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RCEP and TPP: Can They Converge into an FTAAP?

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EXECUTIVE SUMMARY

- Policy makers in Asia and the Pacific view the RCEP and the TPP as pathways to a Free Trade Area for Asia-Pacific (FTAAP) that will be comprehensive and of high quality and that will harmonise the rules of integration of the existing smaller scale FTAs in the region.
- An FTAAP, using either of the TPP or the RCEP pathways, is possible if endorsed by major powers like the US, Japan and China. The most widely heard comment on the FTAAP idea is that it is unlikely to happen because of the political conflict between major economies like the US and China.
- Currently, there are two possible scenarios: a) The RCEP and the TPP will merge to form an FTAAP; or b) the RCEP and the TPP will remain separate and without the US and China having dual membership. Considering the pros and cons on both sides, it is more likely that the RCEP and the TPP will remain separate.

¹ The paper was initially written for the APEC Study Centre Consortium Conference held on 11-12 May 2014 in Qingdao, China. A longer version of the paper with details on proliferation of FTAs in Southeast Asia, RCEP and TPP was published by ISEAS in June 2014 (http://www.iseas.edu.sg/documents/publication/Trends_2014_2.pdf).

- Within this fluid context, it is imperative for ASEAN to maintain its ‘centrality’ and to respond effectively to potential conflicts arising out of the RCEP and TPP agreements. ASEAN states recognize the benefit of having both the United States and China as key partners, and they can be expected to continue keeping both of them interested in the regional trading architecture.

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INTRODUCTION

Over the last two years, two mega-regional trade agreements (RTAs) – the Regional Comprehensive Economic Partnership (RCEP) and the Trans Pacific Partnership (TPP) – are being negotiated to generalise the bilaterals and smaller regional agreements into more coherent region-wide or cross-regional arrangements. While RCEP negotiations involve sixteen countries (the ten ASEAN member countries, plus China, Japan, South Korea, India, Australia and New Zealand) aiming to attain a comprehensive and mutually beneficial economic partnership agreement that will entail deeper engagement between ASEAN and its FTA partners², TPP negotiations involve twelve countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam) and the aim is to liberalise trade in goods and services; encourage investments; promote innovation, economic growth and development; and support job creation and retention. However, both the RCEP and the TPP are currently facing complex challenges and are encountering difficulties in reaching a conclusion. While the TPP has missed multiple deadlines since the end of 2013, the RCEP, which began its journey in May 2013, has a likelihood of completion by the end of 2015.

At the same time, there are increasing discussions that an enlarged TPP and/or an enlarged RCEP will lead to the creation of a Free Trade Area for Asia-Pacific (FTAAP) that is expected to be comprehensive and of a high quality and that will harmonise the rules of integration of the existing smaller scale FTAs in the region. This paper examines the possibility of convergence of the mega-RTAs, the RCEP and the TPP, into an FTAAP.

WHAT IS AN FTAAP?

The idea of an FTAAP was first floated in 2004 by the APEC Business Advisory Council (ABAC), during the 12th APEC Economic Leaders' Meeting. The FTAAP proposal for ABAC members was meant 'to accelerate progress toward achievement of the Bogor Goals and full global liberalisation in the WTO' and to minimise 'the possible ill effects associated with the increasingly complex web of RTAs/FTAs in the APEC region'³. Academics like C.F. Bergsten subsequently argued that an FTAAP would deliver on the following points:

² China, India, Japan, South Korea, Australia and New Zealand are ASEAN's FTA partners.

³ APEC Business Advisory Council (ABAC), 2004. 'Bridging the Pacific: Coping with the Challenges of Globalisation', Report to APEC Economic Leaders, Santiago, Chile.

