



The Habibie Center ASEAN Studies Program ASEAN BRIEFS

Issue 1/September 2013

REGIONAL COMPREHENSIVE ECONOMIC PARTNERSHIP Key Issues and Policy Options

SUMMARY

This ASEAN Briefs is based on The Habibie Center's Talking ASEAN. This dialogue is held monthly and studies about current development on ASEAN regionalism, especially in Political-Security, Economic as well as Socio-Cultural Pillar. The latest forum, which was held in July 2013, has discussed widely on Regional Comprehensive Economic Partnership (RCEP) negotiations in ASEAN.

The key recommendation of this ASEAN Briefs is that, with regard to RCEP, ASEAN Centrality should be the ultimate conduct for when Free Trade Agreements (FTA) are negotiated with partners and that the RCEP should be made to work for ASEAN Member States and its partners by harmonizing existing trade agreements through this comprehensive economic partnership.

The Habibie Center
ASEAN Studies Program ASEAN Briefs

Project Supervisor:
Rahimah Abdulrahim

Editor-in-Chief:
Hadi Kuntjara

Program Coordinator:
A. Ibrahim Almuttaqi

Researcher:
Herjuno Ndaru K.,
Adhe Nuansa Wibisono

Finance and Administration:
Tia Nurhidayati

Design and Publication:
M. I. Qeis

The Habibie Center- ASEAN Studies Program
Jl. Kemang Selatan no.98, Jakarta 12560 Indonesia
(P): +62 21 7817211
(F): +62 21 7817212

INTRODUCTION

Regional Comprehensive Economic Partnership (RCEP) is a trade agreement that now has been discussed and started for negotiation amongst ASEAN and its FTA Partners, namely Australia, China, India, Japan, Korea, and New Zealand. Due to the 'noodle bowl' problem of Free Trade Agreement (FTA) that leads to trade complexity, RCEP is expected to bring together a combined market of three billion people (roughly 40 percent of the world's population), with a combined GDP of about US\$ 17.23trillion (roughly a third of the world's current GDP). The negotiations for the RCEP which began this year in 2013 are expected to be concluded by end of 2015. RCEP is aimed at simplifying the various trade agreements between the 10 ASEAN Member States and its 6 FTA Partners in a bundling agreement. However, the idea to have a bundling agreement is not that simple as it will impact ASEAN's external economic relations and policies. In particular, there are three key policy issues identified in this brief regarding: (1) value added of RCEP; (2) utilization of FTAs; & (3) open membership of RCEP.

POLICY ISSUES

1. Value Added of RCEP

Over the past decade, the number of FTAs involving at least one Asian country has more than tripled—from 70 in 2002 to 257 as of January 2013. This surge in FTAs has been driven by a significant increase in the number of proposed or under negotiation FTAs. Of the 257 FTAs announced as of January 2013, 132 have been signed, with 109 already in effect; 75 are being negotiated, and 50 have been proposed (ADB, 2013). Within Asia, FTAs involving the ASEAN+6 countries have increased at an even faster rate than Asia's FTAs as a whole, growing from 27 in 2002 to 179 in January 2013. These huge numbers of FTAs that ASEAN members are engaged in are reflective of the phenomenon of overlapped FTAs. Overlapped FTAs leads to complex and different trade rules amongst parties as well as non-parties.

At this point, value added of RCEP is critical if the complexity of trade rules that currently exist in Asia Pacific is to be simplified. A comprehensive and coherent trade and investment agreement would allow for integration of production processes across the region and simplify the different rules of origin (ROO) provisions. ROO provisions could be simplified by trade facilitation measures, such as simplification of customs clearance procedures and mutual recognition of standards. It would help to lower import costs and through this reduce the overall production costs for companies or even Small and Medium-sized enterprises.

In addition to that, unifying and simplifying the complexity of trade agreements in ASEAN could be beneficial for ASEAN member states as it will increase GDP (although GDP is not only the single measurement for a country to determine the economic status and capability) as shown by the Economic Research Institute for ASEAN and East Asia (ERIA)'s calculation

on the potential rise in percentage point of GDP in ASEAN when countries are bounded into a trade agreement. The data in Table 1 shows the different percentage points obtained for ASEAN by having trade agreement either: (a) at the ASEAN level alone; (b) with the ASEAN+1 FTAs (with and without the coexistence of a possible rival China-Japan-Korea FTA); and (c) with an ASEAN+6 FTA otherwise known as the RCEP. Overall, the 10 ASEAN member states obtain greater points when they use RCEP as their channel to export and import goods and services.

