

Economics of RCEP for Indonesia

By

Michael G. Plummer,

*The Johns Hopkins University, SAIS-Bolgona
and East-West Center*

***Presentation to Conference, «Trade
Outlook, TPP, RCEP and Other Trade
Policies,» Jakarta, 30 January, 2013***

Things are Looking Up....

- Indonesia has been a top performing country globally since the Great Recession, and continues to grow at a solid pace despite eurozone crisis, uncertainties elsewhere in OECD, and downshift of Chinese economy. ADB, Oct 2012: 6.5% in 2011; 6.3% in 2012; 6.5% in 2013. We heard IMF estimates this morning.
- To no small degree this success has been accomplished by maintaining a generally outward-oriented but balanced approach to development, taking advantage of the international marketplace but without an exaggerated focus on net exports (delighted to hear the focus on imports by Amb. Marciel and Minister Gita this morning).

...Still, Plenty of Policy Challenges, Trade Policy Included

- Nevertheless, as we've also heard this morning Indonesia continues to face many medium- and long-term policy challenges for which it should be preparing.
- This conference deals with one of these policy challenges: trade policy.
- We should, of course, remember that trade policy isn't applied in a vacuum and requires complementary policies be in place in order for them to work, from investments in education to infrastructure. Minister Gita mentioned these.
- We also need to keep in mind that trade policy often gets a «bad rap» in the media and public policy circles in Indonesia; trade contributes to productivity, growth and development by effecting structural change, which creates winners and losers.
- Hence, complimentary policies also require compensation for equity, efficiency, and political economy reasons.

The RCEP

- I have been asked to talk about benefit-cost analysis of the ASEAN RCEP for Indonesia.
- Peter has already discussed the quantitative results from our model, which shows gains to Indonesia from RCEP of \$18 billion, and \$62 billion from the TPP-16.
- The difference is due to a number of factors, including the deeper template in the TPP and greater access to markets with which Indonesia does not have an FTA.
- But it is important to stress that Indonesia does not have to choose one or the other; it can do both, as four of its ASEAN colleagues are already doing.

Stakes for Indonesia

- In my remarks, I would like to draw attention to some salient issues related to Indonesia's participation in the RCEP.
- I will try not to repeat what others have already contributed!
- Hard to do, as so much has been covered in such little time.

Potential Benefits of RCEP

- Gains from RCEP will critically depend on what the agreement looks like.
- Note that a condition to join is for there already to be an ASEAN+1 FTA to be in place.
- Hence, the benefits will be a function of value added, and as I discuss later, «flexibility» could impose important limits on potential gains.
- In our model, we get significant gains from cumulation, due to drop in costs associated with the rules of origin and increased utilization rates.
- Motivation for the «new regionalism»; makes great sense if goal of regionalism is to profit from regional production networks (bilaterals won't cut it).

Income effects...but preference erosion

- Another potential effect will derive from the non-existing FTAs in RCEP, especially across Northeast Asia.
- This will create growth spillovers but also could imply that there will be preference erosion for Indonesia in these markets.
- Assuming it continues in the process, India would also gain from additional access to the «+3» and given relative factor endowments, this could be disadvantageous to Indonesia.

Potential Risks of RCEP

- This leads us to a discussion of some of the risks.
- The idea of «flexibility» in RCEP seems to be used frequently, in part to distinguish it from the TPP, which is «rigid».
- I wonder if, after almost four decades of ASEAN economic cooperation, the private sector might equate «flexibility» with «shallowness».
- If RCEP is merely a political expression, then flexibility via large exclusion lists and limited coverage may help facilitate a quick deal.
- But RCEP isn't intended as a political deal; rather it is an expression of ASEAN Centrality in the realm of *economics*.
- Certainly, Indonesia is interested in a solid accord.

Potential Problems of «Flexibility»

- By including areas such as cumulation of rules of origin, trade-facilitation-related areas, and topics that are not «sensitive» could yield positive results.
- But large exclusions lists (e.g., ASEAN-India only covers about 70% of goods and no services) could be engineered to maximize trade and investment diversion. This would be particularly costly in the era of globalization.
- The private sector is looking for much more. A «flexible» RCEP may have little effect on promoting value chains, which in turn could produce disappointing effects for ASEAN in general....

Indonesia and Value Chains

- ...and for Indonesia in particular.
- Indonesia could gain a great deal out of plugging more fully into regional production chains.
- These production chains, in turn, can enhance employment, efficiency, and the process of upgrading, which is a key goal of the gov't.

Regionalism and Value Chains

- We can infer some of these changes from our model but direct estimates of the impact of regionalism on production chains tend to be limited and anecdotal.
- However, recently-released TiVA data would suggest that Indonesia lags behind its Asian BRIICS counterparts in participating in these value chains.
- For example, foreign value added share of Indo exports was only half that in China (15% versus 29%) and even 50% less than India (23%).
- In electrical mach (most important for ASEAN value chains), 27% compared to 38% in China (no sectoral data for India).

The RCEP Template: Stakes for ASEAN Centrality

- Importantly, there is a threat to ASEAN Centrality if RCEP isn't sufficiently «deep».
- In the «contest for templates», a shallow (excuse me, ***flexible***) RCEP will lose in devising the FTAAP template, which after all is the big payoff.

Concluding Remarks

- The «new regionalism» potentially holds great advantages to Indonesia.
- Indonesia would gain more from the TPP than RCEP (under current assumptions) due to a «deeper» template, but of course more difficult to implement politically.
- Also important to note that «TPP» versus «RCEP» is a false choice.
- ASEAN and Indonesia are already committed to RCEP.
- It will take strong leadership to make sure that «flexibility» generates positive results.
- A shallow agreement could have positive political benefits but ambiguous economic effects; besides, opportunity costs would be high.
- Recall the problems of the Bogor Vision!

RCEP, Indonesia and ASEAN Centrality

- RCEP is a test of ASEAN Centrality, which is actually a goal noted in the AEC Blueprint.
- In addition to its leadership role in the region, ASEAN needs to better leverage its unity.
- Indonesia constitutes 40% of ASEAN GDP; it needs to be the key leader in this process. Not easy, for the reasons Minister Gita said. But it's necessary.
- Indonesia and the region will gain in terms of economics if the accord is sufficiently deep.

Final Remarks: Think Globally

- As a final point, the new regionalism needs to be nested in multilateralism.
- Doha is at an impasse; but much can be done without the single undertaking. Minister Gita mentioned Trade Facilitation but other accords on the table.
- We'll see what comes out of Bali in December. But what's important is to ensure that the new regionalism is complementary to multilateralism.
- I believe it is (given incentives and policy orientations) but other scenarios are possible.
- And ideally the new regionalism will be a protagonist to re-invigorate Doha!