RCEP: A game changer for trade in Asia

– *Textile and apparel supply chains are key beneficiaries*

The RCEP is the largest plurilateral trade agreement in the world, comprising about a third of the world's population and global GDP. By eliminating tariffs on at least 92% of goods traded and opening up at least 65% of services sectors, the RCEP will certainly encourage more cross-border trade, investment and flows of people across the Asia-Pacific region, thus expediting economic and trade integration in the region.

The RCEP will create a unified set of trade rules for the Asia-Pacific region to replace the multiple 'ASEAN-plus-one' trade deals, which will also solve the 'spaghetti bowl' problem of the ASEAN becoming entangled with a bunch of FTAs and different rules for each trading partner. This marks a big step towards forming an integrated trading region in Asia, like North America and Europe, which have had integrated trading arrangements for over 20 years. The RCEP not only harmonizes the different rules of origin of its member countries, but also sets generous regional-content requirements for a lot of products. For example, once a company can prove that a pair of shoes it produced reaches an RCEP regional value content level of 40%, it can export the shoes to any of the 15 RCEP countries and enjoy preferential access, and this 40% regional value can come from any of the 15 RCEP members.

RCEP's unified rules of origin and regional cumulation provisions will make it significantly easier for products made in its member countries to qualify for preferential access when entering other markets in the region. This will encourage companies to source inputs and intermediate goods from other members within the trade bloc, further strengthening the regional supply chains in the Asia-Pacific region. Businesses will also be able to enjoy more flexibility and lower costs through effective orchestration of their supply chains in the region.

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I. What is RCEP?

1. Negotiations and conclusion

After eight years of negotiations, 15 Asia-Pacific countries signed the Regional Comprehensive Economic Partnership (RCEP) in a virtual ceremony in Hanoi, Vietnam on 15 November (see exhibit 1 below).

The RCEP involves the 10 Association of Southeast Asian Nations (ASEAN) member countries[1] as well as China, Japan, South Korea, Australia and New Zealand. The RCEP will come into force 60 days after a minimum of six ASEAN members and three non-ASEAN partners have ratified the deal, which is expected sometime next year.

Exhibit 1: Timeline of RCEP negotiations

Nov 2012	• 16 countries announced the launch of RCEP
May 2013	• First round of negotiations was held
Nov 2017	• Released the first Joint Leaders' Statement, stressing the need to consolidate existing FTAs and build new economic linkages
Sep 2018	• Negotiations on four chapters concluded
Nov 2019	• India announced its withdrawal from RCEP to protect 'vulnerable' sectors
Nov 2020	• 15 Asia-Pacific countries signed the RCEP

[1] The ASEAN includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

2. Objective and coverage of RCEP

The RCEP's objective is to establish 'a modern, comprehensive, high-quality, and mutually beneficial economic partnership that will facilitate the expansion of regional trade and investment and contribute to global economic growth and development'.[2] The RCEP has 20 chapters covering trade, market access and economic cooperation, among others.

Exhibit 2: Key areas under the RCEP agreement

Trade in goods

Tariff elimination of at least 92% of goods traded among RCEP members over the next 20 years.

Rules of origin

A new, unified set of rules of origin will be established.

Trade in services

At least 65% of services sectors will be fully open with increased foreign shareholding limits. A 'negative-list' approach will be used for foreign investment in services sectors.

