The RCEP and Its Potential Impact on Saudi Regional Exports

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On November 15, 2020, 10 Southeast Asian economies, joined by Australia, China, Japan, New Zealand and South Korea, formed the Regional Comprehensive Economic Partnership (RCEP) – the world's largest trading bloc, representing about a third of the global economy (BBC 2020). This comprehensive agreement covers import tariffs and other market access barriers, investment facilitation, standardization of rules and procedures, and economic and technical collaboration, among other areas.

Although in its current format, the RCEP's scope and schedule of tariff reduction are less aggressive than some of the other regional free trade agreements (FTAs), it will have a significant impact on regional trade and investment flows. Economies that decided to forgo participation (i.e., India and the United States [U.S.]), as well as all other major RCEP trading partners, will also be affected. Those with a significant share of imports from RCEP members will likely benefit from the ensuing lower import prices. From the exporter's perspective, this impact would vary depending on the structure of exports to the region, the current and future tariff regimes, and the exporter's 'physical' presence in the region via joint ventures or other forms of direct investment.

The role of RCEP economies in Saudi exports

Saudi Arabia has strong economic ties with the RCEP economies, which accounted for over 50% of total Saudi exports in 2019 (WITS 2020).[1] These flows are dominated by crude oil – at 76.7% of the total exported value from Saudi Arabia in 2019 (WITS 2020). Despite such significant trade volumes, the RCEP agreement is unlikely to majorly affect the Kingdom's dominant position in the region. Among major regional importers, only South Korea has a 3% effective import tariff on Saudi crude, which has not disrupted the Kingdom's position as a top exporter to this market. Others, including China and Japan, already apply a most favored nation (MFN) import tariff on crude oil of 0% for all oil imports, including those from Saudi Arabia (ITC 2020a). Moreover, South Korea has already eliminated the import tariffs on crude oil for major regional exporters, such as Australia, Malaysia and Indonesia, in accordance with existing FTAs. Despite that, none of these exporters were in South Korea's top 10 oil import sources in 2019.

The impact of the RCEP will likely be more substantial on intra-regional trade and outside import flows of plastics (Harmonized System [HS] code 39) and organic chemicals (HS code 29). The products in these categories rank second and third in Saudi Arabia's total exports (following mineral fuels), with respective values of US$19.0 billion and US$12.7 billion in 2019 (ITC 2020b). The export-driven plastics and organic chemicals industries are also essential to Saudi Arabia's economic diversification and development strategy.

RCEP participants account for 54.1% of global plastics and 60.5% of organic chemicals Saudi exports (based on mirror data) (WITS 2020). Furthermore, the Asia Pacific region is expected to dominate these sectors over the next decade, with a projected 3.9% compound annual growth rate (CAGR) in plastics (Grand View Research 2020) and the fastest anticipated growth in the organic chemical segments

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[1] Calculations are based on the mirror data.

(Coherent Market Insights 2017). Hence, the Asia Pacific market will likely remain the priority for Saudi petrochemical exports.

The value of Saudi exports and their shares of export markets vary within the broad categorization of the HS29 and HS39 articles. Table 1 shows a set of products and their six-digit HS code lines (selected based on their total export volumes and export growth rates), and the share of RCEP economies in their total exports.

Table 1. Shares of RCEP in Saudi Arabia's export of specific organic chemicals and plastic products.

Product code (HS 2012)	Product name	Exports 2019, $ billion	Exports to RCEP, % of total	Top RCEP export destinations, % of total
290243	Para-xylene	1.00	69.2%	China (69.2%)
290250	Styrene	1.50	71.6%	China (66.4%)
290511	Methanol	1.20	68.6%	China (26.7%), Japan (22.1%)
290531	Ethylene glycol	1.31	72.4%	China (72.3%)
290943	Monobutyl ethers	2.81	73.4%	China (60.0%)
390110	Polyethylene with gravity under 0.94	4.15	52.0%	Singapore (22.2%), China (14.2%)
390120	Polyethylene with gravity of 0.94 or more	4.79	52.5%	China (24.7%), Singapore (16.7%)
390210	Polypropylene	5.43	24.3%	Malaysia (6.6%), Singapore (6.0%)
390720	Polyethers, in primary forms	0.63	44.7%	China (21.5%)
390740	Polycarbonates, primary forms	0.61	79.9%	Singapore (40.2%), China (37.7%)
390930	Amino-resins, phenolic resins and polyurethanes	0.45	59.0%	South Korea (25.1%), China (23.2%)

Source: WITS (2020).

