to those observed in ASEAN+1 FTAs (ASEAN, 2020a; 2020b).

3.2. Mitigating Impact of RCEP on the Economic Shock in East Asia

The economic impact of RCEP as a regional trading bloc will contribute significantly to East Asia mitigating the negative effects of the US–China trade war and the COVID-19 pandemic shock (Plummer and Petri, 2020; Park, Petri, and Plummer, 2021). Figure 5 shows the impact of RCEP on East Asia, as well as the negative impact of the US–China trade war on the region. The trade agreement under RCEP creates a positive impact on output in the region – mitigating the negative effect of the US–China trade war through market access, creating greater flexibility in the GVC, and inducing better technology adoption in the region. The figure also shows that RCEP has a more significant impact than the CPTPP (see Figure 5).

Figure 5: Economic Impact of RCEP and CPTPP on East Asia

Global income effects of Asia-Pacific trade policies in 2030
(income gains/losses in billions of US dollars)



CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership
RCEP = Regional Comprehensive Economic Partnership

Note: "Business as before" assumes a return to a pre-trade war path; "Sustained trade war" assumes path defined by post-phase one tariffs. Bars show incremental effects of adding each policy to all previous policies. The policy denoted "India" involves adding India to the RCEP15 agreement to form RCEP16.

Source: Petri and Plummer (2020).

Park, Petri, and Plummer (2021) also found a positive impact of RCEP on mitigating the negative impact of the US–China trade war on East Asian countries. The study highlights that RCEP is expected to mitigate the impact more than the CPTPP by generating positive output growth. According to Park, Petri, and Plummer (2021), the US–China trade war is expected to reduce world GDP by 0.38%. The adoption of the CPTPP will offset the negative effect by 0.14%, while RCEP will offset the negative impact by 0.33% on top of the CPTPP effects. The gains from RCEP, in addition to the impact of the CPTPP, are positive for all RCEP member countries.

RCEP also reflects the importance of the CJK effects in the region. The CJK countries are likely to have the largest gain from RCEP, mainly because they dominate the regional GVC activities. China reaps the largest gains from RCEP activities (Petri and Plummer, 2020). The key benefits from RCEP depend critically on the participation and positioning of the respective AMS in the GVC in both manufacturing and services. This is reflected by Indonesia, Malaysia, Thailand, and Viet Nam. The ASEAN LDCs – Cambodia, the Lao PDR, and Myanmar – are also expected to have positive gains from RCEP.

3.3. Key Elements of RCEP for the Post-Pandemic Era for Sustainable Growth

RCEP also has several key elements that will be crucial for sustainable regional transformation:

- (i) A single ROO framework for the 15 member countries could have an accelerating and enhancing impact on GVCs in the region. RCEP includes an agreement for a single ROO framework that could be applied across the agreement's 15 member countries. A recent study by the authors (Thangavelu, Narjoko, and Urata, 2021) highlighted that the co-sharing rule adopted in RCEP is less restrictive across other forms of ROO and regulations. Under RCEP, businesses need to show that a product has a regional value content level of 40% or has undergone a change in tariff heading at the 4-digit Harmonized System (HS) code level of classification. The single ROO framework under RCEP will have important implications

for GVC activities in the region in terms of greater intra-industry trade and investment, and is likely to create more value-added activities in the region.

- (ii) It has the key element of the CJK effect, as the RCEP agreement sets the first free trade arrangement for trade and investment for these countries. The CJK impact could be significant and could have a positive impact on ASEAN and its LDCs in terms of greater flows of goods and services in the region. The CJK framework under RCEP is expected to intensify the GVC network and activities in the region – increasing the trade and investment activities of AMS that have strong trade linkages to CJK. ASEAN LDCs such as Cambodia are in a unique position to take advantage of the trade linkages to the CJK framework under RCEP and structurally transform their domestic economies.
- (iii) The RCEP agreement also has crucial elements for services liberalisation in key services trade – e-commerce, financial, professional, and telecommunication services. These services will be critical for structural transformation in the post-pandemic recovery in terms of the digital transformation of services in the East Asia region. The digital transformation of services will also accelerate the services linkages in GVCs and the servicification of manufacturing activities (Thangavelu, Wang, and Oum, 2018).