- create positive gains from free trade induced by the world's largest single trade bloc;
- become a stepping stone towards global free trade by inducing the WTO and non-members like the EU to resume the multilateral Doha Development Agenda (DDA) negotiations;
- become the best available "Plan B" alternative to the DDA;
- prevent competitive liberalizations in the Asia-Pacific region and mitigate the negative effects of the proliferating hub-and-spoke type of overlapping RTAs by consolidating the sub-regional trade blocs into a large umbrella;
- revitalize APEC;
- ameliorate the China-US economic conflict, caused mainly by trade imbalance between the two nations; and
- maintain US engagement in Asia⁴.

However, at that time, it did not get much attention from the APEC Leaders. This was not unexpected since the FTAAP was expected to possess regular characteristics of FTAs, i.e. they were expected to be legally binding and had high chances of discrimination against non-members. But this very nature also contradicted APEC's unique feature – voluntary, non-binding and open regionalism. Hence, the pursuit of an FTAAP was thought to be detrimental to APEC's fundamental nature. Moreover, there were deep doubts about an APEC FTAAP being realised. It was after all difficult for the US and China to mutually agree on a high-quality FTA. The same was true for Japan, China and South Korea, whose broader economic cooperation, in addition to their defensive trade positions against each other especially in relation to sensitive sectors like agriculture, cars, etc., were constantly mired in historical conflicts and unsettled territorial disputes. In a 2006 joint study by the Pacific Economic Cooperation Council (PECC) and the ABAC, it was even reported that 'the FTAAP is not politically feasible at the present time or in the near term'.⁵

Nevertheless, during the 14th APEC Economic Leaders Meeting in 2006, a decision was made to undertake a feasibility study on FTAAP, which was viewed as an American strategy to be part of East Asia's regionalism initiatives. Around that time, East Asian economic integration was

⁴ Bergsten, C. F. (2007). 'A Free Trade Area of the Asia-Pacific in the Wake of the Faltering Doha Round: Trade Policy Alternatives for APEC', in by Charles E Morrison and Eduardo Pedrosa (ed) *An APEC Trade Agenda?: The Political Economy of a Free Trade Area of the Asia-Pacific*, A Joint Study by ABAC and PECC, Singapore: Institute of Southeast Asian Studies.

⁵ The Pacific Economic Cooperation Council and the APEC Business Advisory Council, 2006. 'An APEC Trade Agenda?: The Political Economy of a Free Trade Area of a Asia- Pacific'

gaining momentum. While FTAs in East Asia were rapidly proliferating, the first East Asia Summit was held in Malaysia in December 2005, to move the nations of East Asia towards a community. There were also regular discussions on establishing an East Asia Free Trade Agreement (EAFTA), which was promoted by China, and a Comprehensive Economic Partnership for East Asia (CEPEA), which was advocated by Japan. Both these initiatives excluded the United States.

Since 2006, APEC has been examining the feasibility and desirability of an FTAAP as a longer-term vision for both APEC economies and the world economy. There has been no concrete decision on what pathways to use to achieve an FTAAP or on the timing of such an arrangement. As APEC is not geared for a negotiation anytime soon, the pathways at this point in time seem to run outside of APEC. This was observed with the emergence of the RCEP and the TPP, and in the 2010 APEC Leader's Summit, it was announced that an FTAAP should be pursued by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6 (now combined as the RCEP), and the TPP. But how far is that feasible?

CHALLENGES FOR AN FTAAP

An FTAAP, using either of the TPP or the RCEP pathways, is possible if endorsed by big powers like the US, Japan and China. The widely heard criticism of the FTAAP idea is that it could not be realised because of the political conflict between these powers. Moreover, in their current forms, the membership and nature of these two initiatives vary significantly. The TPP, for example, does not include major powers like China or India. Among ASEAN members, Thailand and the Philippines are still considering their options while Indonesia views TPP as being too complex with its inclusion of labour and environmental issues and holding a range of difficult issues for Indonesian domestic economy. In contrast, Indonesia is a member of RCEP and is leading the negotiation process for the agreement. Significantly, the US is not part of RCEP negotiations.

