



# Regional trade agreements in the Indo-Pacific: does the EU risk losing sight of their importance?

By Michael Reiterer | 28 January 2022

## Key Issues

- Through its policy papers on Asia-Europe Connectivity, Indo-Pacific Strategy and Global Gateway, the European Union expresses its commitment to play a larger global role in terms of geopolitics and geo-economics.
- However, since 1 January 2022, two major regional trade agreements, CPTPP and RCEP, are in force in Asia without the EU and the US participating.
- At the intersection of trade and security, the EU needs to devise a policy of engagement, to play according to its strength, to safeguard its role as standard setter, and participate in the sustainable reconfiguration of supply and value-chains post-COVID.
- Whether or how to participate in the regional FTAs, fitting in the planned EU-ASEAN regional FTA to protect EU interests are the crucial decisions to take.

On 1 January 2022, the second major regional trade agreement in Asia, of which neither the EU nor the United States are members, the Regional Comprehensive Economic Partnership (RCEP), entered into force. The first one was the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the successor to the Trans-Pacific Partnership Agreement, which has been in operation since December 2018. Both agreements have an impressive scope, in terms of GDP of members, trade volume, and populations covered. Important as these figures are, their significance depends to a large extent on the depth of coverage, the standard setting and rulemaking, and the export of these rules. Free trade agreements have a tendency to cover an ever-increasing array of issues, like environmental and social standards, non-

tariff barriers, and investment aspects. COVID-19 was a catalyst that highlighted the strategic importance of supply chains and their resilience. The great power competition between the US and China and the weaponisation of trade policy under the angle of national security exacerbates these challenges. The rules-based international trading system is the casualty of these developments.

This policy brief looks at the approach the European Union has recently taken on trade (and related issues like standard setting) in the Asia- and Indo-Pacific as reflected in the three main policy papers, the 2018 Connectivity Strategy for Asia, the 2021 Indo-Pacific Strategy, and the 2021 Global Gateway. Against the background of the two above-mentioned regional trade agreements, this stance

is important in carving out a role for the EU in the region in terms of geo-economics but also geopolitics. Intensifying the EU's engagement in the Indo-Pacific economic powerhouse would reinforce the role of the EU, as this is an area where Europe can play to its strength and contribute to stability, prosperity, and security. Considering joining one or both agreements is an option; setting priorities while taking into account the planned bi-regional agreement with ASEAN is a must.

### EU-Asia Connectivity Strategy

[Connectivity](#), allowing people, goods, and services to move across and between Europe and Asia, is clearly identified as a driving force for economic growth and jobs, global competitiveness, and trade. The goal is to establish efficient and sustainable connectivity based on international rules. To this end, internationally agreed practices, rules, conventions, and technical standards should enable the interoperability of networks and trade across borders. Like in the Single Market, a level playing field for economic operators - including the crucial transport sector - should provide trade and investment opportunities. Efficient, economically viable, and environmentally sustainable trade routes between Europe and Asia are required. As 70% of the trade goes by sea and 25% by air, these two modes of transport are particularly important. The progressive opening of Arctic routes adds not only a new economic but also security dimension, where Russia plays a crucial role.

The importance of the nexus between connectivity and security is growing: in addition to traditional transport, transfer of data, energy connections, and resilient value chains (just-in-time delivery) and their security as well as the mobility of people, are crucial. Finding the right policy mix between facilitation and securisation poses a formidable challenge.

While traditional security, like fighting terrorism, organised crime, piracy, and trafficking remains essential, climate change and cybersecurity add a new dimension; the latter impacts critical infrastructure. 'Flow security' needs an adequate political and security environment which can only be provided through international cooperation, based on international agreements and standards. The

multifaceted problems also require cross-sector cooperation like taking into account international ocean governance to promote free and fair trade.

### The Indo-Pacific Strategy

Compared to the EU-Asia Connectivity Strategy, the [Indo-Pacific Strategy](#) puts more emphasis on trade and investment, as the Indo-Pacific and Europe account for over 70% of the global trade in goods and services and over 60% of foreign direct investment flows. For the EU, trade with the Indo-Pacific is the most important of all regions, as it is the second largest export destination. The region's waterways like the South China Sea and Malacca Straits, and the access to the Suez Canal, are crucial security spots.

