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The Regional Comprehensive Economic Partnership (RCEP): an analysis of its potential benefits for China

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Abstract

Regional Comprehensive Economic Partnership (RCEP) is a mega-regional free trade agreement aimed to remove tariff and non-tariff trade barriers, increase trade facilitation, liberalise investment, and promote global value chains among the member countries. The study aims to know the importance of RCEP regarding trade, foreign direct investment and other economic affairs for China and its potential economic benefits for members. It has provided for a 90% tariff reduction on trade among its 15 members. It can potentially increase trade and FDI inflow to China through the trade and FDI creation effects. Establishing a business-friendly market in the Asia Pacific region and the tariff reduction provisions of this agreement have many advantages for the Chinese economy. Among its members, China is the leading economic power. Therefore, she will get maximum economic benefits as, according to statistical simulations, it will increase her international trade, exports, services, and FDI inflow. The current 2.2% tariff imposed on Chinese exports in the RCEP market will be decreased to 0.4%. The expected economic profit to China from this agreement is 214 billion dollars, equal to 2.2% of its GDP and a 13.4% increase in FDI inflow.

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1. Introduction

The RCEP is new mega-regional FTA signed by 15 Asia Pacific nations on November 15, 2020, which are China, Australia, Japan, Brunei, Laos, Cambodia, Malaysia, Indonesia, New Zealand, Singapore, Myanmar, Thailand, Philippines, Vietnam, and South Korea (Fig. 1). The agreement was signed during the virtual ASEAN Summit hosted by Vietnam. The idea of RCEP was primarily approved by the leaders ASEAN in 2012 and later in the same year the guiding rules and goals for discussing the theme were developed. Ultimately during the 7th Summit on November 20, 2012, they officially launch the RCEP negotiations.

The determined objectives of the RCEP are to facilitate trade among member countries, foreign investment facilitation, technical and economic collaboration, cooperation in intellectual property rights, and settle trade-related disputes. The guiding principles of this agreement are to reduce both tariff and non-tariff barriers and further liberalise international trade based on the member's obligations under the World Trade Organization among member countries. It aims to get a progressive, comprehensive, high-level, and communally useful financial partnership among the member countries. Likewise, it is also aimed to eliminate technical challenges to trade, encourage common understanding among members about one another's values, procedural rules, ensure greater trade regulatory cooperation, reduce transaction costs for businesses, and institutionalize further trade and FDI to establish a mutually advantageous economic partnership among members. These arrangements will hugely increase trade, investment, and other economic-related affairs among member counties.

Figure 1: Map of RCEP Region.

Regional integration is very helpful in strengthening trade, FDI inflow, and other related economic relations among the signatories. Such is also the case of the RCEP. In RCEP some countries like China, South Korea, and Japan are big economies and are producing powers especially China, therefore, they will get more economic benefits from this free trade area. It significantly decreases tariff i.e., 90% and non-tariff trade barriers among the countries which are its member and also facilitates investment. As China is the major producer of services and goods and a big FDI destination among the member countries, therefore, it is important to examine how RCEP is going to increase Chinese trade flows, investment and what are the potential benefits of these trade flows and investment for the economy of China. This study aims to investigate the value of RCEP trade and investment liberalization for China in altering the noted trade and investment relationships by exploring the factors of trade flows and investment among the members of RCEP.

2. Literature review

Though RCEP is a very new development, many studies have been conducted on it. Literature on the RCEP can be broadly divided into two sub-sections: establishment of RCEP and its role in trade and investment liberalization. Mostly the existing literature is related to its establishment, working procedure, and projected economic benefits.