The second challenge for an FTAAP using the RCEP or the TPP as pathways is the differences in development stages (*Table 1*) and accordingly also differences in priorities among the negotiating partners. While the TPP has been declared a 21st-century, high-standard, comprehensive FTA that will deepen economic integration, the RCEP is advocated to be more in line with the requirements of developing countries in Asia.

Table 1: Varying Levels of Development

Low Income Economies (US\$1,035 or less)	Lower Middle-Income Economies (US\$1,036-US\$4,085)	Upper Middle Income Economies (US\$4,086-US\$12,615)	High Income Economies (US\$12,616 and more)
Cambodia and Myanmar	Indonesia, India, Laos, Philippines, Vietnam	China, Malaysia, Thailand, Mexico, Peru	Australia, Brunei, Japan, Korea, Rep., New Zealand, Singapore, Canada, Chile, United States

Note: Economies are divided among income groups according to 2012 gross national income (GNI) per capita

Source: Author's compilation from World Bank (country classification data)

Third, both negotiations face complex challenges and are therefore difficult to bring to a successful conclusion. The TPP, although said to be in its final stages, is facing difficulty as the partner countries are reluctant to close the talks without assurances that the United States will stick to its commitments and not face any roadblocks from the Congress, especially on issues such as intellectual property rights, labour and environmental standards. The negotiating countries want the United States administration to secure the Trade Promotion Authority (TPA), a 'fast track' procedure that pre-commits the Congress to implement legislation, without amendment and within a specified time frame. However, short-term prospects for trade liberalization in the United States both at the global and the regional level have been dimmed by the expiration of the TPA in 2008⁶. Given increasingly fractious US trade politics, it is highly unlikely that trade accords with major partners can be successfully concluded and enacted in the absence of such procedures. Similarly, the RCEP negotiations are not without complications, especially if one keeps in mind the difficult dynamics between China, Korea and Japan. The deadline of end-2015 looks too optimistic.⁷

⁶Bergsten, C. Fred; Noland, Marcus and Schott, Jeffrey J. (2011). 'The Free Trade Area Of The Asia- Pacific: A Constructive Approach To Multilateralizing Asian Regionalism', *ADBI Working Paper Series*, No. 336

⁷ Zhiming, Xin. "North Asia free-trade area agreement enormously beneficial but years away," *China Daily*, September 1, 2011.

OPPORTUNITIES FROM AN FTAAP

An FTAAP (with 21 members⁸) under certain conditions can bring both a maximum trade creation effect and a minimum trade diversion effect, to use terms coined by Jacob Viner in 1950⁹. The conditions for an economically beneficial regional trade agreement (RTA) are outlined as below¹⁰:

- Market size of the RTA: the larger the better
- Pre-RTA intra-regional tariff: the higher the better
- Pre-RTA extra-regional tariff: the lower the better
- Pre-RTA intra-regional trade volume: the deeper the better
- Competitive pre-RTA industrial structure: the tougher the better
- Complementary post-RTA industrial structure: the stronger the better
- Pre-RTA level of economic development gap: the narrower the better
- Geographical proximity: the closer the better

Most of the member economies that are currently negotiating the TPP or the RCEP satisfy most of the above conditions. Looking at the individual conditions, first, *Table 2* shows that the consolidated market size for both the TPP and the RCEP (55.6 per cent of the world population and 56.5 per cent of the world GDP) is large enough to create a positive trade creation effect. In other words, in general, there will be a net trade creation effect from large markets because both cases do offer economies of scale. Second, while the pre-RTA tariff structure is a debatable factor, lower tariff rates (6.4 per cent and 6.9 per cent for RCEP and 3.9 per cent and 4.4 per cent for TPP members, compared to 6.9 per cent and 9.4 per cent for the world as a whole) may generate net trade creation effect. Third, the higher ratio of intra-regional trade among RCEP and TPP member economies of over 40 per cent and 38 per cent respectively is a promising factor that can be expected to bring a large trade creation effect (*Table 3*).