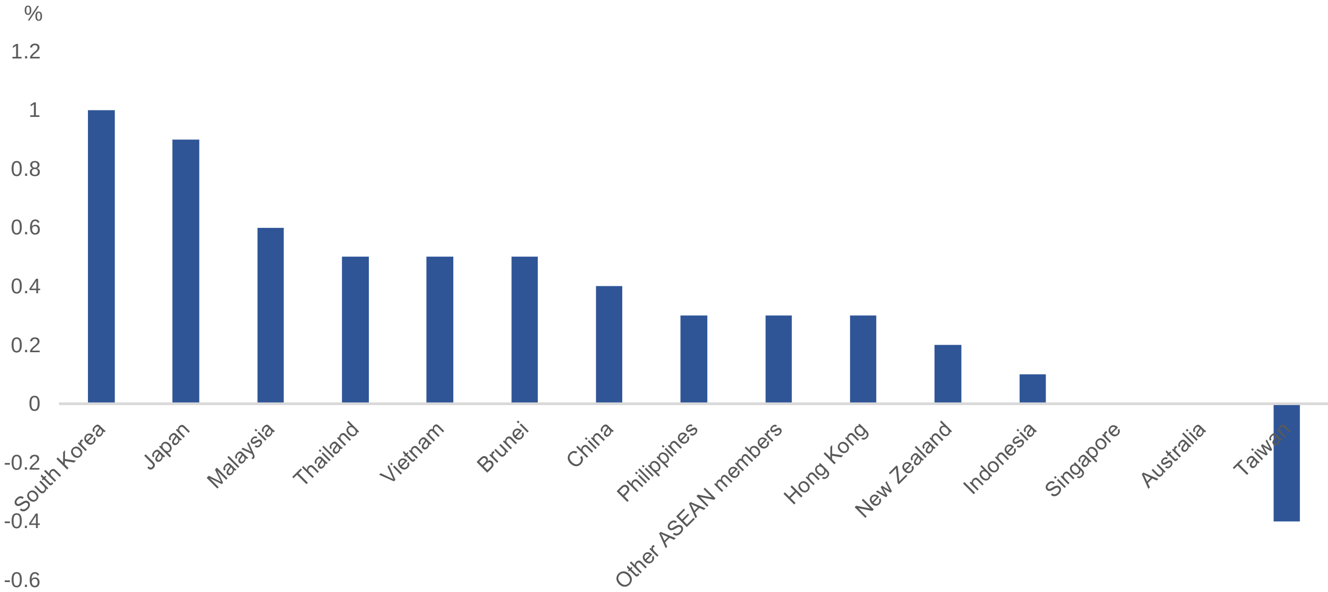
In addition, the RCEP also covers customs procedures and trade facilitation; sanitary and phytosanitary measures; standards, technical regulations, and conformity assessment procedures; trade remedies; temporary movement of natural persons; investment; intellectual property; e-commerce; competition policy; small and medium enterprises; economic and technical cooperation; government procurement; and dispute settlement.

[2] "Summary of the Regional Comprehensive Economic Partnership," ASEAN, see https://asean.org/storage/2020/11/Summary-of-the-RCEP-Agreement.pdf

3. Benefits of RCEP

It is forecast that the RCEP will raise global GDP in 2030 by an annual US$209 billion. These benefits will go mainly to China, Japan and South Korea, with GDP gains of US$100 billion, US$46 billion and US$23 billion respectively. In terms of percentage increase in the GDP, the largest beneficiaries will be South Korea, Japan and Malaysia (see exhibit 3).[3]

Exhibit 3: Projected GDP gains (in %) for RCEP members, Hong Kong and Taiwan in 2030



Source: Peter A. Petri and Michael G. Plummer, "East Asia Decouples from the United States: Trade War, COVID-19, and East Asia's New Trade Blocs", PIIE Working Paper, 20-9, June 2020.

[3] Peter A. Petri and Michael G. Plummer, "East Asia Decouples from the United States: Trade War, COVID-19, and East Asia's New Trade Blocs", PIIE Working Paper, 20-9, June 2020. All estimates presented in the current article are based on the assumption that the China-US trade war will continue.

II. How is RCEP different from CPTPP?

Both the RCEP and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)[4] are multilateral free trade agreements (FTAs) dominated by Asia-Pacific countries. However, the two trade deals differ in composition of members and scale (see exhibit 4 & 5).

