

# Asia-Europe Economic and Trade Connectivity in the Age of Rising Protectionism

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## 1. INTRODUCTION

The international trading system is facing its biggest challenges since the 1930s. In part this is due to a new global landscape in which the distribution of power has broadened to include a diversity of economies at different levels of economic development and featuring a variety of policy regimes. It was far easier to produce accords under the auspices of the General Agreement on Tariffs and Trade (GATT), under which multilateral commercial governance fell from its creation in 1947 until it was superseded by the World Trade Organisation (WTO) in 1994, when only a few dominant, like-minded, developed countries led multilateral cooperation. Today, those same countries are joined by emerging and developing economies characterised by different economic interests and approaches, making negotiations far more complicated. In fact, the many required reforms associated with the “democratisation” of global governance have challenged all multilateral institutions, including the World Bank and the International Monetary Fund (IMF).

The need to give greater weight to emerging and developing economies is obvious but how to do this is far less so. Moreover, the sword is two-edged: emerging and developing economies are also finding it difficult to take on leadership responsibilities in this new context, especially when they profited to some extent from advantages as less-developed economies. For example, if China has become the second largest economy in the world, the world’s largest exporter, a leader in several key high-tech areas, a major exporter of foreign direct investment (FDI), and a supplier of infrastructure even in developed economies, should it still be able to benefit from special preferences reserved for developing countries?

These secular challenges are being exacerbated by policy trends in leading economies, in particular the United States, which has led global trade governance from the beginning. The “America First” doctrine of the Trump administration is

ostensibly predicated on the fundamental arguments of *mercantilism*, namely, that trade is a zero-sum game in terms of its welfare effects and, hence, an optimal policy is to ensure that exports exceed imports. At his inauguration, President Trump laid out his vision: “We must protect our borders from the ravages of other countries making our products, stealing our companies and destroying our jobs. Protection will lead to great prosperity and strength.” This constitutes a major break with previous US trade strategies. While some observers had hoped that, over time, harsh rhetoric would yield to pragmatism, no such change has been in evidence, e.g., the Trump Administration has withdrawn from the Trans-Pacific Partnership (TPP) trade agreement, applied controversial tariffs on steel and aluminum imports based on “national security” considerations, threatened to pull out of the WTO, and initiated a full-blown trade war with China, the first major conflict in the global trading system since the 1930s.

As outward-oriented, trade-dependent regions, the economies of Asia and Europe have large stakes in an open and vibrant international trading system. Given this new inward-focused approach of the United States, can they step in to provide the necessary leadership to support international commerce in the 21st century?

Thus far, signs have been positive. For example, the two regions have responded to this challenge by embracing regional approaches to trade cooperation: Europe has been building regional links for over sixty years and has a great deal of experience in forging practical approaches to removing commercial impediments at the border as well as behind it. Regional cooperation is less advanced in Asia; even though the Association of Southeast Asian Nations (ASEAN) began cooperation over 50 years ago, its accomplishments have been more modest, despite the fact that it is still the most advanced organisation of regional cooperation in the developing world. In addition, Asia has been very active in forging “mega-regional” trade agreements, which could have an important bearing on regional and global trade and investment flows, as well as rule-making, in the coming decades. Further, the European Union (EU) has been active in forging closer links via bilateral arrangement with key players in the Asia-Pacific region.

In this short paper, we consider some of the associated leadership challenges facing Asia and Europe in charting a path forward. It begins in Section II with an overview of mega-regionalism in the Asia-Pacific region and its potential effects. Section III considers implications for Europe, followed in Section IV by a review of Asia-Europe approaches to removing impediments to trade and boosting connectivity. Section V gives some concluding remarks.

## 2. MEGA-REGIONAL TRADE COOPERATION IN THE ASIA-PACIFIC

To begin, it is worth noting that a large majority of preferential trading arrangements concluded or initiated by Asian economies are bilateral free-trade areas (FTAs), which tend to be easier to negotiate than, say, larger memberships. Moreover, a majority of these FTAs are with economies outside of Asia. Thus, when Asian governments consider bilateral accords, they think globally, rather than just regionally. These priorities reflect the driving forces behind regionalism in Asia, which tend to be economic rather than political, though of course political and diplomatic dimensions continue to be important to various degrees. Indeed, this might distinguish Asia from bilateral and regional accords elsewhere, which tend to be politically dominated. For example, early integration initiatives in Europe, beginning with the Coal and Steel Community and the European Economic Community, had strong political backing (integrating France and Germany after World War II, Cold War priorities), even though the economics were not obvious at the time. Even monetary union in the EU was made possible due to political reasons, that is, post-Cold War incentives and, in particular, facilitating the political integration of East and West Germany. In fact, the need to support economic integration in Asia is even helping to overcome some of the most difficult obstacles to cooperation in the region; a decade ago few if anyone could have foreseen that China, South Korea and Japan would be able to improve relations sufficiently to sit down and negotiate an FTA. Yet, that is exactly what was agreed to at their May 2012 Summit; a China-South Korea-Japan FTA has not been concluded but negotiations continue.

