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To: [Committee, Treaties \(REPS\)](#)
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Subject: RE: JSCT - RCEP Hearing - 30 July 2021 [SEC=OFFICIAL]
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Response to Question on Notice from Josh Wilson MP to witness Dr Jeffrey Wilson, as made at JSCOT RCEP Hearing of 30 July 2021

[Paraphrased QoN: *If the economic benefits from regional trade agreements like RCEP accrue largely from value chain effects, rather than conventional tariff reduction, how can we assess and quantify the potential benefits of these FTA ex ante?*]

Estimating the economy-wide effects of preferential trade agreements ex ante is notoriously difficult. The prevailing way this is currently done is using computable general equilibrium (CGE) modelling, an econometric technique that creates a model of an economy and then adjusts known parameters to estimate how policy changes will affect levels of output. Almost all ex-ante analyses of trade agreements conducted today use a specific CGE model called the Global Trade Analysis Project (GTAP) model, which is specifically designed to estimate how changes in tariff levels will increase trade between, and the output of, a simulated group of economies.

(A short summary of how the GTAP model is provided in David Cheong (2010), 'Methods for Ex Ante Economic Evaluation of Free Trade Agreements', *ADB Working Paper Series on Regional Economic Integration* (No. 52), <https://www.adb.org/sites/default/files/publication/28526/wp52-ex-ante-economic-evaluation.pdf>).

One shortcoming of the GTAP model is that it struggles to account for complex trade policy effects such as value chain effects. Simplifying the technical details greatly, GTAP models a policy change as a "price wedge" (i.e. it converts a proposed policy to an effect on the price for a traded commodity). This is convenient for quantifying simple trade policy effects (such as a tariff reduction), and with some modifications can also be used to measure trade policies of intermediate complexity (such as tariff rate quotas or export subsidies). However, it does not adequately account for value chain effects, where trade creation is not due to changes in relative prices, but simplification of border measures.

A consequence is that estimates of the trade and GDP from RCEP using CGE models such as GTAP will underestimate its effects. One of RCEP's principal features is its single rule-of-origin regime, in which products produced within the bloc can pass freely within value chains transiting multiple countries. RCEP's provisions on services trade, investment, digital trade and technical barriers all similarly contribute to value chains. Each of these policy changes are difficult to properly capture with the GTAP model, and in some applications are ignored.

Unfortunately, trade economists have yet to develop robust econometric techniques that adequately capture value chain effects in ex-ante FTA modelling.

This means the answer to the question “How much will RCEP increase the GDP of its members” is “we don’t know”. It will be larger than estimates generated using the GTAP model due to RCEP’s prominent value chain effects, but how much larger is impossible to model econometrically. It does suggest that it is inappropriate to compare estimates for RCEP to those generated for other trade agreements (particularly bilateral FTAs, which do not offer value chain effects).

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