Clearly, exports of most of the listed products are heavily dependent on the RCEP market. In 2019, polypropylene and polyethers were the only products to have a share of the RCEP market in total Saudi exports below 50%. Other products – both organic chemicals and plastics – rely on RCEP countries for over 70% of their export value. Moreover, organic chemical exports are dominated by one country within the RCEP – China – with a share of over 60% in key products. The export portfolio of plastics is more diversified among the RCEP importers, despite considerable Chinese presence in some instances.

Changes in tariff terms

Despite having a competitive advantage in the cost of inputs, and in some instances in the economy of scale and expertise, Saudi petrochemical producers face tough competition in the Asia Pacific market from both local exporters and other major global players, including those from the U.S., India and Germany.

Unlike mineral fuel exports, the changes in tariff and non-tariff barriers can have a significant impact on the regional plastic and organic chemical trade flows.

Based on the data provided in Table 1, China is a key export market for Saudi Arabia's plastics and organic chemicals. Given the size of China's economy and the trajectory of its economic recovery from the COVID-19 crisis, especially compared with many other economies, it will likely retain and reinforce its current status as a key export market. Thus, it makes sense to focus the analysis of the changes in the tariff regimes under the RCEP on China. Table 2 shows China's current effectively applied tariffs on imports of selected plastics and organic chemicals sourced from Saudi Arabia and its major competitors within the RCEP group.

Table 2. Current Chinese import tariffs on plastics and organic chemicals for selected exporters.

Product code (HS 2012)	Product name	Current effectively applied import tariff, %				
		Saudi Arabia	*South Korea*	*Japan*	*Singapore*	*Thailand*
290243	Para-xylene	2.00%	2.00%	2.00%	0.00%	0.00%
290250	Styrene	2.00%	1.30%	2.00%	2.00%	2.00%
290511	Methanol	5.50%	5.50%	5.50%	0.00%	0.00%
290531	Ethylene glycol	5.50%	5.50%	5.50%	5.00%	5.00%
290943	Monobutyl ethers	5.50%	0.00%	5.50%	0.00%	0.00%
390110	Polyethylene with gravity under 0.94	6.50%	5.90%	6.50%	6.50%	6.50%
390120	Polyethylene with gravity of 0.94 or more	6.50%	5.90%	6.50%	6.50%	6.50%
390210	Polypropylene	6.50%	6.50%	6.50%	0.00%	0.00%
390720	Polyethers, in primary forms	6.50%	1.95%	6.50%	0.00%	0.00%
390740	Polycarbonates, primary forms	6.50%	3.90%	6.50%	0.00%	0.00%
390930	Amino-resins, phenolic resins and polyurethanes	6.50%	0.00%	6.50%	0.00%	0.00%

Source: ITC (2020a).

Exports from Saudi Arabia to China, including the products listed in Table 2, are currently subject to the MFN tariff regime. Other major exporters of these products who do not have a preferential trade agreement with China, e.g., Germany or the U.S., receive the same terms. This regime is also currently applied to Japanese exports until the RCEP tariff schedule comes into force.

South Korea is already eligible for preferential tariffs under the 2015 FTA with China. The tariff discount is especially notable for plastics, such as polyethers and amino-resins. In the organic chemicals group, monobutyl ethers – an essential Saudi export to China – qualify for a zero rate. However, important products such as polyethylenes and polypropylene received a minor concession or were exempt from reduction commitments.

The Association of Southeast Asian Nations (ASEAN) countries, represented in Table 2 by two major petrochemical producers – Singapore and Thailand – have been granted preferential import tariffs from China. These are lower than those applied to other RCEP economies. With the exception of a few positions – polyethylene, ethylene glycol and styrene – the tariffs on the products listed in tables 1-4 have already been reduced to zero within the China–ASEAN FTA framework.

Thus, Saudi Arabia and other non-RCEP exporters are already to some degree disadvantaged in terms of market access to China compared with most regional producers. However, this also means that the RCEP agreement will not change the existing tariff landscape in a dramatic and swift fashion. While South Korea and Japan will, to a varying extent, improve their current terms of trade with China, the tariff concessions for the ASEAN exporters will be incremental given their current preferential status.

Table 3 illustrates this thesis. It shows China's RCEP import tariff commitments to Japan, South Korea and the ASEAN block for organic chemicals and plastics.