Flach *et al.* (2021) study says that the RCEP makes the biggest free trade area in the world. The contract has a huge capacity to enhance international trade volume among the countries that are its member and also push the enlargement of the value chains in “Factory Asia”. The study further argues that RCEP is supposed to increase trade among members, which will decrease demands from non-member states to the member states due to the trade diversion. Those states that are largely linked with their member countries but not its members their trade volume is affecting negatively with RCEO member countries. Moreover, the study of Lee and Oh (2020) examined the panel data of international trade of ASEAN countries with their 29 main trade allies and found that the RCEP led to four times higher trade than to non-member nations. The studies of Li and Whalley (2017) and Itakura (2014) argues that this FTA will influence over nearly half of the total population of the world and the member countries are composed of 30% of the global economy. Therefore, it has noteworthy financial effects on the countries that are a member of it. Likewise, Ratna and Huang (2016) studied that RCEP is decreasing the costs of trade through the removal of both tariff and non-tariff measures while China is the largest exporting country therefore it is significantly increasing Chinese international trade.

As concerned the impacts of free trade agreement on foreign investment, the study of Adams et al. (2003) founds that removing restrictions from FDI and facilitating its market access are directly accelerating and increasing foreign direct investment. Additionally, free trade agreements are also affecting FDI indirectly through trade effects. Export-platform foreign direct investment gets advantages from the arrangements of trade liberalization, just like indigenous exporters. Additionally, the firms which are investing vertically in a few states, or vertical foreign direct investment, are also benefiting from free trade agreements because of the decreasing trade expenses of the goods transported frequently inside companies. Conversely, improved trade is substituting for horizontal foreign direct investment, made with the goal of searching overseas markets. Such facilities are offering by RCEP; therefore, it will enhance foreign direct investment. Li *et al.* (2017) says that RCEP is most important regional FTA in the Pacific region. The study investigated the effects of this free trade agreement on FDI used an advanced “Computable General Equilibrium” model. The model is based on the principle of firm heterogeneity extended to Foreign Direct Investment. The model is capable to estimate the increase of foreign investment alongside both the intensive and extensive margins.

Liberalisation of investment regime under the Regional Comprehensive Economic Partnership is modelled as affecting Foreign Direct Investment both directly through Foreign Direct Investment liberalisation and indirectly through trade liberalisation. It will promote considerable rises in FDI to China through both these ways. But competition from imports pushes the minimum producing overseas companies; exports growth of companies utilizing foreign direct investment will increase foreign investment. The direct FDI impact from investing liberalisation will encourage foreign direct investment from member countries. In this regard, the expected economic profits to China from RCEP are from 103 to 214 billion dollars or 1.1% to 2.2% of GDP. Ma, Xu, Xeng and Wang (2020) examined the current position of Chinese FDI in ASEAN member countries. Chinese FDI volume in ASEAN member states improving year-on-year to 71.55 billion dollars. Though, the share of Chinese total foreign direct investment was only 5.3% and was decreasing. The study found that FDI of China in the ASEAN was commonly concentrated in fields that had low tax rates and larger potential markets. This RCEP will also improve the volume of Chinese FDI towards the ASEAN countries.

3. Theoretical framework

RCEP has established the biggest trade bloc of the world and paved the way for the deep economic integration of the member countries. This free trade agreement provided vital momentum to increase the member countries solid pledge to pursue free and wide-range trade and expand investment regimes to speed-up financial recovery. Since the endorsement of the RCEP idea in 2012 by ASEAN leaders (Fukunaga, 2013) it attracted the attention of economists. China has more ability among the member countries of RCEP to sell goods and services at a lower price and she is also enjoying a lower opportunity cost than the RCEP other members. Therefore, to know about the economic benefits of RCEP for China this study will be based on the Comparative Advantage Theory of International Trade and Domino Theory of Regionalism. The Comparative Advantage Theory of International Trade is attributed to English political economist David Ricardo. He has described it in his book “On the Principles of Political Economy and Taxation”.