Under RCEP, services trade is expected to grow, as nearly 65% of services in member countries will open up for trade and investment. The service sector liberalisation under RCEP also highlights a shift from the ‘positive list’ approach adopted in ASEAN+1 FTAs, where only certain service sectors are open for trade and investment, to the ‘negative list’ approach adopted in RCEP, where most service sectors are open for trade and investment unless specifically excluded. RCEP members are also given a certain period to shift to the negative list approach after entering into the agreement. The negative list approach reduces uncertainty in service sector liberalisation and increases regional trade and investment in service sectors.

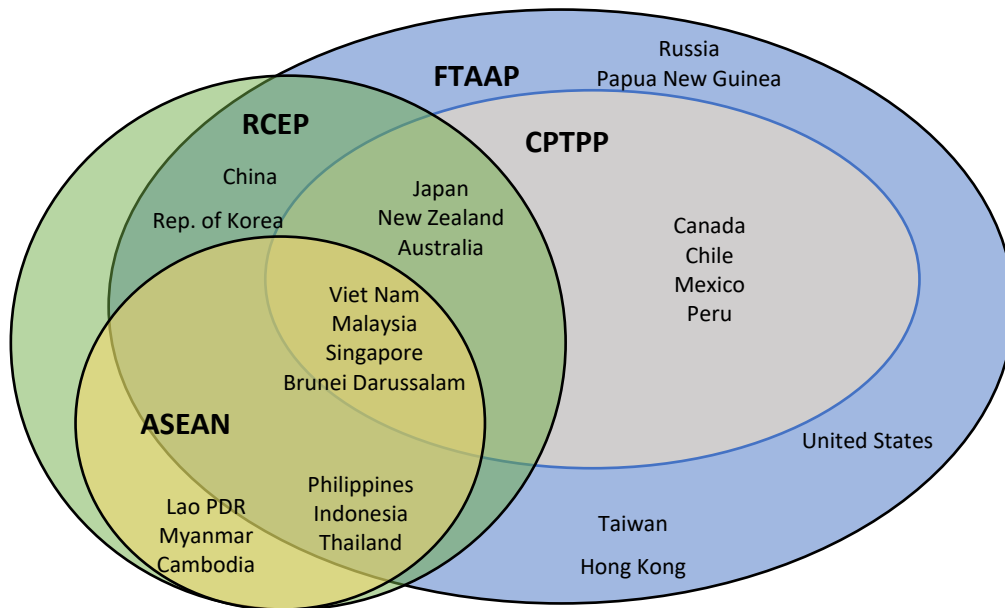
- (iv) The RCEP agreement has the key feature of economic cooperation and technical assistance. Under the RCEP agreement, there is differential treatment for member countries to implement the RCEP commitments and economic cooperation support for domestic capacity building and trade reforms in the domestic economy. In particular, technical assistance for human capital development, regional vaccination cooperation, green transformation, and infrastructure investment will be a key area of consideration (Armstrong and Drysdale, 2022). We provide further detail discussion below.

3.4. Importance of ASEAN Centrality for Post-Pandemic Transformation

One of the key features of RCEP is the role of ASEAN as the centre of activities for the multilateral FTA. ASEAN centrality is critical for sustainable economic development and regional integration in ASEAN and East Asia.

The East Asian regional integration architecture is shown in Figure 6. The centrality of ASEAN is clearly reflected in RCEP in terms of adopting the institutional structure of ASEAN, such as RCEP Secretariat, and as market-driven regional integration. The RCEP Secretariat is expected to maintain the breath of trade and investment across the 15 member countries due to the vast economic and institutional diversity to meet the RCEP commitments, and ASEAN with the ASEAN Secretariat will create the dynamism and depth of integration in terms of deeper economic cooperation in East Asia by accessing new markets and deepening integration through connectivity and technological innovation. ASEAN centrality is critical for the post-pandemic recovery and structural transformation of the region in terms of sustainable and inclusive growth. ASEAN centrality is further necessary for enhancing regional cooperation and inducing greater liberalisation and deeper structural reforms in the region for all AMS to fully benefit from the RCEP agreement.

