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What's next for the CPTPP?

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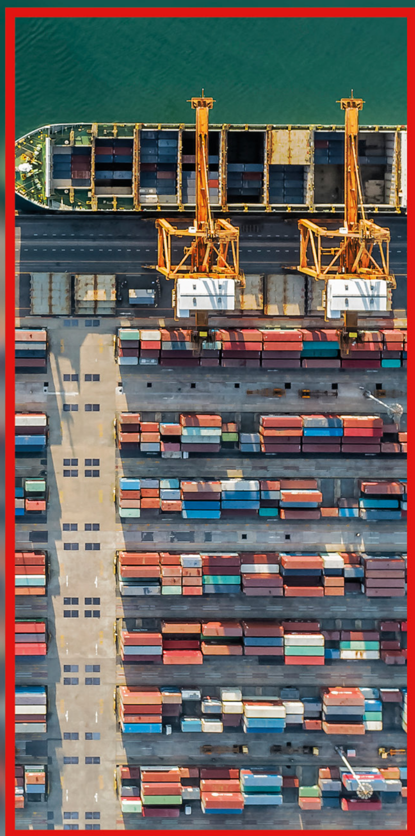

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What's next for the CPTPP?

The crafters of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) may have wished they had chosen a more concise name, given all the attention it has received. In 2021 a flurry of membership applications to the mega, Asia Pacific-focused free-trade agreement (FTA) took many observers by surprise, given the protectionist currents swirling in the global economy and the risk posed to international economic co-operation by a widening cleft between the US and China. These developments suggest that, contrary to widespread fears, global appetite for trade liberalisation persists—although this is being driven as much by geopolitical considerations as economic opportunities.

EIU's core assumptions, over our forecast period of 2022-26, assume that an enlarged CPTPP will include the UK, Ecuador and South Korea, as these countries seek to diversify their trade partnerships and economic structures. Membership by other emerging markets, such as Colombia, Indonesia, Thailand and the Philippines, is also likely.

Geopolitics will be a key driver of negotiations to join the CPTPP. While we assume that CPTPP members will eventually welcome China into the framework, given the size and attractiveness of its market, this will come at the cost of either allowing some dilution of CPTPP rules or overlooking aspects of non-compliance with them. In turn, Chinese membership will foil Taiwan's bid to join the agreement, owing purely to political factors; as an open and trade-dependent economy, Taiwan would be a natural candidate for CPTPP enlargement.

The result will be a framework that will constrain the full potential of the agreement, particularly in terms of the benefits it will bring to local business environments in Asia. Under an ideal scenario, the CPTPP could drive future foreign trade and investment via stronger rules that devote attention to areas including better intellectual property rights (IPR) protection, enhanced administrative transparency and fairer treatment between private, foreign and state-owned firms. These gains, however, depend on good faith compliance with CPTPP rules, which will be difficult to achieve in practice.

CPTPP existing and future members

Ratified
- Australia
- Canada
- Japan
- Mexico
- New Zealand
- Peru
- Singapore
- Vietnam

Ratification pending
- Brunei
- Chile
- Malaysia

Applicants
- China
- Ecuador
- Taiwan
- UK

Potential members
- Colombia
- Indonesia
- Philippines
- South Korea
- Thailand

Potential members	Population (m)	Nominal GDP (US$ bn)	Goods exports (US$ bn)	Goods imports (US$ bn)
Colombia	50.9	271.6	32.3	41.2
Indonesia	267.5	1,058.8	163.4	135.1
Philippines	109.6	361.2	48.2	82.0
South Korea	51.3	1,637.9	516.6	434.7
Thailand	69.8	501.3	227.0	186.1

	Population (m)	Nominal GDP (US$ bn)	Goods exports (US$ bn)	Goods imports (US$ bn)
Ratified				
Australia	25.5	1,359.1	251.2	210.9
Canada	37.7	1,643.8	391.6	419.5
Japan	126.5	5,045.6	631.5	602.7
Mexico	128.9	1,072.6	417.2	383.2
New Zealand	5.0	209.2	38.7	36.7
Peru	32.8	205.6	42.9	34.7
Singapore	5.7	340.0	411.6	318.0
Vietnam	97.3	271.0	282.7	251.9
Ratification pending				
Brunei	0.4	12.0	6.5	5.2
Chile	19.1	253.0	73.5	55.1
Malaysia	32.4	337.0	185.4	152.3
Official applicants				
China	1,412.0	14,867.0	2,497.2	1,982.2
Ecuador	17.5	99.3	20.5	17.1
Taiwan	23.6	669.2	342.2	267.5
UK	67.9	2,711.3	399.1	548.0

Sources: National source data; EIU.