In addition, authoritarian regimes disrespecting human rights also impact trade. The same applies to policies undermining fair trade through disrespect for rules culminating in economic coercion. This endangers supply and value chains. COVID-19 showed the interdependence of economies as well as the fragility of their resilience. This impacts strongly on the security of the EU, in addition to political disasters like the exodus from Afghanistan. In showing leadership the EU needs to move beyond established relationships, taking up new challenges. In line with climate change diplomacy, instruments should be used to accelerate the green and digital transitions. This will contribute to realising the EU's goal to reach more strategic autonomy and to securing the resilience of its global supply chains. Connectivity, for instance, should be smart, green, and sustainable within Europe and beyond. The granting or withdrawal of trade preference, e.g., incentive arrangement for sustainable development and good governance (GSP+), or other 'carrots' will be used in pursuing a value-based foreign policy.

Establishing a critical mass of countries supporting environmental, human and labour rights, due diligence, and best practices will incentivise the private sector to commit to responsible business conduct. This will also help in fighting deforestation and loss of biodiversity.

In order to achieve post-COVID recovery, resilient and diversified value chains are essential and this

needs to be factored into the EU's trade policy in the Indo-Pacific.

Supply disruptions for semiconductors call for diversification but also for intensification of planning with reliable partners such as Japan, the Republic of Korea, and Taiwan. The position of Taiwan in the political landscape is crucial: the looming threat of an attempt by China to integrate the country into the motherland is a source of insecurity and tensions with neighbouring countries and beyond.

The competition between China and Taiwan to join the CPTPP reveals the strategic importance of trade policy which can become a source of tensions: China does its best to block the accession of Taiwan. Accession would add a further twist: whoever is first could exercise veto power as a member of

Thailand, and Vietnam demonstrates, the approach has to be inclusive. Although the effect of China joining the WTO in 2002 did not meet the high expectations of liberalising China, working with China in trade matters is essential. This is a challenge for economic diplomacy as all three roles of China, partner, competitor and systemic rival, are at play in trade.

As the Indo-Pacific-Strategy points out, work in international forums, like promoting UN Guiding Principles on Business and Human Rights in Asia, implementing and further developing existing trade agreements (with Japan, South Korea, Singapore, Vietnam, and the Pacific States) and striving to conclude additional ones (with Australia, New Zealand, Indonesia, Malaysia, the Philippines, India, and – noteworthy – Taiwan) as well as with ASEAN

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the club. Therefore, the only solution would be a package deal in which the partnership takes both in at the same time. This, in turn, could be facilitated through a larger group of new members, which would somewhat dilute the problem. Alternatively, members might be inclined to avoid this battle by keeping both parties out.

Re-invigorating the WTO is necessary to avoid unfair practices and technical barriers to trade, like industrial subsidies, economic coercion, forced technology transfers, and intellectual property theft. To this end rules and standards setting with Indo-Pacific partners is essential for the EU. New areas like the green and digital transition need to be covered too, to avoid the dominance of a Sino-inspired regulatory environment.

As the EU's Responsible Supply Chains in Asia project with China, Japan, Myanmar, the Philippines,

and the West African Community, are on the agenda. Depending on essential progress in the crucial political issues, the Comprehensive Agreement on Investment with China could be ratified, as it is economically of mutual interest.

With the Indo-Pacific as the technological hub for new technologies and digitalisation, digital partnerships are high on the agenda to enhance technical and research cooperation on infrastructures, digital transformation of business and public services, and skills development; this would facilitate digital trade. Interoperability of standards for emerging technologies, such as Artificial Intelligence (AI), based on democratic principles and fundamental rights, building more resilient technology supply chains, supporting values-based innovation and facilitating business opportunities for start-ups and SMEs are important goals. They are necessary to stay ahead of the curve of innovation, where data

governance, trusted data flows, and data-based innovation are determining factors.