Exhibit 4: Frameworks of RCEP and CPTPP

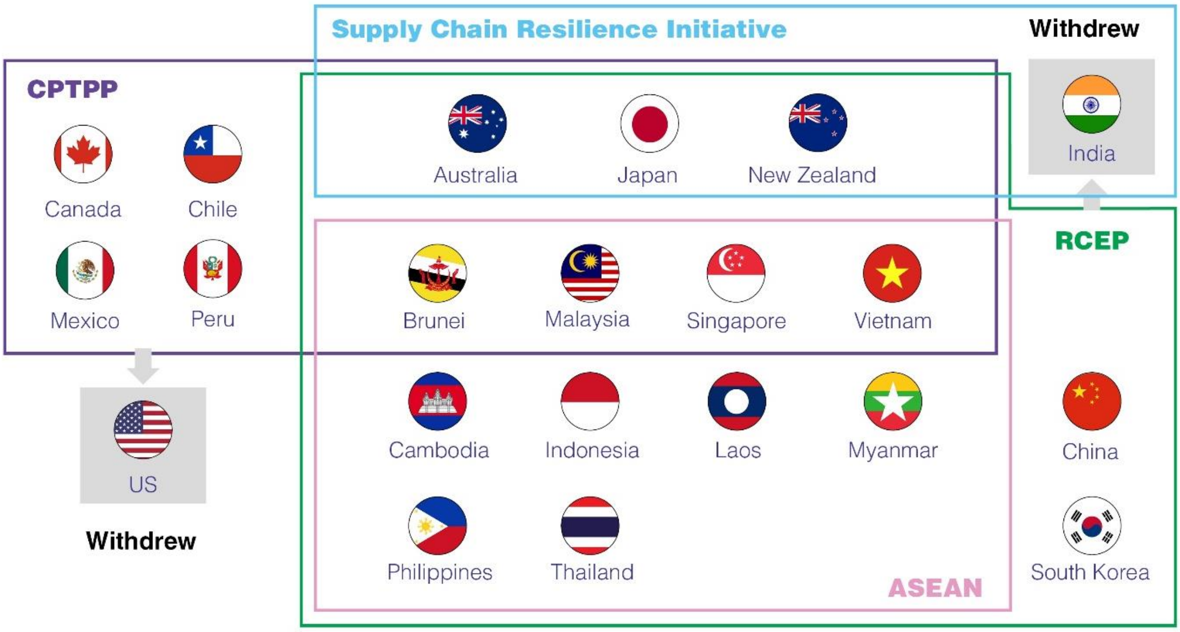


Chart based on design by Nikkei Asia

Exhibit 5: Comparison of the scale of RCEP and CPTPP (2019)

	RCEP	CPTPP
GDP	US$25.84 trillion	US$11.20 trillion
(% of world total)	(29%)	(13%)
Population	2.27 trillion	0.51 trillion
(% of world total)	(30%)	(7%)
Trade	US$10.42 trillion	US$5.78 trillion
(% of world total)	(28%)	(15%)

Source: World Bank, ITC Trade Map; compiled by Fung Business Intelligence

[4] The CPTPP, which concluded in 2018, was originally known as Trans-Pacific Partnership (TPP) and was meant to include the US, but the US withdrew from the deal in January 2017 after Donald Trump took office.

Besides, the two trade deals have different focus and aspirations, which also have implications for the accession of other countries to the deal.

First, the RCEP focuses more on traditional aspects of FTAs such as trade in goods (and more on manufactured goods and less on agricultural produce), aiming largely to reduce tariffs and harmonize rules of origin. Meanwhile, the CPTPP has been billed as a 21st-century trade agreement, setting high standards in the protection of labour rights, the environment and intellectual property, as well as introducing WTO-plus and WTO-extra rules[5] on state-owned enterprises, digital trade and government procurement. Even in trade in goods, the RCEP is less ambitious than the CPTPP, eliminating only 92% of tariffs, compared with tariff elimination of 98% among CPTPP members.

Second, in addition to its less rigorous requirements in liberalization measures, the RCEP provides differential treatment (such as gradual tariff cut and longer transition period) for developing economies, while the CPTPP applies the same high-standard rules for both developed and developing countries. This could make it easier for interested economies to join the RCEP but not the CPTPP. The relatively easy and open accession to the RCEP also manifests the 'open regionalism' the trade bloc pursues.

[5] 'WTO-plus' rules are more stringent than requirements of existing WTO agreements, while 'WTO-extra' rules are new policy tools that go beyond current WTO commitments.

III. RCEP and the regional textile and apparel supply chain

Through tariff liberalization and trade facilitation, the RCEP, once implemented, is expected to boost intra-regional trade of textiles and apparel and deepen supply chain integration in the region. In 2018, the 15 RCEP member countries together accounted for 46.8% of the world textile and apparel exports and 16.2% of the world textile and apparel imports, according to the World Trade Organization database.

From a supply chain perspective, an interdependent textile and apparel production network has been forming and developing within the RCEP trade bloc. China, Japan and South Korea have played as major suppliers of textile inputs (such as manmade fibres, fabrics, yarn and trims), while China and some less developed ASEAN countries, such as Cambodia, Vietnam, Indonesia and Myanmar, are leading producers of garments and home textiles, with the final products mostly shipped to the US and Europe and, to a lesser extent, to regional consumer markets such as Japan, South Korea, Australia, New Zealand and China. Meanwhile, Australia has served as a major supplier of raw cotton and wool for the region.

On top of the tariff reduction already realized by existing FTAs among the 15 RCEP member countries, tariffs on textiles and apparel will be further reduced or eliminated under the newly signed RCEP. For instance, according to each party's schedule of tariff commitments[6] released:

- Vietnam will reduce tariff rates of many tariff lines of fibres, fabrics and yarn (such as woven fabrics of cotton under HS code 5208.11.00, 5208.12.00, 5209.11.00 and 5209.12.00) imported from China from the base rates[7] of 12% to a range of 1.2%–9% over 10, 20 or 25 years' time.

- China, on the other hand, will eliminate tariffs of over 100 tariff lines for Japanese fibres, fabrics and yarn (HS50–60) in the first year when the RCEP comes into force, and will phase out most of the remaining tariffs for Japanese textiles and apparel to zero over a period of ten years from the base rates of 5%–19%.