Figure 6: Regional Trade Groupings in East Asia



ASEAN = Association of Southeast Asian Nations, CPTPP = Comprehensive Progressive Trans-Pacific Partnership, FTAAP = Free Trade Area of the Asia Pacific, RCEP = Regional Comprehensive Economic Partnership.

Source: Authors.

4. Policy Discussion: The Role of RCEP in Balancing the Trade and Pandemic Shocks

The economic impacts of RCEP as a regional trading bloc are significant for East Asia to mitigate the negative effects of trade and economic shocks, such as the US–China trade war (Petri and Plummer, 2020; Park, Petri, and Plummer, 2021). The trade agreement under RCEP is also expected to create positive impacts on output in the region, mitigating the negative effects of the COVID-19 pandemic shock.

A recent study by Petri and Plummer (2020), accounting for only the US–China trade war, highlighted that all RCEP member countries would gain from the trade agreement, and no member country would experience a negative impact (Singapore and Brunei have the smallest marginal gains). RCEP also reflects the importance of the CJK effects in the region, as it provides the first free trade

arrangement for CJK that allows for greater movement of goods and services in the region.

The key benefits of RCEP depend critically on the participation and positioning of the respective AMS in GVCs for both manufacturing and services. This is reflected in the gains of Indonesia, Malaysia, Thailand, and Viet Nam, which have stronger GVC participation in regional and global value chain activities. The ASEAN LDCs – Cambodia, Lao PDR, and Myanmar – also experience positive gains from RCEP but need to undertake deeper structural reforms to fully benefit from the agreement.

The importance of regional cooperation under ASEAN and Asia-Pacific Economic Cooperation (APEC) and multilateral trade arrangements such as RCEP – in balancing sustainable and inclusive growth from trade – will be fundamental to manage the impact of globalisation in the region.

The RCEP agreement has a broad framework in terms of economic and technical cooperation (chapter 15) and institutional provisions (chapter 18) to support recovery from the pandemic shock. Technical and economic cooperation (chapter 15) under RCEP could provide the framework to address key concerns to mitigate the pandemic shock. The chapter allows for ‘narrowing the development gap and maximizing the mutual benefits for the implementation and utilization of the agreement’⁷ (Chapter 15, page 15-1). Under the economic cooperation framework, RCEP could address key issues at the broad and sectoral level related to trade and investment. The institutional provisions under RCEP provide a ‘living’ agreement framework, setting up specific RCEP Joint Committee to address and review issues related to (i) trade in goods; (ii) trade in services and investment; and (iii) sustainable development in terms of SME development, technical and economic cooperation, and other emerging issues.

4.1. Impact of RCEP to Balance the Trade and Pandemic Shocks

World Bank (2022) highlighted the emerging challenges for the global and regional pandemic recovery in terms of macroeconomic imbalances due to higher fiscal debt, supply chain bottlenecks, the widening skilled gap, the increase in

⁷ See <https://www.dfat.gov.au/sites/default/files/rcep-chapter-15.pdf>

poverty, and the importance of the resilience of the GVC. The RCEP economic cooperation and institutional provisions could address the following key issues for regional sustainable recovery from the pandemic shock.

- (i) There is a need to review the rising trade costs at the border and behind the border for the RCEP member countries. The rising trade and transaction costs will have a significant impact on the recovery of developing countries – particularly the recovery of the ASEAN LDCs. UNCTAD (2021a) highlighted the rising cost of production caused by higher intermediate input and import prices directly affecting the efficiency and effectiveness of the regional and global value chain activities. Under technical and economic cooperation, there could be a coordinated effort to identify, monitor, and address the rising border and behind-the-border trade costs. This is critical for developing the resilience of the GVC activities to rising transaction and trade cost in the region. The issues of rising border and behind-the-border issues from the pandemic shock on RCEP member countries could be reviewed under the institutional provision of the RCEP Joint Committee on Goods.
- (ii) It is likely that the trade and transaction costs will differ across developing and less developed RCEP member countries, hence differential technical and economic cooperation is essential to balance the uneven effects of trade and the pandemic in the region. The differential treatment and support for ASEAN LDCs are a critical part of the RCEP framework to address countries at different stages of growth and the diversity of the RCEP members.
- (iii) The COVID-19 pandemic has uneven economic and social impact on domestic economies and region. The unbalanced effects of the pandemic shock are also felt across sectors as labour-intensive and labour-movement sectors such as garment and textiles in the manufacturing sector and key services such as tourism, logistics, and aviation industries. It is important to review the uneven impact of the pandemic shock across the sectors, and policies could be targeted at supporting the recovery of these labour-intensive industries.

