

## **Are RCEP and TPP Effective?**

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### **Abstract**

*Whether or not the Regional Comprehensive Economic Partnership (RCEP) and Trans-Pacific Partnership (TPP) would promote international trade is under dispute. This article uses a revised traditional gravity model to perform empirical examination of this problem and finds that RCEP, TPP, FTA/EPA, and WTO would drive and have promoted international trade empirically. However, the role of RCEP has been decreasing or not so large recently. On the other hand, the role of the TPP seems to be increasing. The distinction in the roles of the TPP and the RCEP are important to increase international trade and to obtain sound economic growth and there will be conflict between them. Also, the increase is larger in developed countries than in developing ones. Moreover, real GDP, along with the trade agreements and shorter distances are related to increases in international trade. On the other hand, the effect of distance on international trade has been decreasing. Improvements in IT may have influenced this trend.*

**Keywords:** EPA, FTA, gravity model, International trade, IT, RCEP, TPP, WTO

### **1. Introduction**

RCEP negotiations began by leaders from ASEAN in 2012. RCEP is an ASEAN-oriented proposal for a regional free trade area, which would initially include the ten ASEAN member countries and those countries which have existing FTAs with ASEAN: Australia, China, India, Japan, Republic of Korea, and New Zealand. RCEP will build on and expand Australia's existing FTA with ASEAN and New Zealand, AANZFTA. The objective of starting RCEP negotiations is to realize a modern, comprehensive, high-quality, and mutually beneficial economic partnership agreement that will cover trade in goods, trade in services, investment, economic, and technical cooperation, intellectual property, competition, electronic commerce, dispute settlement, and other issues. There are not so many studies examining RCEP as it has not started and it has only been discussed recently. Davidson (2015) found that possibilities for trade expansion between China and Malaysia are marginally lower under the RCEP structure compared with ASEAN. Kawasaki (2015) showed that the income gains of Asia-Pacific Economic Cooperation (APEC) economies is 1.2% of regional GDP by the TPP, 2.1% by the RCEP, and 4.3% by the Free Trade Area of the Asia-Pacific (FTAAP). Basu, Sen, & Srivastava (2016) showed that the possible success of the RCEP negotiation would depend on the extent to which countries of this partnership agreements are able to obtain a consensus on large tariff elimination, a common market access, comprehensive coverage of WTO + issues, and behind-the-border integration measures. Das, Rishi, & Dubey (2016) found that RCEP promotes intra-industry type trade flows in the region and helps to sustain trade flows. On the other hand, the TPP, which includes Canada, Mexico, Japan, Australia, New Zealand, Chile, Peru, Malaysia, Singapore, Vietnam, and Brunei would have dramatically reduced tariffs for international trade among these countries. Market obstacles of promoting trade and investment would be almost eliminated if the agreements are realized. 12 countries agreed to realize the Trans-Pacific Partnership (TPP) under former President Obama through severe discussion. U.S. Congress had not yet approved the TPP, and the deal had not yet been taken into effect, but the possibility of the realization including the United States became quite low. President Trump fulfilled a presidential campaign promise. It should also be noted that TPP excludes China and RCEP now excludes the United States.

Whether or not the rest of the 11 countries continue to try to ratify in each country's congress cannot be judged easily because of the withdrawal of the United States. Some countries accept severe conditions, namely, opening their economies, in exchange for the expectation of promoting exportation to the United States. There may be some possibilities that these countries would not be so active in achieving the TPP without the United States. Rahman & Ara (2015) found that South Asian countries excluded from the TPP could face a tremendous negative impact on their economies. Cerdeiro (2016) showed that Asian TPP member countries are expected to benefit most from the agreement. Cheong & Takayama (2016) showed that TPP member countries gain profits from TPP tariff reductions. On the other hand, there has been a worldwide recognized organization that promotes free trade called the WTO, but it should be noted that it is not an agreement. The WTO provides a forum for the negotiation of agreements with the goal of reducing obstacles in markets to international trade and ensuring a level playing field for all, thus contributing to economic growth and development. This organization provides a legal and institutional framework for the implementation and monitoring of these agreements and for the settlement of disputes that arise from their interpretation. The WTO was born out of negotiations, and everything it does is the result of negotiations. WTO is an organization, and the bulk of the WTO's current work comes from the 1986–94 negotiations called the Uruguay Round and earlier negotiations under the General Agreement on Tariffs and Trade (GATT). The WTO is currently host to new negotiations under the Doha Development Agenda launched in 2001 (WTO's HP). There are a lot of studies that have shown the GATT/WTO have played important roles in the promotion of international trade. Most studies in general evaluate the roles highly, however, whether or not the effects of the WTO on international trade are positive remains disputed in academic fields. Tomz, Goldstein, & Rivers (2007) used Rose's (2007) data to find positive WTO roles. Liu (2009) also found that the GATT/WTO has been effective in driving international trade. However, Rose (2007), which has been cited often, drew data from 175 countries over 50 years and found little evidence of the WTO's role in promoting its members' international trade.