⁸ FTAAP, based on current membership of RCEP and TPP, will have 21 members – Australia, Brunei, Cambodia, Canada, Chile, China, India, Indonesia, Japan, South Korea, Laos, Malaysia, Mexico, Myanmar, New Zealand, Peru, The Philippines, Singapore, Thailand, the US and Vietnam.

⁹ Trade creation is the phenomenon of displacing the less efficient domestic production to more efficient partner country production. This leads to economic gain as now the country's resources are more efficiently utilised. However, it is also possible that preferential treatment is extended to a partner country that replaces a more efficient non-FTA partner. In that case, there will be trade diversion: the importing country is using a less efficiently produced import.

¹⁰ Kim, Sangkyom; Park, Innwon and Park, Soonchan, (2013), 'A Free Trade Area of the Asia Pacific (FTAAP): Is It Desirable?', *Journal of East Asian Economic Integration* Vol. 17, No. 1, pp.3-25

Table 2: Key Economic Indicators of RCEP, TPP and APEC Economies, 2012

	Population (million)	GDP (nominal, US\$ billion)	Per Capita GDP (nominal, US\$)	Simple Mean Applied Tariff Rate (%)	Simple Mean MFN Applied Tariff Rate (%)
RCEP (A)	3,403.86	21,191.08	18,984.23	6.40	6.94
TPP (B)	792.83	28,136.01	32,901.26	3.89	4.43
APEC (C)	2,784.28	41,763.60	24,219.17	4.92	5.76
World (D)	7,046.37	72,440.45	10,280.54	6.95	9.45
A+B	3,917.80	40,901.52	20,940.26	5.88	6.47
(A+B)/D (%)	55.6	56.5	203.69	84.66	68.41
A/D (%)	48.31	29.25	184.66	92.05	73.44
B/D (%)	11.25	38.84	320.03	55.94	46.91
C/D (%)	39.51	57.65	235.58	70.75	60.95

Source: World Bank Database, World Trade Organization

Table 3: Intraregional Trade Share: 2000-2011 (%)

	2000	2005	2010	2011
ASEAN	22.7	24.9	24.6	24.1
RCEP	40.6	43.0	44.1	43.8
TPP	48.1	43.5	39.0	38.6
APEC	72.2	69.5	67.1	66.1

Source: author's estimate using IMF statistics and The Apec Region Trade and Investment Report, 2012

Where pre-RTA competitive industrial structure is concerned, the large number of members (total members should TPP and RCEP be consolidated are 21), will make competition between industries inevitable. However, with the liberalisation of sectors, more competition will generate efficiency gains for members of the groupings. For the last two conditions—development gap among members and geographic proximity—the expected welfare effect is difficult to estimate and most likely will not be positive. The developmental level of members is diverse in both the mega-RTAs, but the geographic proximity leading to lower transaction cost is more feasible under the RCEP than the TPP.

There are studies that have quantified the likely welfare effect of these RTAs. One such study by Petri, Plummer and Zhai¹¹ surmises that while the TPP¹² offers benefits of around US\$451 billion, the RCEP (termed as Asian-track in the study) offers US\$644 billion. Benefits increase with the scale of the integration project. The study further mentions that both China and the US will gain substantially from an inclusive FTAAP agreement compared to sub-regional tracks since that will give them more access to each other's markets. It estimates that global FTAAP benefits are at US\$2.4 trillion under the TPP template, US\$1.3 trillion under the RCEP template, and US\$1.9 under a template that averages the two.

TWO SCENARIOS FOR AN FTAAP

From the above, one should say that while the formation of an FTAAP is a challenge, the opportunities it offers are many. However, currently, there are two possible scenarios:

- a) RCEP and TPP merge to form a region-wide Asia-Pacific FTAAP; and
- b) RCEP and TPP remain separate and the US and China will not have dual membership
(Table 4).

