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Three short-term effects of Asia's largest trading deal

The recently signed RCEP trade deal is expected to eliminate a range of tariffs on imports within 20 years, but what does that mean in the short run?

Vietnam's Prime Minister Nguyen Xuan Phuc (L) and Minister of Industry and Trade Tran Tuan Anh (R) cheer after the virtual signing ceremony for the Regional Comprehensive Economic Partnership (RCEP) in Hanoi, Vietnam, 15 November 2020

Source: Shutterstock

Three important effects of RCEP

The Regional Comprehensive Economic Partnership or RCEP is a new trade agreement between 10 ASEAN countries in Asia Pacific, along with China, Japan, South Korea, Australia and New Zealand. The agreement replaces existing trade agreements between ASEAN countries and the other five countries. It also brings China and Japan, and South Korea and Japan, into trade agreements together for the first time.

Although, RCEP will take time to come into force, with ratification in each country yet to be completed, but the primary aim is to reduce tariffs on imports within 20 years. Admittedly, that is a long time and raises the question of the short-term relevance of this trade agreement if any at all.

But we think, three important impacts are likely to be felt quite quickly.

A well-timed boost for free trade

This trade agreement sends an important signal that could be more powerful than actually reducing the import tariffs.

RCEP is a vote in favour of free trade after years of rising frictions - and some of the deal's own signatories could do with this message: China and Australia came to the table to sign RCEP, but have been exchanging threats to restrict imports of key products.

RCEP is a vote in favour of free trade after years of rising frictions

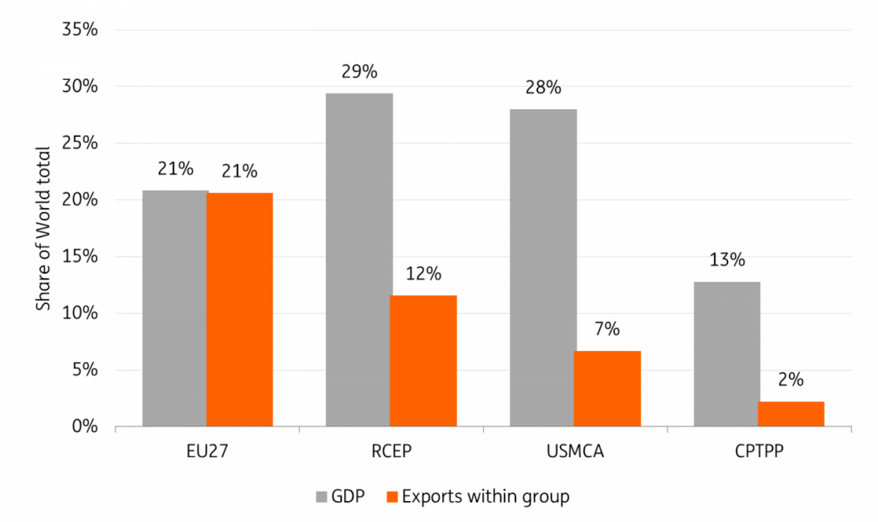
Countries outside the newly-formed trade bloc may be given pause for thought about the costs of their own trade barriers – especially India, which was initially part of the negotiations but left the table in 2019. Though it was never part of the talks, the US now stands outside of two major trade blocs in Asia-Pacific, having quit negotiations for a Trans-Pacific Partnership deal. These talks evolved into the 2018 CPTPP deal between many of the RCEP countries (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, Viet Nam) and Canada, Mexico, Chile and Peru.

2 Tackling trade costs

Although the countries in the agreement account for nearly 30% of world output, trade flows between the 15 countries account for around 12% of world trade – larger than the CPTPP and NAFTA's replacement, the USMCA.

This share could grow further if the deal can make a meaningful difference to regional trade costs, which are relatively high.

Trade between RCEP countries has the potential to grow



Source: UNCTAD, ING

Trade costs between RCEP countries have proved stubbornly high despite the patchwork of trade agreements already in place.

For example, the costs relating to the combination of tariffs and non-tariff barriers between Lao PDR and Brunei are more than eight times higher than the costs of trading these goods within the countries' borders. Also, trade costs between Thailand and New Zealand are double the costs of selling the goods in their domestic markets.

RCEP should help to lower trade costs

Additional costs of international trade relative to domestic trade, %

	Lao PDR	Brunei	Myanmar	Cambodia	Philippines	Singapore	Indonesia	Japan	Korea	China	Thailand	Malaysia	New Zealand	Australia
Lao PDR		850	652	166	358	267	295	189	232	137	53	218	334	298
Brunei	850		390	235	214	141	207	232	194	176	146	90	197	230
Myanmar	652	390		305	241	155	169	152	147	114	96	120	292	214
Cambodia	166	235	305		203	157	170	130	126	113	64	109	221	158
Philippines	358	214	241	203		123	121	85	95	97	79	83	155	129
Singapore	267	141	155	157	123		108	130	114	116	102	62	162	123
Indonesia	295	207	169	170	121	108		104	106	104	84	72	140	103
Japan	189	232	152	130	85	130	104		74	73	66	74	113	92
Korea	232	194	147	126	95	114	106	74		60	88	74	112	87
China	137	176	114	113	97	116	104	73	60		76	65	102	82
Thailand	53	146	96	64	79	102	84	66	88	76		47	100	75
Malaysia	218	90	120	109	83	62	72	74	74	65	47		99	72
New Zealand	334	197	292	221	155	162	140	113	112	102	100	99		53
Australia	298	230	214	158	129	123	103	92	87	82	75	72	53	

Source: ESCAP-World Bank Trade Costs Database, ING

As a free trade deal, tariff reductions are an important part of RCEP, but the deal should also focus minds on non-tariff barriers between RCEP countries in anticipation of the opportunities ahead. For one, the deal will create a large market for goods produced to the same standards, helping ASEAN producers currently producing different specifications for China, Japan and Korea.

At the border, new rules of origin requirements will treat RCEP countries as equals with regard to qualifying for zero tariffs. And an alternative mechanism will qualify goods if they have been transformed into a different tariff code in an RCEP country. Times for border compliance procedures in some RCEP countries currently rank among the longest in the world, so there are significant potential gains from streamlining administration.

3 Intra-Asian trade flows matter for global supply chains

Trade between RCEP countries forms some of the early links in supply chains that go beyond the region, including electronics and textiles exports to Europe and the US. A reduction in trade costs could benefit resilience in supply chains by making it cheaper (and more feasible) for suppliers to substitute inputs.

> When negotiations began eight years ago, RCEP signatories could have hardly anticipated how significant the commitment to reducing trade barriers could become.
>
> But as well as countering protectionism, RCEP could be a decisive step in reducing trade costs in the region and therefore boost trade flows and supply chain resilience.