Comparative advantage is an ability in the economic affairs of a state or form to make a particular service or good at a lower opportunity cost than its trading partners. It enables the producing country or company to sell its goods and services at a low rate than the other competitors (Ricardo, 1817). This theory presents “opportunity cost” as an element of analysis for selecting some specific goods and services among different available choices for manufacturing which can be sold at a good price and large amounts in the targeted market. It recommends that states will participate in international trade with each other, trading the items in which they have comparatively more advantages. In the RCEP market, China has a good position to produce more and more goods at a lower price thus it will defiantly increase Chinese exports to the member countries. Likewise, RCEP is also facilitating FDI while China is a good destination of investment due to her good manufacturing capabilities and cheap labour than many other member countries, large market, and investment friendly policies.

Likewise, the Domino Theory of Regionalism also helps us to understand the rationale behind the establishment of RCEP and its potential benefits for the member countries (Rieder, 2006). This theory argues that exports to regional block are a very healthy activity for the strengthening of international trade and overall financial development of the nation. It is also working as a strong force of pro-membership of regional free trade agreements like RCEP. In the last two decades, regionalism in trade and economic affairs spread like wildfire. This theory also helps to answer the question, why are states keen to liberalise trade and economic relations regionally but hesitant to do so multilaterally? The reason is that multilateralism is very difficult to handle in today’s trade problems and complexity.

4. Research methodology

RCEP is a free trade agreement, has huge economic benefits for the member countries’ economies. To know about its impacts on the Chinese economy this investigative study has been developed. It is both qualitative and quantitative study in nature conducted through explorative, descriptive and analytical approaches. Inductive technique is also adopted in the analysis of the financial impact of RCEP on the economy of China. A thorough assessment of existing literature has been done through the Content Analysis Technique. This CAT method is extensively using in social sciences (Khayyam, Shah & Tahir, 2018). Since the 19th century, it is using in study of secondary data (Harwood & Garry, 2003). The facts, figures and data to explore the economic benefits of RCEP for China are collected from published articles, reports of different organizations like Asian Development Bank and other documents about the economy of China.

5. Economic potentials of RCEP member countries

The RCEP member states account for around 30% (2.2 billion people) of the total world’s population, 30% (26.2 trillion dollars) of total global Gross Domestic Products, and 25% (12.7 trillion dollars) of international trade as of 2020 statistics (ADB Briefs, 2020), which is making it the biggest trade union in world history (Table 1).It is also first free trade agreement that covers at the same time China, Korea, and Japan. Pertinent to mention here that RCEP is also the first agreement which involves two of the world's three biggest economic powers.

Table 1: Economic and Trade Statistics of RCEP Member Countries (in billion dollars)

Country	GDP	Total Trade
Australia	1450.50	492.57
Brunei	14.01	12.14
Cambodia	20.92	35.42
China	14342.90	4577.84
Indonesia	1204.48	338.96
Japan	6210.70	1426.52
Laos	13.20	12.02
Malaysia	398.95	443.19
Myanmar	86.93	36.72
New Zealand	191.73	81.88
Philippines	360.86	183.84
Singapore	335.54	750.03
Vietnam	200.86	518.18
South Korea	1482.76	1045.58
Thailand	452.67	482.53

Source: European Parliament. (2021, February). Short overview of the RCEP. Policy Department for External Relations Directorate General for External Policies of the Union.

This RCEP had unified the existed bilateral free trade agreements among the ASEAN member countries and its 5main trade partners (Das, 2020). It is leading to regionalism and broader regional integration from an economic perspective. Therefore, it is very beneficial for all member communities in term of boosting their international trade, exports, imports, and foreign direct investments outflow and inflow. In this age of globalization economic cooperation among willing nations is significant for their development as well as overall welfare. Its three members China, Japan, and South Korea are the 3 among the 4 biggest Asian economies. Several statistical analysts forecasted that it would provide notable economic advantages to members, as well as "pull the economic center of gravity back towards Asia, with China poised to take the lead in writing trade rules for the region", leaving the US behind in the management of financial affairs of the region. It also reduces trade costs which can defiantly incentivize companies and countries to exports to member countries. Considerable increase in trade flows from \$428 billion to \$445 billion depend on the trade situation, are expected for the region of RCEP (Petri & Plummer, 2020; Plummer at al. 2010).