- Moreover, Japan will phase out the tariffs on almost all textiles and apparel (under HS code 50–63) exported by other RCEP members to zero in 10 or 15 years' time from the base rates ranging from 1.9% to 12.8%.

[6] https://www.dfat.gov.au/trade/agreements/not-yet-in-force/rcep/rcep-text-and-associated-documents

[7] The base rates set out in each member country's schedule reflect the most-favoured-nation (MFN) applied rates of customs duty of each member country effective on 1 January 2014.

Another significant benefit brought about by the RCEP is the harmonization of rules of origin and customs procedures, streamlining overlapping and tangled rules (known as the ‘spaghetti bowl effect’) under existing FTAs implemented by RCEP countries. Once the trade pact takes into effect, a unique and standardized certificate of origin is sufficient to ship the same products to all RCEP member countries. Thus, transaction costs within the bloc will be substantially reduced and a simpler and more stable environment for trade will be created.

Specifically, the rules of origin under the RCEP are liberal and based on specific product traded. For textiles and apparel, manufacturers in the RCEP trade bloc can source textile inputs from anywhere in the world, and the finished products may still be eligible for preferential market access to RCEP countries.[8]

All in all, we expect that the RCEP, once ratified and implemented, will boost intra-regional trade of textiles and apparel and strengthen the regional textile and apparel supply chains. Particularly:

1) By liberalizing tariffs and harmonizing rules of origin, the trade pact is expected to further lower the cost of trade within the trade bloc, boost intra-regional trade and benefit the 2.2 billion consumers living in the region.

2) It is expected to deepen the international division of labour and form a more integrated regional supply chain for the textile and apparel industry, with each RCEP country consolidating its competitive advantage (such as labour cost, skills, technology, capital and resources of raw materials, etc.) along the textile and apparel supply chain.

3) Brands and retailers serving the RCEP markets will probably re-balance their sourcing strategies, by sourcing more textile inputs from the bloc and placing more production within the region to benefit through the trade pact.

[8] Textiles and apparel produced in an RCEP country using originating materials from one or more of the RCEP countries, or using non-originating materials, provided that all non-originating materials used in the production of the good have undergone a change in tariff classification at the two-digit level (for apparel, home textiles, and some fibres, fabrics and yarn) or four-digit level (for some fibres, fabrics and yarn) of the Harmonized System, are considered originating goods under RCEP and eligible for preferential tariff treatment.

IV. Our take

From a global perspective, the successful conclusion of RCEP sends a strong signal to the world: A large bloc of Asia-Pacific countries remains committed to free trade, interconnected supply chains and rules-based world order at a time when some other countries have turned to protectionism and unilateral moves.

For China and other Asian countries, the RCEP deal allows them to play a key role in setting rules and standards for regional trade. Currently, both the RCEP and CPTPP – the two mega trade deals in the Asia-pacific region – are without US participation. In the absence of the US from the two trading blocs, Asian countries will have the opportunities to write regional trade rules on their own.

The RCEP will promote intra-Asian integration around the ASEAN and China. With trade flows in intermediate goods between the ASEAN and China expected to increase, the supply chains of the two economies will be more interconnected than ever and the two economies are likely to form an expanded version of the 'world's factory' – a 'China + ASEAN' world's factory. As such, the notion of de-Sinicization of global supply chains will become even more unrealistic and impossible.

For Hong Kong, it can still benefit from the deal even though it is not yet an RCEP member. First, the expected growth in regional trade will create new opportunities for companies in the maritime and trade sectors, given Hong Kong's status as a premier international shipping hub and trading centre. Second, Hong Kong businesses with manufacturing operations in the Chinese Mainland will enjoy preferential access to other markets in the region. Lastly, Hong Kong could join the RCEP to fully reap the benefits of the trade deal and could even strive for assuming the role of the RCEP secretariat. In fact, Hong Kong has already shown its interest in joining the RCEP.

For Hong Kong sourcing businesses, their role as the world's foremost global supply chain orchestrator will surely gain them opportunities. As the regional supply chains in the Asia-Pacific region continue to evolve under the RCEP, Hong Kong sourcing companies can play an important orchestration role in rebalancing and restructuring regional supply chains. In particular, businesses with a strong supplier network and deep relationships with suppliers in the region will be in the best position to fully tap the opportunities arising from increasingly integrated regional supply chains in the Asia-Pacific region.

Fung Business Intelligence

Fung Business Intelligence collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consulting services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

Fung Group

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including trading, logistics, distribution and retail. The Fung Group comprises over 30,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

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