Disputes continue about the role of the GATT/WTO, especially for the field between developed countries and developing countries. Subramanian & Wei (2007) found WTO international trade effects only for developing economies. Eicher & Henn (2011) showed that the WTO increases international trade among developing countries at the expense of distance. Lee (2011a) & Tesón (2012) showed that protectionism in developing countries can cause economic stagnation. Kohl (2014) showed the importance of accounting for institutional heterogeneity of countries to mixed results on the GATT/WTO's effects. Gil-Pareja, Llorca-Vivero, & Martinez-Serrano (2016) showed that GATT/WTO effects operate through both trade margins but mainly through the intensive margin. Christopher (2011) showed that economic freedom does not have the expected impact on international trade. Frickel, Kotcherlakota, Tekorang, & Elder (2011) indicated that the North American Free Trade Agreement (NAFTA) promotes exports in the region. Lee (2011b) indicated that the proliferation of RTA in recent years does not drive the future of the multinational trading system because of the exclusive trade preference of RTAs and promotes discriminatory international trade practices that dampen trade.

Other studies (e.g., Coulibaly 2009; Korinek & Melatos, 2009; Kurihara, 2011; Park, 2009; Vamvakidis, 1999; Varzary, 2011; Xuepeng, 2010) also analyzed the effect of RTAs on international trade. Moreover, there is some possibility that the introduction of a common currency has influenced international trade. Kurihara (2003) showed that the introduction of the U.S. dollar as the domestic currency would be beneficial to APEC countries. Glick & Rose (2016) showed that evidence exists to support both RTAs and currency unions (CU), which cause international trade at the extensive margin. Hayakawa, Ito, & Kimura (2016) showed that there are positive effects on international trade owing to tariff reduction while the effects of non-tariff barrier (NTB) are not strong. Kutuk & Akbostanci (2016) found that the FTAs do not have any impacts on either exports or imports in Turkey. Mujahid & Kalkuhl (2016) showed that only RTAs are found to have increased food trade among countries compared with WTO. Park & Park (2016) showed that trade effects of RTAs in the APEC are stronger than the general case covering all RTAs in the world. Afesorgbor (2017) found that a positive effect of African RTAs is about 27-32%. The gravity model has been used often to examine international relations. This model is often extended by including variables such as language relationships, contiguity, colonial history, exchange rate regimes, and other variables (Rose, 2007; Liu, 2009; Fidrmuc & Fidrmuc, 2016). Ahmed & Martinez-Zaizoso (2016) confirmed that distance between countries as an indicator of the cost of remitting is found to be a weak proxy. Cheong, Kwak, & Tang (2016) found that distances have effects on the extensive margin declines while that on the intensive margin rises over time for most specifications.

Magerman, Studnicka, & Van Hove (2016) also found the negative effects on distance and positive effects on adjacency; however, the effects vary by different kinds of empirical methods. Rauch (2016) showed that distances between countries should be measured as weighted harmonic means of pairwise distances of local economic activity. Wagner (2017) confirmed that the exports decline significantly with distance within a firm for a product. However, Internet or transaction costs should be taken into account when examining the relationship between distance and international trade (Hoonsawat, 2016; Basedes & Cole, 2017). Some articles have recently cast the question of this model itself. Lee (2011a), Anderson & Wincoop (2003), and Fragikos & Nikos (2011) indicated that estimation by gravity model suffers from omitted variables bias, and comparative statics analysis can be found.

Another problem is so-called zero trade observations. This implies that zeros (the data of trade volume) are not randomly dropped, which can cause sample selection bias. This article considers these points when conducting empirical analyses. The next section shows the empirical methods and the data used here. Section 3 demonstrates the results and examines them. Finally, this paper ends with a brief summary.