- (iv) The post-pandemic impact will be significant on traditional services trade, which depends on the movement of people, such as through tourism, aviation, and logistics. These industries are critical for ASEAN LDCs in terms of employment and the participation of SMEs. These industries are not expected to recover in the short run until a framework for the movement of people in the region is established. RCEP could provide a platform to develop a framework for the movement of people in the ‘new normal’ GVC activities.

4.2. Impact of RCEP in Creating Sustainable and Inclusive Integration

RCEP is a ‘living’ agreement, which allows it to address current key issues that affect regional integration in terms of trade and investment under the institutional provisions (chapter 18). The following are the current important issues that RCEP should address urgently for sustainable and inclusive integration of the region.

- (i) The effect of the pandemic shock tends to be felt more by unskilled and older workers. It also has an uneven impact on gender and increases the vulnerability of females in the labour market and households. There could be more support under economic cooperation to increase the technical education and skills of vulnerable groups affected by the pandemic. Economic cooperation to support skills development for the ASEAN LDCs could be undertaken with the support of other international organisations such as the World Bank and the Asian Development Bank.
- (ii) The effects of the pandemic are also felt unevenly on larger firms and SMEs. Given that larger firms have more access to financial markets and banks to leverage their risk of pandemic shock, it is likely that SMEs are ‘crowded out’ of the financial markets and banks. There is a need to review the financial inclusiveness of SMEs due to the pandemic shock.
- (iii) The RCEP framework also allows member countries to address economic cooperation to develop the regional and domestic capacity to create a more resilient region against external shocks such as the pandemic. Under the RCEP economic cooperation framework, a regional platform for the consideration of mass testing and vaccination rollout against the COVID-

19 virus could be an important area of cooperation. This could be critical for ASEAN and its LDCs in the post-pandemic recovery due to the lack of fiscal resources and health infrastructure in these countries. The regional platform for mass testing and vaccination rollout could be reviewed under the RCEP Joint Committee for Sustainable Development.

- (iv) The pandemic has also increased the vulnerability of the fiscal status and sustainability of many East Asian countries and AMS. There is a need to review the fiscal sustainability of the RCEP member countries and to develop a platform for short-term loan support that could be provided under the RCEP framework of economic cooperation.
- (v) RCEP will provide domestic and regional platforms for the structural transformation of GVCs in the post-pandemic recovery. With the persistence of the COVID-19 pandemic, in terms of its restrictions on the movement of people and border lockdowns for more than 15 months (since the virus was first observed in December 2019 in China), the risks and costs of the COVID-19 pandemic for businesses have increased. The higher risk from the COVID-19 pandemic will induce most multinational firms to undertake digital innovation and automation, which will directly affect the GVC activities in the region. This will have implications for domestic industrial activities in manufacturing and services. ASEAN LDCs must undertake policies to induce structural transformation of their industries to higher value-added activities, which will support the GVC activities induced by the CJK effects through RCEP. For example, Obashi (2022) highlighted the rising GVC activities in computers, electronic and electrical products, and transport equipment for Cambodia and Viet Nam. However, there is a need to accelerate the structural transformation of these industries, especially in Cambodia, to increase GVC participation in parts and components. Structural transformation in ASEAN LDCs, such as Cambodia, could be through investing in critical infrastructure, upgrading their Special Economic Zones, or improving the skills and human capital of workers.