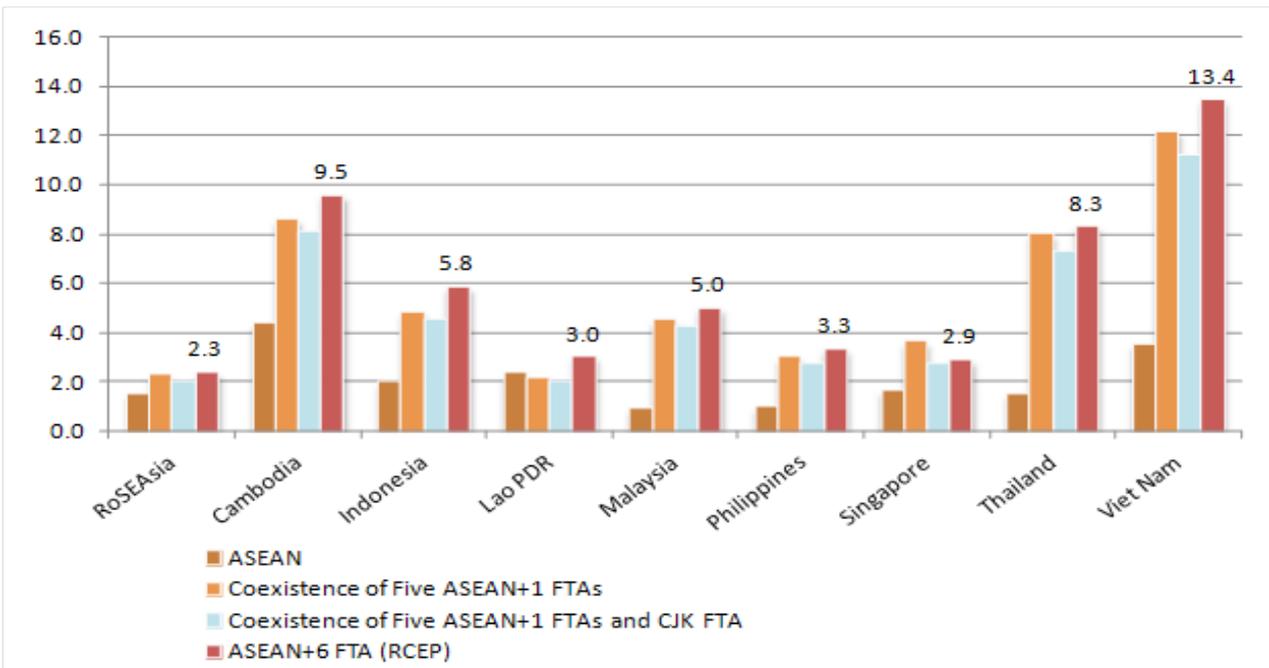
With regards to the benefits of RCEP mentioned above, some considerations that might make RCEP become more relevant to address the problem of the "noodle bowl" are as follows :

- ASEAN needs to rationalize their various FTAs and RCEP will provide opportunity to simplify trade agreements and prevent the potential loss from competing initiatives, such as Trans Pacific Partnership (TPP).
- ASEAN needs to think about its centrality and by obtaining more benefit in RCEP, ASEAN members will stick to this negotiation rather than struggle towards their interests in another negotiations.
- RCEP will enable facilitation for regional or international production networks. By having integrated production networks, the value chain amongst ASEAN and its FTA partners will move forward

However, instead of benefits mentioned above, there are also some challenges that should be looked at carefully in pursuing RCEP, namely :

- Capacity gap of certain countries. ASEAN member states need to enhance their capacity in trade negotiation as well as development level so that liberalization has wide benefits for all people.
- Since negotiation of similar trade initiatives also take place in Asia Pacific and some ASEAN member states are also parties of those initiatives, such as Trans Pacific Partnership (TPP), RCEP may lose its value added to ASEAN Member States, unless RCEP agreement offers something interesting for ASEAN members who are also involved in TPP negotiations.
- There are also worldwide trends among some economies, including ASEAN member states such as rising economic nationalism. In ASEAN this trend is possibly increasing due to blowback reaction to the increased level of industrialization. These trends could hamper trade agreement talks in ASEAN, including RCEP.
- Lack of stakeholder involvement or engagement in negotiation process would be also be a challenge for RCEP talks as trade negotiation needs accountability to their stakeholders. Whilst government officials and policy makers are heavily involved in the negotiations, there is less interaction and involvement with other stakeholders with the RCEP negotiation process.