5.1. RCEP role in customs procedures, trade facilitation, and investment

The main benefits of the RCEP for the member countries are the trade easing, removal of non-tariff and tariff barriers of trade as well as services sectors, further trade liberalisation, facilitation of investment, and improving the overall business phenomenon in the region through guidelines connecting to intellectual property rights safety, governments procurement practices, e-commerce and many other. According to the simulations of Petri and Plummer

(2020) study, this new trade bloc is expected to contribute to the growth of Gross Domestic Product of members by 0.4% (187 billion dollars) real income by 2030 on a permanent base annually (Table 2).

Table 2: RCEP Real Income Effects, 2030

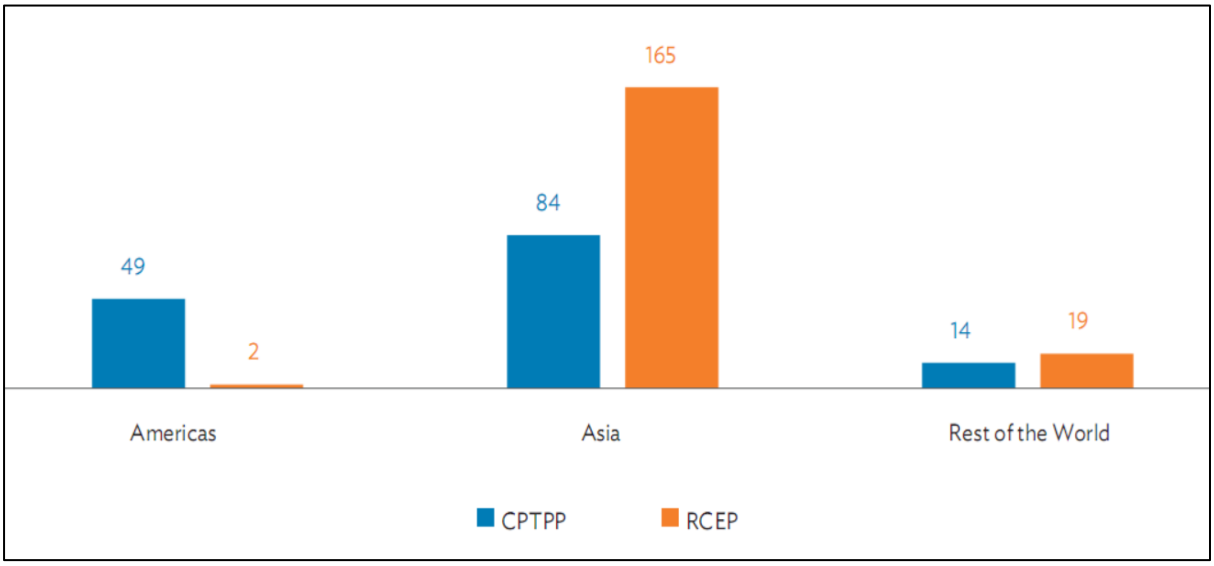
Economy	Income ($ billion, 2030)	Incremental Change ($billion)	Incremental Percentage Change (% of GDP)
RCEP members total	43,516	187	0.4
Australia	2,590	1	0.0
Brunei	31	0	0.5
China	27,839	85	0.3
Indonesia	2,192	3	0.1
Japan	4,924	48	1.0
South Korea	2,243	23	1.0
Malaysia	675	4	0.6
New Zealand	264	1	0.2
Philippines	680	2	0.3
Singapore	485	0	0.0
Thailand	812	4	0.5
Vietnam	497	3	0.5

Source: Petri and Plummer (2020, June).