## 2. Theoretical Analysis and Empirical Method

In international trade literature, the gravity model has become a popular method to estimate trade flows. This model has been repeatedly employed in academic study. In its simple form, this model for bilateral trade states that imports (or exports) of country  $i$  from country  $j$  ( $\text{TRADE}_{ij}$ ) are proportional to the product of the two countries' GDPs ( $\text{GDP}_i$  and  $\text{GDP}_j$ ) and inversely proportional to their geographical distance ( $\text{dist}$ ):

$$\text{TRADE}_{ij} = \alpha_0 \frac{\text{GDP}_i^{\alpha_1} \text{GDP}_j^{\alpha_2}}{\text{dist}^{\alpha_3}} \quad (1)$$

A typical, empirical specification without bilateral fixed effects is given as following equation (2):

$$\ln(\text{TRADE}_{ijt}) = a_1 \text{WTO}_{ijt} + a_2 \text{RCEP}_{ijt} + a_3 \text{TPP}_{ijt} + a_4 \text{FTA/EPA}_{ijt} + a_5 \ln(\text{GDP}_i \text{GDP}_j)_t + a_6 \text{dist}_{ijt} + \mu_{it} + \mu_{jt} + \varepsilon_{ij} + \varepsilon_{ijt} \quad (2)$$

where  $i$  and  $j$  are countries and  $\text{TRADE}$  means the volume of bilateral trade. As one of the purposes of this article is to analyze whether or not the RCEP and TPP will be effective in the future, the two dependent variables are included. Along with RCEP and TPP, which have not been into effect, WTO and FTA/EPA are dummy variables that take the value one if both  $i$  and  $j$  are members (or under negotiation) at time,  $t$ , and zero otherwise.  $\text{Dist}$  is the distance between the capitals of countries  $i$  and  $j$ .  $\text{GDP}$  is the product of their real GDP. According to Lee (2011a) and Subramanian & Wei (2007),  $\mu_{it}$  and  $\mu_{jt}$  are the country-by-time dummies. They control for country-specific unobservable that change over time but not across trading partners, GDP per capita, area, and the multilateral resistance terms as explained in Subramanian & Wei (2007). Other factors that affect international trade can be included with these  $\mu_{it}$  and  $\mu_{jt}$  variables.  $\varepsilon_{ij} + \varepsilon_{ijt}$  are bilateral time-varying and time-invariant unobservable. Finally, to include the zero trade observations, the dependent variable is considered to be in  $(\text{TRADE}_{ijt} + 1)$  as in Liu (2009). It is sometimes noted that the coefficient estimates from log-linear regressions are inconsistent when a large number of zero trade observations are present in the sample for empirical analysis. The data are from Direction of Trade Statistics (IMF; for the  $\text{TRADE}$  data), WTO (for the data on WTO membership and RTA), International Financial Statistics (IMF; for the data on real GDP), and info please (for distance data) from 1995-2015 at 5-year intervals (1995, 2000, 2005, 2010, and 2015). Non-OECD countries are available data countries for each sample as possible. If any data were lacking, the country is omitted for that time. Non-OECD includes 50 countries.

## 3. Estimated Results

Table 1 reports the results of equation (1). Both cases, the country-by-time dummies and non-country-by-time dummies, are estimated.

**Table 1. Estimated Results for the Gravity Model of International Trade**

	Country-by-Time Dummies Excluded		Country-by-Time Dummies Included	
	OECD	Non-OECD	OECD	Non-OECD
	(1)	(2)	(3)	(4)
WTO	2.11*** (5.45)	1.95*** (5.32)	1.14** (2.59)	0.92** (2.53)
RCEP	0.97** (2.34)	1.69** (2.44)	0.46* (1.89)	0.72 (1.40)
TPP	1.30*** (3.98)	1.62*** (4.02)	1.13* (1.82)	1.20* (1.90)
FTA/EPA	1.58** (1.92)	1.63*** (2.99)	1.18 (1.21)	1.17** (2.32)
Real GDP	0.45*** (6.13)	0.49*** (6.77)	0.25** (2.37)	0.29** (2.40)
Distance	-2.11*** (-4.00)	-3.03*** (-4.28)	-1.05* (-1.75)	-1.51** (-2.28)
F-value	823.45	859.98	356.47	321.78
D.W.	1.87	1.90	0.97	0.88
Adj.R <sup>2</sup>	0.65	0.71	0.44	0.41

*Note.* Numbers in parentheses are t statistics. \*\*\* denotes significant at 1%, \*\* at 5%, and \* at 10% level.