Note. All data are for 2020; official applicants are current as at February 2022. Trade figures are on a balance-of-payments basis.

Which countries are interested in CPTPP membership?

The CPTPP has the potential to unleash important changes for global and regional economies. Its standards, scope and ambition eclipse those of the Asia-focused Regional Comprehensive Economic Partnership (RCEP), while its provisions on "newer" economic topics—such as the digital economy—are more relevant to the 21st-century global economy than the rules under the World Trade Organisation. Realising this potential, however, will require good faith compliance with CPTPP rules—an outcome that is far from certain, given the varied political and economic reasons why many potential joiners want to accede to the agreement.

In the immediate term, we expect several countries to be at the forefront of CPTPP enlargement. These include the UK, which, despite it not being a "Pacific" country, we expect to join the pact successfully as it looks to broaden its economic partnerships after Brexit. Ecuador, which aims to diversify its economy away from oil and other commodities, may see a tougher road ahead: its application will be complicated by challenges in its business environment, including the uncertain outlook for pro-business reforms. By contrast, we expect Colombia, which maintains a more open attitude to foreign trade and investment, to enjoy an easier accession process should it apply to join the pact (a caveat here, however, is Colombia's presidential election, due in May, which has a chance of bringing to office a protectionist government that does not pursue CPTPP membership).

South Korea will probably submit a formal membership bid within the first half of 2022, which we expect to be successful. The greatest areas of uncertainty around that bid will stem from South Korea's ongoing diplomatic spat with Japan, although both countries' membership of RCEP suggests that these political differences can be overcome in view of greater economic objectives. We expect future membership discussions to feature in Indonesia, the Philippines and Thailand within 2022-26, given their generally pro-trade inclinations, which CPTPP members are likely to welcome with open arms.

Governments that have expressed interest in joining CPTPP

	Date of application	Difficulty in joining
Applied		
UK	June 21	Low
China	September 21	Medium
Taiwan	September 21	High
Ecuador	December 21	Medium
Likely to apply		
South Korea	Probably within H1 2022	Low
Colombia	n/a	Low
Thailand	n/a	Low
Indonesia	n/a	Medium
Philippines	n/a	Medium

Source: EIU.

The conversations around Chinese and Taiwanese membership will be more difficult, given the geopolitical calculations underpinning their applications. China is aiming to cement its regional and global economic footprint, not only for its own development goals, but also to counterbalance diplomatic pressure from the US. By formally tying its economy more tightly with trans-Pacific supply chains, China will hope to frustrate the US's campaign to force third countries to "choose a side" between the two.

Taiwan's calculations are similarly grounded in geopolitics. Although CPTPP membership has been a long-standing policy goal, membership would also help to resist the island's growing international isolation by China. More formalised trade ties could also help Taiwan to deepen its connections with key regional partners, such as Japan and Australia, particularly as security tensions with China intensify.

The surge in interest by recent (or potential) applicants contrasts with the dim ratification prospects of three existing CPTPP signatories: Brunei, Chile and Malaysia. Joining the CPTPP is not a policy priority in Brunei, while political turmoil in Malaysia has generated legislative gridlock (the country has also been sceptical over the agreement since it was signed in 2018). In Chile, the president-elect, Gabriel Boric of the leftist Apruebo Dignidad coalition, is a CPTPP-sceptic, suggesting that ratification will remain off the legislative agenda until the next presidential election in 2025.

Where is the US?

The question of whether the US joins the agreement is crucial, given deepening rhetoric around the US enhancing its presence in Asia under its "Indo-Pacific" economic framework strategy. The US led the Trans-Pacific Partnership (TPP), the precursor to the CPTPP, before leaving it in 2017 under the previous presidency of Donald Trump. US engagement would come with obvious benefits; it could help to enhance some of the protocols originally in the TPP that have been watered down in the CPTPP, particularly in regard to the protection of intellectual property rights (IPR) and investment protection mechanisms.