Table 3. China's RCEP tariff commitments.

Product code (HS 2012)	Product name	Chinese import tariff terms under RCEP		
		South Korea	*Japan*	*ASEAN (including Singapore and Thailand)*
290243	Para-xylene	No commitment	No commitment	Annual 0.1% reduction
290250	Styrene	Gradual reduction to 1.6% starting year 17	Annual 0.1% reduction	Annual 0.1% reduction
290511	Methanol	No commitment	No commitment	Gradual reduction to 0% over 20 years
290531	Ethylene glycol	No commitment	No commitment	No changes
290943	Monobutyl ethers	0% starting year 1	0% starting year 1	0% starting year 1
390110	Polyethylene with gravity under 0.94	No commitment	No commitment	No commitment
390120	Polyethylene with gravity of 0.94 or more	No commitment	No commitment	No commitment
390210	Polypropylene	No commitment	No commitment	0% starting year 1
390720	Polyethers, in primary forms	0% starting year 1	0% starting year 1	0% starting year 1
390740	Polycarbonates, primary forms	Gradual reduction to 0% over 10 years	Gradual reduction to 0% over 15 years	Gradual reduction to 0% over 10 years
390930	Amino-resins, phenolic resins and polyurethanes	Gradual reduction to 0% over 10 years	Gradual reduction to 0% over 15 years	Gradual reduction to 0% over 10 years

Source: RCEP (2020).

China's RCEP tariff terms listed in Table 3 can be broadly divided into three groups: no commitment, a gradual decrease and a steep reduction. A number of tariff lines with significant import values, including polyethylene and polypropylene, were excluded from the tariff reduction schedule for South Korea and Japan. Imports of styrene, polycarbonate and amino-resins will be subject to the gradually reduced tariff. ASEAN producers will get additional benefits for their para-xylene and methanol exports. Regional exports of monobutyl ethers and polyether will not be subject to import tariffs as soon as the RCEP agreement comes into force.

The RCEP generally has not changed the import tariffs for polyethylene and polypropylene – the products with the highest Saudi revenues from exports to the RCEP countries. However, other products that generate high export revenues (monobutyl ethers) for Saudi Arabia or have seen rapid export growth (polyethers) may be affected by the new Chinese tariff terms.

Besides setting up product-specific tariff terms, the RCEP tariff schedule reduces any uncertainty surrounding future regional trade regulations. It provides a clear multi-year tariff schedule and a comprehensive geographic coverage, reducing the probability of other unexpected bilateral or multilateral preferential deals within the RCEP countries. Thus, RCEP petrochemical producers and global exporters can plan their product lines, trade patterns and investment decisions accordingly.

Important non-tariff clauses

The alleviation of non-tariff barriers to trade and investment confers additional advantages on RCEP regional petrochemical producers targeting regional markets. In particular, the RCEP defines common rules of origin with the following terms for organic chemicals and plastics:

Table 4. RCEP rules of origin for specific products.

Product code (HS 2012)	Product name	Rules of origin
290243	Para-xylene	CTH, RVC40, or CR
290250	Styrene	CTH, RVC40, or CR
290511	Methanol	CTH or RVC40
290531	Ethylene glycol	CTH or RVC40
290943	Monobutyl ethers	CTH, RVC40, or CR
390110	Polyethylene with gravity under 0.94	CTH or RVC40
390120	Polyethylene with gravity of 0.94 or more	CTH or RVC40
390210	Polypropylene	CTH or RVC40
390720	Polyethers, in primary forms	CTH or RVC40
390740	Polycarbonates, primary forms	CTH or RVC40
390930	Amino-resins, phenolic resins and polyurethanes	CTH or RVC40

Source: RCEP (2020).

Note: Specific rules of origin are defined as follows:
- ***CTH*** *- all non-originating materials used in the production of the good have undergone a requirement of a change in tariff classification at the four-digit level of the Harmonized System;*
- ***RVC40*** *- the good must have a regional value content of no less than 40% as calculated according to the RCEP rules;*
- ***CR*** *- the chemical reaction rule. Any good that is a product of a chemical reaction shall be considered to be an originating good if the chemical reaction occurred in an RCEP-member party.*

All the products in focus are subject to the RVC40 rule, meaning that the transformation of any imported goods from third parties that results in a value added of more than 40% is subject to preferential import tariff treatment within the RCEP economies. The terms for some organic chemical products are even more liberal – a chemical reaction in the production process within the RCEP economies is sufficient to qualify the final exported good for the RCEP tariffs. Besides, the harmonization of relevant certification and reporting requirements across the RCEP economies will further facilitate the regional petrochemical trade.