Table 1 : Potential Economic Impact on GDP of RCEP (Percentage Point) accumulated from 2011 to 2015



Source : Yoshifumi Fukunaga, 'RCEP and its Implication to ASEAN's External Economic Relations', Paper Presented on The Habibie Center's ASEAN Dialogue, *Regional Comprehensive Economic Partnership : Implications on ASEAN's External Economic Relations and Policies* on July 29, 2013.

2. Open Membership of RCEP

Trade diversion is an issue that will occur if ASEAN does not include their key trading partners in their trade agreements. As major trading partners that are excluded may be individually hurt, it will raise the risk of retaliation in trade relations. One study (Bhagwati, 2008) argues that the system of preferences embedded in bilateral or regional FTAs is destroying the principle of nondiscrimination in trade, with FTAs serving as stumbling block against multilateralism rather than building the blocks for it.

Given to that, open membership is important to ensure that an FTA will give open opportunities and benefit to its parties. Some considerations on why open membership in RCEP becomes an important factor are as follows :

- In the Guiding Principle of RCEP, there is a clause allowing for an open accession process, however the precise details are not elaborated.
- Based on WTO principles, any WTO members should not be prevented from joining any trade arrangement involving other WTO members. This is also applicable to the RCEP.
- Since ASEAN has committed itself to open regionalism, open accession clause membership should be a practice within RCEP. Contrary to closed regionalism which opens broader opportunity for only its members, open regionalism opens opportunity for non-member to also gain some benefits.
- Open membership also enable RCEP as a forum for coordination and harmonization of trade policies to solve the basic problem of FTA, rather than adding another new preferential trade agreement that will lead to the new complexity.

However, open membership could also bring costs to ASEAN and its member states. Some considerations that might be relevant with the costs pertained to ASEAN centrality are as follows:

- Open membership provisions may slow down the progress of negotiating the RCEP.
- Some WTO members with separate custom territories which have expressed an interest in joining RCEP, such as Hong Kong, Taiwan and Macau, may be politically constraint by the 'One China Policy' orientation within ASEAN Member States' foreign policy.
- Confusion over definition of 'Other External Economic Partners' although on the RCEP's Guiding Principle it is mentioned. However, due to the focus of the negotiation involving six member states is on the agreement, provision about "Other External Economic Partners' might be less-prioritized.
- Confusion over process of open membership, mainly caused by ASEAN decision making process and the progress of negotiation itself which is still at the early phase.

3. Utilization of FTAs

Although there is variation across studies on the utilization rates of FTAs in East Asia, it is quite common to find utilization rates as low as 10%–20%; rarely are they above 30%. However, the most recent enterprise surveys conducted by Asian Development Bank (ADB) and Asian Development Bank Institute (ADBI) in seven countries suggest that utilization rates could be improving, as firms become more aware of and familiar with FTAs. 32% of firms in the sample reported that they used FTA preferences for exporting their goods (Kawai and Wignaraja 2012). Despite these recent potential increases, utilization rates of FTAs in ASEAN and East Asia are still considered low.

The ADB and ADBI surveys show that, while lack of information on FTAs was cited as the most significant reason, low margins of preference (compared to MFN) and delays or administrative costs associated with rules of origin (ROOs) are also significant barriers to the wider use of tariff cuts (Kawai and Wignaraja 2011). Because the cost of complying with ROOs and other requirements are perceived to be higher than the benefits gained, importers choose to ignore the preferential tariffs and use most favored nation (MFN) rates. One study (Pomfret, 2007, 923) claims that much of the world's trade continues to use MFN rates, despite the proliferation of FTAs. Therefore, at this point, RCEP should be aware that the underlying problem in getting the benefits of FTA is not necessarily on the agreement, but how business and people can utilize tariffs cut as well as non-tariff harmonization in FTA amongst the parties.