Member countries, especially the ones with dual membership, will favour merging RCEP and TPP in order to avoid inefficiency stemming from the coexistence of the two RTAs. Moreover, since enlarging an FTA entails a larger trade-creation effect for the member countries vis-à-vis a trade diversion effect, there should technically be a higher probability of the RTAs combining. However, the member countries of both the RCEP and the TPP are at varied levels of economic development. This will lead to varied negotiating priorities, resulting in a dual-track approach. The RCEP, driven by ASEAN, will continue to follow a more accommodative approach and will position the RCEP as an extension of the ASEAN Economic Community. Also, the political rivalry between the United States and China encompassing discussion on containment and hegemony in the Asia-Pacific region will make it difficult to combine the two mega-RTAs.

¹¹ Petri, Peter A., Michael G. Plummer and Fan Zhai. (2012). 'The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment'. *Policy Analysis in International Economics No. 98*. Washington: Peterson Institute for International Economics and East-West Center. See also the website: asiapacifictrade.org.

¹² TPP in the study involves 16 members i.e. the current 12 negotiating countries and Indonesia, Korea, the Philippines and Thailand.

Table 4: Possible Scenarios for FTAAP

a) RCEP and TPP will merge	b) RCEP and TPP will not merge
If inefficiency from coexistence of two RTAs are high	As the development gap between members remains or widens
If member countries with dual membership put in an effort to harmonize the rules and regulations across the agreements	Since the RCEP countries have interest in liberalizing manufacturing sector and the TPP countries are more keen on liberalizing services, investment and establishing rules of IPR, competition policy, labour laws etc.
If member countries acknowledge that merging the two agreements will generate economies of scale and hence have a trade creation effect	Since the US and China continue with their international political rivalry
	Since the advanced countries see no benefit from joining RCEP and the developing countries find it difficult to comply with TPP rules.

Source: author's compilation

Taken together, there is more chance for the RCEP and TPP to remain separate than to merge. This separation may also enjoy more support from Asian economies since while they want the US presence in the region, they would also like to keep the US distant from certain regional matters, such as the ASEAN+3 cooperation that involves the ten ASEAN countries and China, South Korea and Japan.

CONCLUSION

Although the RCEP and the TPP are currently being negotiated as agreements that may lead to an FTAAP, many challenges remain. The positive gains from a larger free trade bloc exist. However, at the same time, the trade and investment liberalization promised by the RCEP and the TPP are obstructed by the diversified interests of member economies. Prospects of combining the RCEP and the TPP for a future FTAAP are dimmed by the lack of political will and by problems of compatibility. It is more likely for the RCEP and TPP to develop separately towards an FTAAP.

That said, it is too early to say anything definitive on an FTAAP. There are already discussions about the Chinese joining the TPP and about US interests in RCEP developments. Moreover, as the RCEP and the TPP are still being negotiated and there is no clarity on the form of an eventual FTAAP, it remains to be seen whether the much-hyped FTAAP can be a best practice for a region-wide RTA in the future.

Going forward, it is, thus, important for policy makers, especially in ASEAN states, to bear a few key points in mind. First, ASEAN as an organisation should retain its objective of ‘centrality’ and should respond earnestly to any potential conflicts arising from the RCEP and the TPP. Second, as the ASEAN states recognize the benefits of having both the US and China as key partners, it is very important for them to keep both of these interested in the regional trading architecture. It may be true that a high-quality trade agreement will yield greater gains, but it may also deter new members, such as China, India and other low-income developing countries, from participating. With this trade-off in mind, leaders and policy makers need to carefully balance the depth and scope of such agreement. Finally, as policy makers view the RCEP and the TPP as pathways leading to an effective FTAAP, the countries that have dual membership – four ASEAN members (Brunei, Malaysia, Singapore and Vietnam) and Australia, Japan and New Zealand – need to ensure that trade liberalisation and facilitation either through the TPP or the RCEP should not create conflicting regulations or restrictive rules of origin. Alternatively, through harmonising the rules and regulations across the agreements, these countries would help lower the business transaction cost in the region.

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