However, our view is that a US application remains unlikely. Bipartisan domestic hostility to trade agreements and some of the CPTPP's more controversial clauses, such as the investor-state dispute mechanism, will deter the US president, Joe Biden, from re-opening discussions on membership. Mr Biden will remain wary of losing his credibility among progressive Democrats, given our expectations that the US House of Representatives will swing to Republican control in the November 2022 mid-term elections. These political dynamics will continue to overshadow the pro-trade argument in the US that absence from the CPTPP will cede important regional influence to China.

EIU does not expect the US's decision to remain outside the CPTPP to impede the country's appetite for broader engagement with Asia. However, that engagement will remain driven by competition with China, and will materialise primarily via multilateral frameworks that are explicitly geared around security, such as the Quad grouping (with Japan, Australia and India) and the AUKUS security pact (with Australia and the UK). Collaboration on trade co-operation is likely, but under alternative economic frameworks, such as the new and thus far unnamed trade partnership hinted at by the US in late 2021.

This approach is not without risks. The strategic competition between the US and China has heightened friction in trade, technology, finance and investment. These factors have complicated multinational operations in recent years, as companies and third-party markets face dilemmas around being forced to "choose a side" between the two economic superpowers. The US decision not to re-engage with the CPTPP and instead to pursue diplomacy via alternative, competing trade frameworks risks worsening these regional divisions and may not prove a popular choice in the region.

What are the economic benefits of CPTPP accession?

Estimates from the Peterson Institute of International Economics, a US think-tank, indicate that the CPTPP could generate annual global income gains ranging from US$147bn to US$1.2trn in the period until 2030, based on various scenarios that assume Chinese and wider membership. The obvious benefits of CPTPP membership, however, will be felt in the longer term, as new trade relationships are developed and economies benefit from productivity gains.

So what does this mean for investors? For those with global operations, the reforms necessary to comply with the CPTPP will spark improvements in local business environments. These would include enhancements in regional standards and commercial rules, unified customs and rule-of-origin provisions, and regulatory improvements that promote transparency and more market-based competition. All of these dynamics carry important operational considerations, such as boosting productivity; reducing non-tariff market access barriers; and allowing foreign companies to leverage their global competitive strengths across their key markets. More importantly, these factors are critical in an era when supply-chain agility, diversification and resilience remain important aspects of cross-regional business strategies.

These considerations are equally important for firms that are increasingly tilting their strategies towards localisation, in an attempt to tap into emerging consumer markets. Navigating these topics, along with growing questions around how multilateral trade pacts can meet corporate needs in a more sophisticated digital environment, are inherently related to the ease of doing foreign business.

From the perspective of policymakers, improved regulatory regimes act as catalysts for foreign investment. Stronger IPR protection, including via equal treatment of foreign and domestic companies in local courts, will incentivise the in-country settlement of sophisticated technology. This will allow for a more sustained (if more gradual) transfer of know-how, which will boost the competitiveness of local firms in the longer run. Limits on the role of state-owned enterprises, in areas ranging from competition to government procurement and subsidies, will grant space for both foreign and local private investors to grow.

The China question

China's large market and important role in global supply chains make the country an attractive candidate for CPTPP membership. However, China's difficulties in reforming its business environment will risk undermining some of the CPTPP's most important chapters.

Regardless of CPTPP membership, we expect China to continue the liberalisation of its foreign investment regime, particularly in financial services, as it gradually liberalises its capital account. The country's work to improve its environmental standards and the protection of intellectual property rights, while gradual, also align with the spirit of the agreement. These factors should support China's implementation of CPTPP goals.

CPTPP membership is nevertheless unlikely to force China to tackle more challenging areas of reform in its economy. We have identified three major sticking points:

1. The CPTPP's provisions on state-owned enterprises (SOEs) run against China's recent push to concentrate state influence further in its domestic economy; this has included enlarging and consolidating SOEs to expand their market position.