POLICY OPTIONS AND PRIORITIES

To ensure that the RCEP can resolve the problems raised above and focuses more on getting the full benefits of existing FTAs between ASEAN and its ASEAN+1 partners, there are a number of policy options and priorities that should be taken at the regional, national and sectoral level as follows:

1. At the Regional Level

ASEAN as a regional organization should enhance its governance, especially on its decision making process, so that ASEAN centrality would become the ultimate conduct when they negotiate with FTA Partners. ASEAN should consider the different level of development among its ten members which impact the economic policies that can ASEAN pursues. In addition to that, engagement with stakeholders is important to ensure that the trade policies ASEAN pursues are relevant with people's needs and aspiration.

The surge of FTAs that has been discussed above should bring lessons to ASEAN that under 'noodle bowl' of FTAs, any new trade agreements would be less effective. What ASEAN needs now is the harmonization among five FTAs they have regionally as well as numbers of FTAs that ASEAN Member States have with their trade partners individually.

Harmonization will be successful key for entering ASEAN Economic Community by 2015 as ASEAN Centrality in every policy is important for advancing ASEAN regionalism. Researches also show that the missing point is on the utilization of FTAs, not on the agreement that FTAs make. Therefore, to simplify trade rules and agreements amongst states will be very useful in pushing utilization of FTAs for business and people in Southeast Asia. Therefore there should be less focus on expanding the RCEP or making the RCEP into a new regional FTA which will only add more noodles into the noodle bowl. The most important thing for ASEAN is to harmonize the complex procedures and regulations within ASEAN+1 FTAs, especially on ROO provision and non-tariff barrier measures.

2. At the National Level

Governments need to complement the efforts of RCEP to harmonize current existing FTAs and bring out their full benefits by socializing these FTAs, their guiding procedures, and contact details for any problems that businesses face in exporting or importing goods by using FTAs. In some ASEAN countries, there are

no clear technical supervision and guidance from government to Small and Medium Enterprises (SMEs) who are vital for economic growth within the region. Governments should enhance their capacity in trade negotiation as well as promoting and socializing FTAs to public and especially private sector. Again the emphasis is away from any expansion of the RCEP or turning the RCEP into a new regional FTA but on harmonization so that the many stakeholders within ASEAN and their ASEAN+1 FTA partners can enjoy the full benefits of current existing FTAs as envisioned by the RCEP negotiation process. As a state, Indonesia should perform better towards RCEP and ASEAN Economic Community by 2015. Government should enhance its industrialization plan so that Indonesia, through RCEP, will not only export raw materials, but also processed products with more technologies and added values. This step is important to ensure that Indonesia's participation in global trade will not lead to the exploitation of her natural resources that could result in an environmental as well as resource crisis.

3. At the Sectoral Level

Private sector and several departments in governments should work together to utilize the maximum benefit of FTAs. However, in trade policy, a country should not only discuss the volume of trade, but also how a country could build industrial capacity using their resources and trade with their trade partners. Trade officials of ASEAN governments should work hard on harmonization of Rules of Origin and non-tariff barrier that have been a problem in previous FTAs.

EXPECTED BENEFITS

By creating an open, solid, and harmonized RCEP, it is expected that there will be improvements in the quality of policies and economic relations of ASEAN.

- ASEAN Member States could utilize FTAs better when the procedure, standards, and regulations are clear and harmonized.
- Industrialization at the regional level as well as for each ASEAN Member State will be more effective when international production networks could be facilitated by RCEP.
- At the end, the quality of economic regionalism would be advanced when ASEAN centrality could tackle development gap as well as opportunity for growth.

References

- ADB. Free Trade Agreements. 2013. *Asian Regional Integration Center*. 26 August. <http://aric.adb.org/fta>
- J. Bhagwati. 2008. *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*. New York: Oxford University Press.
- M. Kawai and G. Wignaraja. 2012. Dealing with the Noodle Bowl of Asia's Free Trade Agreements. *Asian Pathways*. 24 April. <http://www.asiapathways-adbi.org/2012/04/dealing-with-the-noodle-bowl-of-asias-free-trade-agreements/>
- M. Kawai and G. Wignaraja. 2011. Asian FTAs: Trends, Prospects and Challenges. *Journal of Asian Economics*. 22 (1). <http://www.sciencedirect.com/science/article/pii/S1049007810000849>
- R. Pomfret. 2007. Is Regionalism an Increasing Feature of the World Economy? *The World Economy* 30 (6).