GLOBAL MARKETS FORUM

Join the conversation exclusively on Refinitiv Messenger

@ReutersGMF #RefinitivMessenger

Q&A-Don't expect immediate flow of goods, services, capital under RCEP; ASEAN to gain, U.S., India losers: Aidan Yao, AXA Investment Managers

The trade and investment deals under the Regional Cooperation Economic Partnership (RCEP) won't result in an immediate flow of goods, services and capital between member countries, but will lead to the formation of supply chains within the Asia-Pacific region and have significant long-term geopolitical ramifications for the United States and India, **Aidan Yao, Senior Emerging Asia Economist at AXA Investment Managers,** told the Reuters Global Markets Forum on Tuesday, February 2.

"As the originator of the deal, ASEAN could gain more of a voice on the global stage for piecing together the world's largest free trade bloc and become a pivotal force in Asia Pacific, where the U.S. and China compete for influence," Yao said.

Vietnam, Indonesia, and Malaysia would likely benefit the most in the region, he added.

Following are edited excerpts from the conversation:

Q: How do you see the dynamics of global trade changing with the RCEP deal, Belt and Road Initiative (BRI), and all the bilateral agreements that have come into effect post-Trump's presidency?

A: These new trade/investment deals won't have much immediate impact on the flow of goods, services and capital. In the case of the RCEP, the deal needs to be ratified by its members, the transition towards zero-tariffs can take up to 20 years in some industries, and most importantly, most RCEP members -- apart from China and Japan, and Japan and Korea -- already have bilateral free trade agreements between them. Our research suggests that deal may add only 0.3 ppt to region's GDP in 2030. Hence, the immediate incremental gain from trade is less than meets the eye. The more significant ramifications in fact lie in future supply-chain formation in the region and some geopolitical implications, both of which are long term in nature.

Q: What sort of impact do you see on supply chains? And which countries do you see deriving the most benefit?

A: The most significant change of RCEP is that it helps to harmonize the rules of origin, which means members will no longer have to follow multiple regulations, cost classifications and documentation/reporting standards under different FTAs (free trade agreements) when trading within the region. Under RCEP, there is only one standard to follow. Practically, this also means that so long as inputs of a products are imported from RCEP members, the product will automatically be qualified for tariff waiver. But if you have a product made in China but has 60% components sourced by non-RCEP countries, say the U.S., that product may not enjoy the preferential treatment. So, RCEP will encourage businesses to build supply chain network within the region.

In terms of winners, our analysis shows Vietnam, Indonesia, Malaysia rank highly on our economic competitive index, which measures labour costs, economic openness, infrastructure quality, ease to do business, etc. Indeed, Vietnam has been a clear winner in gaining low-margin supply-chains migrating out of China in recent years and the country remains a top investment destination in recent business surveys. Not surprisingly, therefore, Vietnam's equity market has been a star performer in Asia and wider EM (emerging markets) over past few years.

Q: What are going to be the geopolitical consequences of RCEP, especially for China?

A: The geopolitical significance should not be downplayed. If we look at various stakeholders. As the originator of the deal, ASEAN could gain more of a voice on the global stage for piecing together the world's largest free trade bloc and become a pivotal force in Asia Pacific where the U.S. and China compete for influence.

China will get to use RCEP and the recently signed Sino-EU investment agreement to demonstrate its continued intention to reform and opening up, against fears that some of its development initiatives – tech sufficiency, for example – may carry a sense of isolationism. Also, by securing its economic ties with its neighbour countries, RCEP can also manage the costs of U.S.-China geopolitical conflicts.

The two losers. The U.S. could suffer a waning of influence in Asia together with its reduced economic connections. And India may also lose, economically and politically, for not being on the RCEP train.

Q: How big could the impact on India be?