In the investment arena, notable RCEP clauses include the prohibition of performance requirements (i.e., export quotas, local content and other supply restrictions and technology transfer requirements, among others), as well as the liberalization of the cross-border movement of capital.

Finally, the agreed upon simplified customs procedures and other enhanced trade facilitation measures will allow for the efficient administration of procedures and the expeditious clearance of goods.

These measures seem to be clearly aimed at developing and integrating regional industrial supply chains. However, non-participating parties would also be able to take advantage of these regulations by establishing or increasing their regional manufacturing presence.

Indirect effects and other considerations

The implementation of the RCEP will not only shift the competitive balance between RCEP members and third-party exporters such as Saudi Arabia. Its impact will also vary across non-regional producers. Other Gulf Cooperation Council (GCC) members have a similar exposure as Saudi Arabia to preferential trade terms with RCEP members. Trade pacts between the GCC and individual RCEP members are currently limited to an FTA with Singapore, and a number of ongoing negotiations with other regional economies. Thus, among the GCC producers, those that are more established in the RCEP region (in the form of fully owned subsidiaries or joint ventures) will be in a preferential position.

The RCEP will likely decrease the competitive advantage of petrochemical exports from India and Taiwan, as these economies have become somewhat sidelined from the Asian integration process. The European Union (EU), on the other hand, has made progress in preferential trade deals with the RCEP members in recent years, signing FTAs with South Korea, Singapore and Vietnam. Canada may become the biggest beneficiary of the RCEP among non-RCEP members. It has secured market access to RCEP countries via the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and a separate FTA with South Korea.

The U.S. currently has FTAs with Singapore and Australia. A lot will depend on whether the new U.S. administration pursues a general shift toward multilateralism and preferential trade. If such a policy pivot occurs, the U.S. still may not be necessarily focused on mending economic ties with China. Other options may include the U.S. trying to regain its influence in the region by proposing alternative collaboration frameworks with the current RCEP participants, and focusing on building an alternative axis alongside Australia, India, Japan and Taiwan. At present, U.S. exporters would be negatively affected by the RCEP, in addition to their current problems caused by the COVID-19 pandemic in other key markets such as Turkey and South Asia.

The range of policy responses from the U.S. shows the potential shifts in the global economic and political dynamics – beyond rerouting trade and investment flows – which may be caused by the RCEP. Other significant trading blocs may emerge, for example, along the U.S. – United Kingdom – EU or U.S. – Japan – Australia – India axes. This would provide GCC/Saudi Arabian producers with opportunities to enhance their cooperation with these countries and diversify their exports.

However, assuming that retaining and expanding its market share in RCEP countries, including China in particular, remains a priority for Saudi Arabia, the strategic response options for Saudi Arabia may include further expanding its physical presence in the region and working toward finalizing FTAs with the RCEP economies, most importantly the China-GCC FTA. The first approach would allow Saudi investors and joint venture partners to benefit from the RCEP's rules of origin and streamlined administrative procedures. The second option can reduce its tariff gap with RCEP exporters, which would otherwise only increase over time, and provide significant economic benefit for both parties. (See Galkin et al. [2018] for an estimation of the gains from the liberalization of trade in plastics between the GCC and China).

Saudi petrochemical and integrated companies have already been investing heavily in China and other RCEP economies. Saudi Aramco has joint ventures with South Korean, Malaysian and Chinese petrochemical producers, while SABIC has a significant operational presence in China and Singapore. From 2020, the RCEP has expanded its geographical scope for potential investments beyond China (the largest market) and ASEAN countries (which have had favorable trading terms with major regional economies).

However, Saudi Arabia and other GCC countries have yet to finalize a number of ongoing and stalled FTA negotiations with RCEP members, including Australia, China, Japan, Malaysia and South Korea. The momentum behind an FTA between the GCC and China seems to be positive, as China is striving to expand its soft power and alleviate the impact of its trade war with the U.S. The recent withdrawal of China from the WTO dispute over its market economy status accentuates China's strategic pivot toward bilateral and multilateral trade and investment agreements. Following on the heels of the RCEP's success, China is aiming to speed up other FTA negotiations, including with the GCC (Global Times 2020).

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