- (vi) Digital transformation will accelerate in the post-pandemic recovery and will have a direct impact on services activities and services trade in the region. AMS should develop a policy framework to manage the structural transformation of the services sector through digital innovation and automation. RCEP could provide the framework to manage the structural transformation of services trade and investment in the post-pandemic period (Ando, Kimura, and Yamanouchi, 2022).
- (vii) During the pandemic recovery, we expect an intensification of the unbundling effects of production and economic activities in the global production value chains, facilitating participation by developing economies, which is important for the structural transformation of East Asian countries and AMS. These processes, in both goods and services value chains, will be intensified by the application of digital technologies. We also expect the acceleration of digital and services trade in the next phase of growth in East Asia (Ando, Kimura, Yamanouchi, 2022; Findlay and Roelfsema, 2022).
- (viii) Under economic cooperation, the development of skills and capacity building of workers will have an important priority under the RCEP agreement. As the region and domestic economies experience structural transformation, it will be important to create the relevant skills for the next stage of growth of the region. Economic cooperation under RCEP could play an important role.
- (ix) The RCEP framework could also address key issues related to climate change and the environment, green transformation of the region in terms of trade and infrastructure, and the development of new urban centres to drive the next phase of economic growth in East Asia.

The objectives of RCEP are to develop a stronger regional integration framework in East Asia that is built on a strong foundation of open regionalism and supporting market and rules-based principles. With rising anti-globalisation and protectionism in East Asia and globally, the market and rules-based trading framework under RCEP will be important in achieving sustainable and strong regional integration and a stable global trading framework. It is critical to emphasise a market and rules-based trading framework that will strengthen and deepen the

regional integration of East Asia. Although we recognise the overall positive impacts of RCEP, it is important to keep in mind that multilateral FTAs like RCEP will generate negative impacts from the trade diversion effects. Recognising this point, it is important to expand the membership or multilateralise RCEP, and eventually lead the way to global free trade under the World Trade Organization to eliminate the trade diversion effects.

It is also important to note that RCEP, as a ‘living’ agreement under the institutional provisions, will be able to address current economic and social issues such as climate change, green transformation, urban agglomeration and trade, skills and human capital development, and digital transformation of the region. ASEAN centrality should play an important role in creating more forward-looking regional integration in East Asia.

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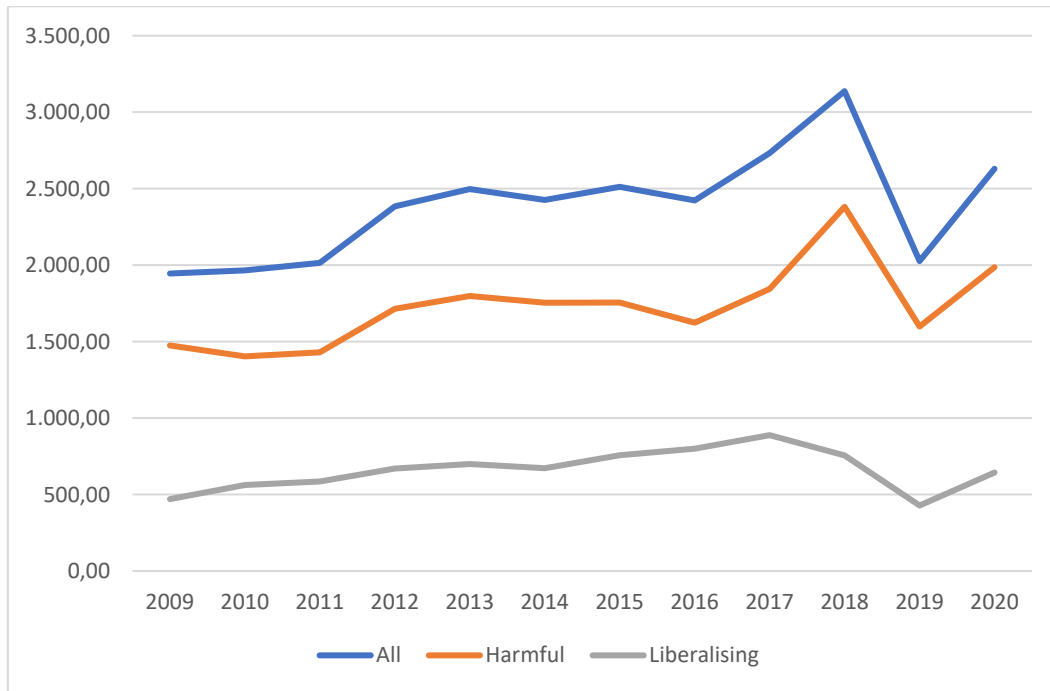
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Appendix

Figure A1: Number of New Trade Interventions by Countries (Harmful and Liberalising), 2009–2020



Source: Global Trade Alert (n.d.).

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