Mega-regional trade agreements are defined as multi-country, comprehensive cooperative agreements designed to address cutting-edge border and non-border barriers with significant implications for regional and international trade. In the Asia-Pacific region, this has involved bringing together an ambitious trade and investment liberalisation agenda in the context of many partners at all levels of economic development. This ambition and diversity explain why the emerging mega-regionalism agreements have taken so long to put into place.

The TPP in particular was designed as a modern trade agreement with the aim of setting a “gold standard” for regional cooperation. The TPP and its successor, the Comprehensive and Progressive Agreement on Trans-Pacific Partnership (CPTPP), include cutting-edge chapters on the digital economy, state-owned enterprises engaged in trade, trade in services, intellectual property rights (IPR) protection, non-tariff barriers, and protection of labour and environmental standards, while at the same time cutting virtually all tariffs to zero (except in a few notable sectors,

such as agriculture). Given the diversity of the region, negotiations were complicated and challenging; TPP negotiations started in February 2008 and an agreement was signed eight years later in February 2016. But it succeeded in creating an ambitious, 21st-century template that brought together pro-trade economies that were rich and poor, policy regimes in which the state was more and less active, varying degrees of openness to the global marketplace with trade/GDP ratios ranging from 30 percent to 400 percent, and featuring an impressive menu of rules that could serve as global templates.

In essence, the main purpose of mega-regionals apart from liberalisation of barriers at the border is to find ways to create and harmonise new international benchmark standards for modern trade that has eluded cooperation under the WTO, which is made up of 164 heterogeneous economies. Hence, the region is forging new standards that could eventually serve as global templates, or at least global “best practices” benchmarks. Addressing such issues is necessary to facilitating real economic connectivity.

In part, the new architecture of mega-regional trade agreements is shaped by the emergence of international corporate networks in Asia that integrate dispersed production, engineering, product development and research across geographic borders.<sup>1</sup> While global production networks date back to the late 1970s, they have become far more prominent in the 21st century, and a more recent development is the rapid expansion of global innovation networks, driven by the relentless slicing and dicing of engineering, product development, and research. These processes have become prominent in Asia but also involve many US and European multinational corporations.

Despite the withdrawal of the United States from the 12-nation Trans-Pacific Partnership agreement in January 2017, the remaining eleven TPP countries<sup>2</sup> have moved forward anyway and the resulting CPTPP went into effect on 30 December 2018, with the expectation that all members will have ratified the agreement by the end of 2019. The CPTPP is remarkably similar to the TPP; it has suspended 22 measures – mostly dealing with the protection of intellectual property – but otherwise remains the same in terms of content. At least five other Asian economies (Indonesia, Korea, the Philippines, Thailand and Taiwan) have expressed interest in joining the CPTPP, and China is currently studying the possibility of member-

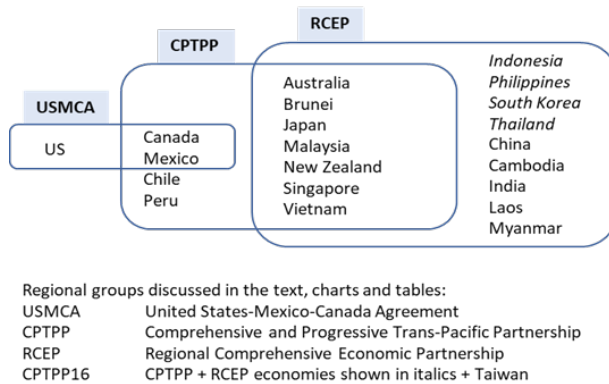
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<sup>1</sup> Ernst and Plummer (2018).