It also reduces trade costs which will defiantly incentivize companies and countries to increase their export to member countries. It will also create competition among the exporters where the already leading in exports will further increase its exports many folds. The contract also incorporates technical collaboration and capacity building to help strengthen the economic relations of the members. This agreement is also allowing huge flexibility (e.g., in implementation timeline) and contains specific requirements for disparity treatment, particularly for Laos, Cambodia, Vietnam, and Myanmar. This confirms that the economies of member nations at different degrees of economic growth, different sizes, and the wider variety of stakeholders have the prospects to increase the advantages from executing their obligations. It also provides for common guidelines of origin for all trading goods. It means that the products that meet the RCEP standards are subject to similar regulations in all fifteen members.

The RCEP's common regulations of origin might promote modern manufacturing procedures and trade logistics agreements. According to the statistical simulation of Ferrantino et al. (2019) this will significantly improve the exports flow of member states to the market of RCEP by $616 billion compared to the baseline in 2030. Exports of goods directed to its signatory countries would rise of all items compared to baseline conditions, with the utmost increases in beverages, food, tobacco by 26.6 percent, textile products by 25.8 percent, transport equipment by 15.4 percent, leather by 13.6 percent, metals by 12%, transportation services by 16.6 percent, and rubber, chemical, plastic products by 11.4 percent. This is a very notable increase in these widely used products of daily life; therefore, it will positively influence the market, industries, and the economies of member states.

Figure 2: Potential Benefits of RCEP-Real Income Increases in 2030 Compared with CPTPP ($ billion)



Source: Petri and Plummer (2020, June).

5.2. Prospects of RCEP for China

RCEP is providing for 90% tariff reduction on imports among its member countries within the 20 years of its execution. As China is the leading international exporter among the member states, therefore, it is going to help China more than the other countries to increase its exports and investment. Trade weighted average tariffs imposed in Regional Comprehensive Economic Partnership markets by China will be decreased from 2.2percent to 0.4percent, while Chinese trade-weighted average tariffs imposed on Regional Comprehensive Economic Partnership member's countries will be decreased from 2.7 percent to 0.5percent. On a broader level, China, Japan, and South Korea will earn the maximum economic benefits from these arrangements (Ferrantino et al., 2019). The highest terrified sectors in China from Regional Comprehensive Economic Partnership are included, transportation equipment 11.3 percent, agriculture 7.5 percent, and textile 4.5 percent. These high taxes caused notable constraints on the other members of the RCEP region that have huge trade sizes with the China (Ferrantino et al., 2019). China under RCEP will reduce tariffs on transport equipment, agriculture, and textile. It will increase its trade and exports in these protected sectors significantly. The common regulation of origin is helping facilitation of supply chains and reducing export expenses. It also creates competition among the exporters where China is leading already therefore will further increase Chinese exports.

The international trade of several goods will increase many folds with the implementation of RCEP regulations. Because of the increased access to huge Regional Comprehensive Economic Partnership markets the big export increase will be happening in the food and beverages sector about 23.4%, driven by growths in China, South Korea, Australia, Indonesia, and Malaysia; textiles export will be increase by 6.7%, driven by in China and Japan; mineral and other related natural resources export will be increase by 6.2%, driven by in China and

Japan; metals export will be increase by 5.8%, driven by China and Australia; rubber, chemical, plastic products export will be increase by 5.5% driven by China, Japan, and Malaysia. Apart from these, the growth in the exports of different types of machinery and other related equipment export will be increase by 4% which will be mainly taken by China.

Likewise, the RCEP will significantly boost the growth of regional trade and transport services which are expected to boost up in total by 235 billion dollars as to the baseline in 2030, mainly of China and Japan. Combinedly, the share of member countries total trade in the RCEP market will increase from 45.4% to 48.3% (Ferrantino et al., 2019). The economic significance of FTA markets as a place for the member countries exports is increasing both at a combined level as well as country level because the traders of member states get more benefit in markets of member nations as compared to doing business in the markets of non-member nations. Likewise, exports of goods from the non-member countries also become comparatively less competitive. Another very important provision of the RCEP is the "establishment of competitive Market" which will boost the Chinese companies' productions, its exports, and investment in the member countries as the Chinese companies and business forms are already more competent than the other member countries. The establishment of competitive and open markets which encourage financial productivity and sustain customer wellbeing will also give many opportunities to China. To attain this objective, the contract contains requirements to implement or retain competition rules and impartial competition authority to implement antimonopoly trade and business rules. Such arrangements will also help China much more in the economic development.