A: The number is harder to quantify, but the direction is clear to me. All else being equal, India will lose out from withdrawing from RCEP. The economic costs are obvious as its exports will not receive the same preferential treatment as others, and the Indian government missed an opportunity to channel external forces to propel domestic reforms. Without the economic membership, India could also be marginalized from other regional cooperation going forward. The good news is that the door is not shut for India to join RCEP in the future. I think RCEP will be stronger and more sustainable if it has India in the club. In that regard, existing members should be pleased if India eventually sign in. But challenge lies with India itself, particularly whether it sees opening as more conducive for development than protecting domestic industries behind a closed door.

Q: What factors could shift the balance for India to join the fold at some point?

A: I think the economic costs will be important. As these costs become evident, there will be natural pressure from the business community to force the government to reconsider its position. Also, again, geopolitics is important. The current tense relation between India and China is not helping as RCEP is seen as China's way to dominate regional trade. A calming of bilateral relationship will go a long way to bring India to the club.

Q: Circling back to you earlier answer, if supply chains are developed within the region, as you predict, where does that leave China and the U.S.?

A: For China, I think the way to adapt is to move up the value chain. Low margin business can migrate out as costs of production are rising. But to stay competitive, China needs to upgrade its manufacturing sector, production process, technology and innovation. These are the things engrained in Beijing's dual circulation and 14th FYP (five-year plan).

The U.S. will likely see a waning of its economic influence if RCEP members trade/invest among themselves. And reduced economic connections can lead to lower political linkage as well. Hence, I think the geopolitical ramifications of the RCEP cannot be underestimated.

Q: So, that would mean more investments?

A: Indeed, more investment. I'm doing some research on how China is fighting climate change to achieve carbon neutrality by 2060. The investment needs for renewable energy, clean infrastructure supporting EV (electric vehicles) and carbon capture could be over RMB 100 trillion in the coming decades. And that's only one item in the dual circulation.

Q: Do you see a huge uptrend in infrastructure development across member countries? If so, which countries would get the maximum interest or investments in physical infrastructure?

A: For RCEP, it’s too early to tell. In the near term, global investment is being held back by the virus, but even without the pandemic, given RCEP modest immediate impact, I don’t think it would be a major driver of infra build-up anyway. Longer-term, the supply chain reconfiguration will prompt investment to countries that gain from the production relocation. So, countries like Vietnam could gain disproportionally from that.

Q: What are the chances that the expectations of success from RCEP may be overblown and depends largely on China? Countries have faced Chinese wrath previously. Ex - South Korea post THAAD deployment or Australia post PM Scott calling for an independent inquiry into origins of COVID-19? Would bilateral agreements actually hold in such cases?

A: Good question. I think it’s unfortunate that many economic issues in recent years were being politicised. But I guess that's a reflection of the world we are living in today. I think the question hits on a very important shortcoming of RCEP, which is its dispute settlement mechanism, which isn't particularly strong based on what's proposed. So, if the dispute settlement mechanism doesn't have teeth, then you are right, it will limit the ability of members to resolve issues. I think that's something RCEP members have to work on when disputes arise in a trial and error process -- crossing the rival by touching the stones, so to speak.

Q: Does the signing of trade agreements such as the RCEP, the CAI (Comprehensive Agreement on Investment) with Europe, etc. put more pressure on the Biden administration to join the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership)? If so, what in the existing agreement would President Joe Biden want to renegotiate?

A: It's entirely possible that Biden may restart the process to join CPTPP – a project it started and supported. The bar for joining the trade pact is much lower than, say, reforming the WTO (World Trade Organisation), which is institutionally rigid and procedurally clumsy as major decisions need to be agreed by all members. In that regard, I think the U.S. can become less protectionist and pursue greater integration with certain countries via deals like USMCA (United States-Mexico-Canada Agreement) and CPTPP. But in today's world, it can no longer single-handedly rewrite the economic rules of the world. Doing so will require having China and EU onboard, which is a challenge by itself.

While Biden is more pro-multilateralism, there is a consensus that the multilateral institutions of the world -- like the WTO -- need significant reforms, which will be challenged by "how to do it" and "when to do it." Biden has not put forward a plan on the "how" part and the time it takes to reform these institutions could outlive Biden's presidency. So, to me, Biden can help to defuse the bomb on the tariff war, but he is no game changer for global trade.