<sup>2</sup> These include Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, New Zealand, Peru, the Philippines, Singapore, and Vietnam.

ship.<sup>3</sup> Even the UK has expressed an interest in joining post-Brexit. Moreover, negotiations to create a Regional Comprehensive Economic Partnership (RCEP) arrangement, launched in November 2012 and composed of 16 Asian economies,<sup>4</sup> received a boost from the US TPP exit. It has completed 25 rounds of negotiations as of February 2019, held seven ministerial meetings as of March 2019, and two Heads of State Summit as of November 2018, underscoring strong commitment at the highest levels. It has the goal of completing the agreement this year. In short, while the United States has always been a key player in and advocate of Asia-Pacific economic integration, the region is clearly intent on moving forward without it.

Figure 1. Asia-Pacific Regional Groups



Source: Petri, Peter A., and Michael G. Plummer, 2019. China Should Join the New Transpacific Partnership, Policy Brief 19-1, Peterson Institute for International Economics, January.

The motivations for deeper economic integration in the Asia-Pacific are many, but the economic rationale is obviously critical. For example, in Petri and Plummer (2019) we estimate that the CPTPP will generate global gains of approximately \$157 billion to member-countries per year by 2030 relative to the baseline. The preponderance of the gains flow from trade creation and there is very little trade diversion, testifying to the open nature of the agreement. These net gains constitute 1 percent of regional income, slightly less than the 1.1 percent estimated from the TPP12. The income gains are led by trade, which are estimated to rise by 6.2 percent. Should the CPTPP expand – and it likely will, based on statements from leaders – the gains

<sup>3</sup> See Petri and Plummer (2019).

<sup>4</sup> RCEP members include 16 Asian economies: Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Korea, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, Thailand and Vietnam.

could be far greater. For example, including Indonesia, Korea, the Philippines, Thailand and Taiwan in the CPTPP, income gains from the “CPTPP16” more than double. The accession of China to the CPTPP would lead to particularly large positive effects: income would rise by \$632 billion (1.5 percent of member-country income) and \$1,225 billion (2.4 percent of member-country income) if it were to join the CPTPP or CPTPP16, respectively. The gains from an expanded CPTPP are far larger than those estimated in the case of RCEP (\$260 billion for member-countries), due to the fact that the RCEP template is less ambitious than the CPTPP and most economies already have free-trade areas (FTAs) in place.

Importantly, these mega-regional agreements demonstrate that Asia-Pacific economies are committed to taking a leadership role in bolstering global markets. This was never a given. In fact, when the United States pulled out of the TPP, many scholars believed that the agreement was dead. Prime Minister of Abe of Japan said that the CPTPP without the United States was “meaningless”. Vietnam, which was slated to gain the most from the TPP due to greater access to the US market, was hesitant to continue in the CPTPP since it would have to adopt many difficult reforms for far less immediate return. Some saw the RCEP as a Chinese reaction to the TPP and, with the United States out of it, predicted that the RCEP, too, would be put on hold. Still, the region opted to move forward with both mega-regionals; the contents of the CPTPP are already influencing other regional agreements and it is likely that plurilaterals at the WTO may well use the CPTPP as a benchmark.<sup>5</sup>

### 3. CLOSER ASIA-EUROPE CONNECTIVITY

European economic cooperation has traditionally been a model for economic cooperation in Asia, though always adapted to the regional context. For example, from the beginning ASEAN leaders looked to Europe for inspiration in searching ideas for regional cooperation – for example, the organisational structure of ASEAN was based on the European Commission – but always filtered to take account of regional exigencies. In particular, the willingness of member-states to pool sovereignty was always far less prominent in ASEAN than in Europe, limiting the degree to which regional cooperation can take place (even in Europe this sovereignty issue is coming back to haunt the region, as evidenced by Brexit). Still, when ASEAN sought deeper integration at the turn of the century, it looked to Europe for ideas: the ASEAN Economic Community (AEC), which was declared to be in effect as of

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<sup>5</sup> For example, the newly-constituted NAFTA, now to be called the US-Mexico-Canada Agreement (USMCA), borrow some from the CPTPP.

December 2015, resembles the idea of the European Economic Community; the “four freedoms” of the 1986 Single Market Program in Europe (i.e., free flow of goods, services, capital and labour) were watered down in the AEC to be free flow of goods, services, skilled labour, and long-term capital (FDI). In sum, the European project has helped mould regional aspirations.

The direct implications of Asia-Pacific mega-regionalism for Europe are not large and, in fact, tend to be positive, due in part to the non-discriminatory elements of the agreement (e.g., improving trade facilitation is an important goal of both the CPTPP and RCEP and associated reductions in trade costs will apply to both member and non-members). For example, Petri and Plummer (2019) show that Europe should gain (marginally) in all mega-regional scenarios due to positive spillover effects of regional cooperation. Still, to the extent that new global rules are being created in the context of the CPTPP, the EU is at a disadvantage.