Foreign investment is playing a very significant role in the financial growth of any country because it not only provides tax to the country but also brings capital, latest technologies, infrastructure development provides jobs to local labours. The creation of a big free-trade region in the shape of RCEP enhanced the attractiveness of the member states to foreign direct investment. As this agreement is creating a free trade region, it is also facilitating foreign direct investment (Neary, 2002). Liberalisation of investment regime under RCEP is modelled as influencing foreign direct investment both directly and indirectly, directly through foreign direct investment liberalisation and indirectly through trade liberalisation. It will promote considerable rises of foreign direct investment in Chinese market through both these means. But competition from imports pushes the minimum productive overseas firms, exports growth of companies utilizing foreign direct investment will lead to increased inflow to China. The direct foreign investment impact from investing liberalisation will encourage foreign direct investment from member countries to China. But this free trade agreement has positive impacts on FDI is less understood. It is regulating the facilitation procedures for FDI.

The ending of restrictions and removing hurdles in foreign investment and easy access to the market are meant to directly accelerate FDI. Moreover, the RCEP also influence positively FDI indirectly via trade facilitation. FDI is benefiting from trade liberalisation measures (Motta & Norman, 1996). Moreover, the companies that investing in many states to carry out various manufacturing duties are also benefiting from free trade agreements like RCEP due to the decrease in the trade expenses (Li & Whalley, 2017; Yeyati et al., 2002) which will also help Chinese companies. China is one of the largest foreign direct investment destinations among the member countries and the facilitation of FDI further through the policies of RCEP will significantly increase FDI both inward and outward. At present, China's direct investment only in ASEAN countries is 71.554 billion dollars (Ma et al., 2020). RCEP is not only increasing the outward FDI of China but inward FDI to China also. Thus, the RCEP will attract considerable FDI to China too, and thus will considerably enhance China's financial welfare. In a standard model of RCEP export trade liberalisation and due to other investment-friendly provisions FDI will increase to China up to 5.86 billion dollars. In this regard, the expected economic profits to China from RCEP are 214 billion dollars or 2.2% of GDP. In the worst-case scenario, FDI will increase 3.7% and the best-case scenario 13.4% (Li et al., 2017).

Foreign direct investment is an important component contributing to the economic development of the host nation. Trade liberalisation affects the performance of companies through adjustments in production thresholds. Decreases in tariff and non-tariff obstacles are facilitating trade and productions. Trade improvement has a good market growth impact on foreign direct investment by promoting the market seeking FDI. The RCEP will decrease the production threshold for exporters by decreasing trade price, and stable trade expenses, thus improving the quantity of exports. This is a big effect of trade liberalisation. Likewise, the RCEP decreases constraints on investment for MNCs from allies; the fixed trading expenditures of overseas companies will reduce, causing decrease in the production threshold for overseas companies. It will motivate further overseas companies to do investment in the FTA area. The adjustments in the production threshold because of the establishment of the RCEP show three impacts of an FTA on FDI. First, the direct FDI encourage impact as the decrease of investment constraints directly decreases the production threshold for overseas companies which are assisting new investments. The second is the negative trade substitution effect. Improved imports boost up the production threshold for companies delivering the local market, taking out the low production overseas companies. Third, the trade growth alongside the wide edge can cause boosts in export-platform DFI or market-seeking foreign investment, which shows the market growth effect of the RCEP (Li *et al.*, 2016).