- Although Vietnam's exemption from certain CPTPP-mandated SOE reforms could serve as a potential model for Chinese membership, that country has struggled to implement these modest conditions since it ratified the agreement. Any similar exemptions would yield a similar outcome with China, given the existing stagnation of its own domestic SOE reform agenda.
- Without stronger oversight and monitoring capabilities, the CPTPP will fail to address concerns often levied by foreign firms regarding discriminatory treatment, poor transparency and unfair subsidies that benefit SOE operations. China will resist implementing these provisions, as it had under the Phase One US-China trade deal.

2. Domestic technology trends, justified by national security concerns, will impede the implementation of the CPTPP's digital chapters.

- China's tightening grip on cybersecurity will preserve impediments facing the free flow of information, regarding both content censorship and cross-border data transfers.
- Since 2017 Chinese authorities have published hundreds of standards and regulations in data security reviews, as part of ongoing implementation of the country's cybersecurity law (and its newly passed laws on both data security and the protection of personal information).
- Although China will voice nominal commitment to ensuring free cross-border data flows—such as via provisions offered under Asia Pacific Economic Co-operation (APEC) frameworks or the Digital Economy Partnership Agreement—authorities will struggle to reconcile this with its increasingly strict domestic regulations.

3. Scepticism over China's ability to adhere to CPTPP labour standards will be a concern for several existing members.

- The most difficult questions will revolve around the allegations of human-rights abuses in Xinjiang, as well as China's reticence to ratify certain International Labour Organisation conventions. The inability of international organisations, including due diligence firms, to conduct supervisory work in China will be cited as an impediment to faithful implementation of CPTPP provisions.
- These concerns had earlier derailed the ratification process of the EU-China Comprehensive Agreement on Investment.
- We attach a strong likelihood that countries such as Australia, Canada, Japan and New Zealand will raise these issues as they debate Chinese CPTPP membership.

What might CPTPP enlargement look like?

There are numerous ways in which CPTPP enlargement could unfold. EIU has considered the implications for our Asian business environment rankings (BERs), based on three potential outcomes that could manifest in 2022-26. We believe the main areas of the business environment to watch for changes will be in policies regarding private enterprises and free competition, including IPR protection and state-owned enterprises; policy and attitudes towards foreign investment, foreign trade and exchange regimes; and other adjustments governing the labour market and technological readiness.

Scenario 1 (limited compliance; full membership ex-Taiwan): 65% chance

Our core forecast, assessed at a 65% likelihood, expects the enlarged CPTPP ultimately to include China, South Korea, Thailand, Indonesia and the Philippines. Taiwan, although a natural candidate for CPTPP enlargement, given its open and trade-dependent economy, will be blocked by China from joining the agreement. This will reflect worsening tensions between China and Taiwan, amid a sustained campaign of international isolation by the former against the latter, as well as the need for unanimous consent as a prerequisite for CPTPP accession. We expect China to lobby—and in some cases to threaten—other CPTPP signatories to block Taiwanese membership.

Under this scenario, we expect implementation of CPTPP rules to be patchy, partly reflecting China's diluting influence on the implementation of the agreement. However, this outcome will still yield moderate improvements to business environments in the Philippines and China, given the enhancement of local regulatory structures, as well as more minor improvements in Indonesia,Thailand and South Korea. This will elevate the competitiveness of their local business environments above India and other South Asian countries that are not party to the agreement. Without ambitious reforms, however, these countries will struggle to position their business environments as being more competitive than China, whose economic weight (and implementation of CPTPP reforms, even on a limited basis) will preserve its attractiveness to multinational investors.

Scenario 1 outcomes (65% chance)

	% improvement in BER
Taiwan	0.0%
South Korea	0.5%
Indonesia	0.5%
Thailand	0.8%
China	1.1%
Philippines	1.6%

Legend
Unchanged
Minor (0.1-0.9%)
Moderate (1-1.9%)
Major (2-2.9%)
Significant (3%+)

Note. Scores reflect % changes in EIU business environment ranking (BER) modelling adjusted against baseline BER forecasts for 2022-26. For full methodology, please see annex.

Source: EIU.

Scenario 2 (full compliance, limited membership); 25% chance

An alternative scenario could see the enlarged CPTPP including South Korea, Thailand, Indonesia and the Philippines. China does not join the agreement, owing to lobbying by the US and its regional security partners, as well as its unwillingness to meet regulatory thresholds. China continues to obstruct Taiwanese membership, however, with the former threatening economic and diplomatic coercion against CPTPP signatories to prevent the latter from securing the unanimous consent needed for accession.