A major study by the Centre for European Policy Studies (CEPS) and the World Trade Institute (WTI) considers the potential of an EU-China FTA (CEPS and WTI 2018), taking a similar approach adopted by the Peterson Institute of International Economics that looks at the potential of a China-US FTA from aggregate and sectoral levels (Bergsten, et al., 2014). The idea of an EU-China FTA was first made by China’s President Xi Jin Ping in the spring of 2014. The CEPS and WTI (2018) study underscores a long list of reasons for the agreement, from economic potential to geopolitical motivations. For example, it estimates that a modest FTA between the EU and China would lead to an increase in income of 1.16 percent and 0.43 percent for China and Europe, respectively, but 1.87 percent and 0.76 percent under a more ambitious scenario. Of course, the political obstacles to creating an EU-China FTA are high, as they are for a China-US FTA, despite the large attendant gains.

Moreover, while the United States seems to be reducing its ambitions for cooperation with the region, Europe is being pro-active: it has already concluded bilateral agreements with Canada, Chile, Colombia, Japan, Korea, Mexico, Peru and Singapore, and has negotiations underway with India, New Zealand, the Philippines, Thailand and Vietnam.

Further, it could gain considerably due to the China-led Belt and Road Initiative, which envisions a massive string of infrastructure investments to connect China to Europe and territories along the way. The March 2019 (non-binding) Italy-China Memorandum of Understanding on Italy’s participation in the Belt and Road Initiative – the first G-7 country to have one – is indicative of a strong desire to improve the connectivity between Asia and Europe (though admittedly controversial). The new Asia Infrastructure Investment Bank (AIIB), of which many European countries are members (and the United States is not), will provide financing of Belt and

Road Initiative infrastructure projects as well as other initiatives. Finally, it could be that the EU will want to consider expanding relationships with the fledgling mega-regional agreements in the Asia-Pacific.

Of course, the United States may decide to join the CPTPP in the future, which existing members would welcome, as indicated by their suspending 22 measures from the TPP rather than excluding them entirely. Indeed, the United States is still committed to a possible Free-trade Area of the Asia-Pacific (FTAAP), which could include all Asia-Pacific Economic Cooperation (APEC) economies (and possibly others), and the CPTPP has an accession clause similar to the TPP. But US re-engagement with Asia-Pacific mega-regionals seems off the table under the current administration. In the meantime, the economic and policy costs of US disengagement will be high.

#### **4. CONCLUDING REMARKS**

For the past half century, trade has made substantial contributions to development in many economies, making a vibrant trading system a global priority. Yet world trade growth is now decelerating, while the complex challenges of today's trading environment and divergences across WTO members have stymied progress on further liberalisation at the WTO. In this vacuum, new experiments in regional economic cooperation have emerged, including a dramatic rise in regional trading arrangements since 2000.

Against this background, ambitious, new mega-regional trading agreements are now emerging as a possible answer to the global stalemate, with the Asia-Pacific region serving as their main incubator. The economics of these mega-regionals are strong; the CPTPP and RCEP are both expected to yield significant gains, and the possible enlargement of the CPTPP to include other East Asian economies, including China, promises even greater gains. Given the outward-oriented nature of these agreements, Europe will likely gain (at the margin) from Asia-Pacific regionalism, given the positive spillover effects associated with the non-discriminatory nature of deep integration (estimates of the effects of the European Single Market Program on non-partners were positive as well).

Still, to the extent that the CPTPP is forging new global standards and best practices in regional trading agreements, Europe will lose out from not being part of the process. Moreover, the potential economic benefits of deeper economic integration between Europe and Asia should be large. Europe has been active in concluding bilateral FTAs with the region and does well to explore new ones, including with China. The Belt and Road Initiative offers great potential in reducing trade costs. In



the medium term, Europe would do well to consider a close cooperative agreement with the CPTPP, perhaps even a formal integration scheme. But most importantly, the new inward-looking approach to trade being adopted by the main protagonist of global economic integration in the post-war period, United States, risks leaving the global system without leadership. This would come at high costs given the nature of globalisation in the 21st century, with developing economies standing to lose the most. There is plenty of potential for economies in Asia and Europe to step up to the plate and cooperate in guiding future global cooperation from the bottom up. Forming cross-regional accords that are open and comprehensive would be a good place to start.

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