The use of either definition finds country-pairs with WTO members to engage in significantly greater bilateral trade relative to country-pairs that have no trade agreements members. Membership in these can be supported for the promotion of international trade. The difference between OECD and non-OECD exists in the promotion of international trade. WTO promotes international trade more in OECD countries than in non-OECD countries; however, the others also promote trade in non-OECD countries. Also, it should be noted that almost all most of the countries now are members of the WTO. The difference between WTO and other agreements is almost clear. RCEP, TPP, and FTA/EPA promote international trade, and the effect on trade is smaller than that for the WTO in general. The results mean that these promote international trade as shown by Xuepeng (2010) and Kurihara (2003), and there is a possibility that the TPP conflicts with the WTO and promotes blocks of countries on the other hand. In the past, trading blocs have decreased international trade, and the typical case is during the 1930s. Also, both the TPP and the RCEP are important to increase international trade. However, there will be conflict between them as both of the members are overlapping each other, and there might occur unexpected and unwanted effects on both and/or one of them economies. FTA/EPA also has a positive influence on international trade. However, whether the difference exists between developed countries and developing ones is not so clear. The increase of real GDP promotes international trade as expected. Increasing distances between countries negatively impacts international trade as many studies have suggested. For the distance between countries, Table 2 shows some interesting points. It is quite difficult to judge the effect of country-by-time dummies on international trade. Some variables are not significant if these dummies are included in the equation. As explained in the previous section, these dummies can control for country-specific unobservable that vary over time but not across trading partners as well as GDP per capita, area, and multilateral resistance terms. This method seems to be one of the effective ones; however, there is some possibility that important variable(s) is(are) omitted. The results are similar whether or not these dummies are included. Next, Table 2 reports the estimation in Table 1, which is divided at the 5-year interval points (i.e., the cases of 2000, 2005, and 2010 are reported). Only the estimations that omit country-by-time dummies are shown.

**Table 2. Estimated Results for the Gravity Model of International Trade**

	1995		2005		2015	
	OECD	Non-OECD	OECD	Non-OECD	OECD	Non-OECD
	(5)	(6)	(7)	(8)	(9)	(10)
WTO	2.21*** (5.50)	1.97*** (5.28)	2.09*** (5.29)	1.93*** (5.22)	1.99*** (5.05)	1.92*** (5.16)
RCEP	1.10*** (4.04)	1.79** (2.27)	0.96** (2.30)	1.64** (2.41)	0.90** (2.39)	1.67** (2.44)
TPP	1.21* (3.03)	1.01* (1.92)	1.25** (2.60)	1.56*** (3.80)	1.48*** (4.01)	1.99*** (4.43)
FTA/EPA	1.46** (2.22)	1.21* (1.86)	1.98*** (3.31)	1.98*** (3.71)	0.98* (1.80)	0.76 (1.28)
Real GDP	0.45*** (6.80)	0.55*** (6.34)	0.41*** (6.05)	0.47*** (6.68)	0.40*** (5.59)	0.44*** (5.37)
Distance	-2.48*** (-4.84)	-3.90*** (-5.66)	-2.01*** (-3.66)	-3.02** (-4.61)	0.33 (0.27)	-0.27* (-1.82)
F-value	798.55	800.62	810.33	814.72	329.21	768.93
D.W.	1.79	1.83	1.84	1.86	0.99	1.58
Adj.R <sup>2</sup>	0.60	0.65	0.64	0.70	0.45	0.66

Note. Numbers in parentheses are t statistics. \*\*\* denotes significant at 1%, \*\* at 5%, and \* at 10% level.

The results are not very clear; however, there are some interesting and important findings. In general, the effects of the WTO on international trade have been decreasing. On the other hand, the effects of the TPP have been increasing. The conclusion of the Rounds such as Uruguay and the start of the WTO partially remedied the situation of the developing countries that wanted to participate in the WTO. However, these countries were then required to engage in serious trade liberalization. The effect of distance has been decreasing. In the case of 2010, the variable is not significant as Kurihara (2011). The coefficient of OECD countries is positive (i.e., not significant). As noted in Kukenova & Monteiro (2008) and Brooks & Benno (2009), one reason is that trade costs have declined sharply since the 1980s. Alternatively, improvements in IT may have contributed greatly. IT promotes international trade while decreasing costs and time.

#### 4. Conclusions

This study found that the trade agreements have increased international trade. However, the degree in most agreements has been decreasing or not as large recently. On the other hand, the role of the TPP seems to be increasing. The distinction in the roles of the TPP and the RCEP are important to increase international trade and to obtain sound economic growth. There will be conflict between them. Also, the increase is larger in developed countries than in developing ones. Traditional international economics teach us that free trade promotes our utility. However, competition under fair condition would sometimes cause serious condition in developing economies. Real GDP, along with the agreements, and smaller distance are related to increases in international trade. The effect of distance on international trade has been decreasing. Improvements in IT may have influenced this trend.

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