The resulted in FDI increase due to RCEP in China another benefit is that overseas companies splitting incomes between the host and home households while national companies' handover all income to the local people. The splitting of revenues for overseas companies is based on a supposition that overseas companies allocate a share of business equity to its labour who are residents of the host country, and thus, the portion of the overseas companies' earnings are distributed among the people of the host country. Companies in China have been enhanced international competitiveness result of market and trade liberalisation. Trade liberalisation among RCEP members will help the exports of overseas companies. Therefore, the trade liberalisation will also help the exports of overseas companies. Export increase links with manufacture increase and enhanced need for overseas investment. The foreign direct investment boost because of export growth indicates the optimistic market growth effect of RCEP on foreign direct investment. Regional Comprehensive Economic Partnership will manage to decrease manufacturing expenses. It will further increase manufacture fragmentation among members, which will lead to further vertical foreign direct investment. Moreover, services sectors liberalisation will also influence foreign direct investment through the market growth effects, or the trade effects. The growing quantity of foreign direct investment always benefits the host state also through technologies overflow and many other direct and indirect ways and means.

The RCEP has multilateral integration prospects for member countries potentially offers larger benefits for its members as compared to bilateral engagement and also offer them effective common geopolitical opportunities. Significant financial profits of this multilateral FTA for Asian Pacific states comprise more comprehensive and integrative trade guidelines to smooth their international trade in the region; revenue and production creation; output and welfare advantages, as well spill-over impacts from decreases in non-tariff barriers and monitoring coordination. Overall, as a concern the economic benefits of the RCEP, China will receive the maximum benefits from the trade creations effects and trade liberalisation. The elimination of trade barriers has considerable financial benefits for all members' countries and China in particular. Another benefit is that the producing member countries of the RCEP like China are supposed to see a boost in the high-tech technologies productions and concentrate on service sector.

According to Zhou (2021), statistical simulation result generated applying the standard GTAP model the real GDP of the People's Republic of China will boost 0.138% and her welfare will be enhanced significantly, boosted by 23.5 billion dollars. This FTA has a positive role in the promotion of the agricultural goods exports and labour-intensive manufacturing industries because tariffs decrease on the food and agricultural products are to some extent greater. This agreement will also have a larger effect on the economy of the coastal regions of China. Another most important thing is that the gaining from RCEP could make lesser the losses of Beijing from its trade war with the United States. If trade war continues, the advantages of this agreement are probably to be greater because of a tough focus of Beijing on the market of Asian. It is leading to well-organized supply chains in the region. The US two close allies in Asia which are Japan and South Korea have already joined this. Therefore, the US new President Biden said after the election that we need to align with democracies in the region to establish new trade partners in the region. The US has the world's 25% share in international trade, therefore, does not want to decrease its share in international trade.

6. Conclusion

Free trade agreements like RCEP with a larger membership and large size of economies are likely to generate greater cumulative financial benefits in terms of boosted trade relations, exports, productions, FDI, services, welfare, and GDP growth. It has wider membership, and many leading economies of the world are its member. Mostly among the members that state whose production capabilities are comparatively higher; get more aggregate economic benefits from the free trade market. This agreement is going to enlarge notably Chinese trade, productions, FDI inflow, and GDP growth because she is in a better position to take benefits from the removing of 90% tariff and non-tariff barriers than other members in terms of trade capacity, production capabilities, and FDI friendly environment.

In the recent past, China emerges as the world's largest economy and trading power but at the same time, it is also facing a lot of problems especially from its Western competitors led by the US. Therefore, China must have better alternative options. The RECP is providing this alternative option to China in trade and investment regimes. The RCEP market account for 30% i.e., 26.2 trillion dollars of global GDP and 25% i.e., 12.7 trillion dollars of global trade. It is the biggest FTA in the history of the world, larger than the European Union, CPTPP, MERCOSUR, and the United States-Mexico-Canada Free Trade Agreement. Another important point of RCEP is that it is the first FTA brought together China, Japan, and South Korea, the leading economies of the world. Therefore, it has huge economic importance internationally. It is further integrating the member countries in terms of economic partnerships. The agreement is going to change the global dimensions of international trade and facilitation of Chinese trade.

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