Under this scenario we would expect strong compliance with CPTPP rules. This will partially reflect the absence of China's diluting effect on CPTPP standards, with a diminished risk of "free riding" allowing good-faith implementation that yields significant reforms in local business environments. The strongest of these effects are felt in the Philippines, Thailand and Indonesia, which are able to position themselves as more attractive regional supply-chain hubs—particularly vis-à-vis China—in the period to 2026. The improvements in South Korea's BER are negligible, however, against our existing assumptions for the evolution of that country's business environment in 2022-26.

This outcome, however, would require a strong degree of reform willingness among emerging-market signatories, which will remain contingent on effective policy formulation and the punishment of rule-breaking behaviour, particularly by developed signatories. The difficulties involved in achieving these prerequisites will keep this scenario at only a 25% chance of being realised.

Scenario 2 outcomes (25% chance)

	% improvement in BER
Taiwan	0.0%
South Korea	0.0%
China	0.0%
Indonesia	2.2%
Thailand	2.8%
Philippines	4.7%

Legend
Unchanged
Minor (0.1-0.9%)
Moderate (1-1.9%)
Major (2-2.9%)
Significant (3%+)

Note. Scores reflect % changes in EIU business environment ranking (BER) modelling adjusted against baseline BER forecasts for 2022-26. For full methodology, please see annex.

Source: EIU.

Scenario 3 (full compliance, full membership); 10% chance

Our final scenario is ambitious. It envisages that an enlarged CPTPP includes China, Taiwan (under its WTO name, to avoid geopolitical tensions), South Korea, Thailand, Indonesia and the Philippines. Under this scenario, all new joiners would see marked improvements in their business environments, with the impact of the CPTPP's stronger regulations and standards very pronounced in emerging markets (namely the Philippines, Thailand and Indonesia). China would similarly benefit from stronger reforms that enhance its openness to trade and foreign investment, while Taiwan's biggest boost would come from the geopolitical significance of its first formal inclusion in a modern Asian regional trade agreement.

As in scenario 2, we expect more modest benefits to materialise in South Korea, given the maturity of its economy and existing alignment with many CPTPP standards. Stronger improvements in that country's score in scenario 3, however, will derive primarily from economic opportunities offered by tighter supply-chain and economic integration with a more open Chinese economy, its largest trade partner.

This outcome, however, is very unlikely. The reasons are mostly geopolitical: China is unlikely to sanction Taiwanese accession, even under its WTO nomenclature, owing to the current hostility in cross-Strait ties. However, economic constraints are also at play: none of these emerging-market economies currently has the political capital to implement aggressively the painful reforms necessary to unlock the full potential that the CPTPP could deliver to their local business environment. As a result, we attach only a 10% likelihood to this scenario.

Scenario 3 outcomes (10% chance)

	% improvement in BER
South Korea	0.7%
Taiwan	2.1%
Indonesia	2.2%
Thailand	3.4%
China	4.0%
Philippines	4.9%

Legend
Unchanged
Minor (0.1-0.9%)
Moderate (1-1.9%)
Major (2-2.9%)
Significant (3%+)

Note. Scores reflect % changes in EIU business environment ranking (BER) modelling adjusted against baseline BER forecasts for 2022-26. For full methodology, please see annex.

Source: EIU.

Methodology

EIU conducts in-house assessment of global business environment rankings (BER) on a quarterly basis, as part of our Country Forecast reports. These include country-level, forward-looking judgments, currently for the 2022-26 period, on topics ranging from political stability and the macroeconomic outlook to general market opportunities. The modelling in this report used BER models, making quantitative adjustments to the quality of local policies covering private and foreign investment, trade, labour and technological readiness under various CPTPP accession scenarios. Guidance included recommendations for "positive", "negative" or "no" adjustments to existing BER scores in each of the concerned categories.

These exercises were conducted by EIU country analysts responsible for covering the markets in question. The results yielded numerical figures, which were then benchmarked (in percentage terms) against the absolute values enshrined in EIU's current (Q1 2022) BER forecasts to understand how various business environments would respond to policy changes necessary for CPTPP compliance under competing scenarios.

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