The prevailing geopolitical tensions in the Indo-Pacific necessitate particular attention to arms trade and dual use export control, nuclear safety, and non-proliferation of nuclear, chemical, and biological weapons, for instance through the implementation and universalisation of the Arms Trade Treaty.

### **Global Gateway**

The new [Global Gateway](#) builds on the two previous strategies, in particular through enlarging the Indo-Pacific concept. Africa is expected to become the main beneficiary.

Global Gateway adds the hitherto missing financial package, €300 bn from 2022-2027, and invites the private sector to join and leverage its capital and knowledge. Financial and operational tools such as technical assistance, policy and economic dialogue, trade and investment agreements and standardisation, will be combined to facilitate quality investments. When financing projects outside the EU, efforts will be made to ensure that trade and investment is not distorted; adhering to procurement standards similar to those applicable in the EU should avoid distortions.

### **Repercussions for the region and the EU**

Japan – which saved TPP through CPTPP after the withdrawal of President Trump – is in the hot seat to manage the double applications by China and Taiwan. Given the bilateral tensions over historic issues with South Korea, Japan will also have to handle an eventual Korean application diligently and put the interest in getting a like-minded partner on board above (mutual) animosity. China will likely use its economic and political might when asking for exemptions or phase-in periods for highly sensitive issues like the treatment of its state-owned enterprises, procurement, intellectual property rights, labour unions, environmental standards, access for foreign investors and non-discrimination, digital economy, and currency convertibility, to name a few.

On the positive side, if China were to upgrade its trade

regime from the RCEP to the CPTPP-level, this would improve economic governance. Although the eleven founding CPTPP members enjoy grace periods, they have agreed not to make concessions to new entrants. Accepting ‘essential national security-based exemptions’ which are foreseen in the treaty, could sound the death bell of the agreement, as China has a rather broad understanding of what falls under this term. Policy makers in China might also count on CPTPP to provide domestic arguments for advancing the reform process which has gone under way. Taiwan, on the other hand, could accept the rules as they stand.

Most importantly, collective bargaining needs to be arranged quickly to avoid China continuing to exercise bilateral pressure on members to accept it on its own terms. Vietnam, Malaysia, Singapore, and Brunei already seem to have been receptive to this persuasion.

While trade specialists will have to analyse the ‘spaghetti bowl effect’ of the various agreements, e.g., to which extent the various rules of origin are compatible, there are also political implications. Nine out of eleven CPTPP members have free trade agreements with China, but only two with Taiwan. Mexico and Canada, which are the two CPTPP members without an FTA with China, form, together with the US, the successor FTA to NAFTA. To make things tricky, this agreement includes the commitment not to sign an FTA with a non-market economy. Thus, the non-CPTPP member US could indirectly block China from joining the CPTPP! If China were to join before the US, it could block the US from re-joining its own creation. Given the state of play of US domestic politics, it appears rather unlikely that the US will re-join.

The rather indefinite US-proposal for an Indo Pacific economic framework covering issues like supply chain resilience, control of exports of critical technology, rules for AI, and cooperation on infrastructure, as well as a proposal for a digital supply chain deal, looks like the US is trying to fill a vacuum it has created itself through its withdrawal from the TPP.

China is already filling this vacuum: Although RCEP was initiated by ASEAN in Bali in 2011 as an

important initiative to show ASEAN centrality, China has become the de facto leader. This was possible, as RCEP does not cover state-owned enterprises or environmental rules. RCEP also offers an attractive trait for investors as it covers interesting emerging markets, high-tech knowledge, and relatively cheap labour within its geographical scope. This gives it a considerable edge in the regional competition.

For the EU, various important issues are at stake: First, the EU has no interest that mini-lateral arrangements, like Quad, be extended. This is not that far-fetched as supply chain security, export controls for sensitive products, and research and development are already discussed. Second, China playing a leading role in RCEP and CPTPP could get a decisive lead in a key sector of competition, rule and standard setting. China has already discovered the importance of these issues and is pursuing its economic statecraft policy with the goal of no longer being a rule taker but a maker. This not only hits head-on the 'Brussels effect', but would be economically costly for European as well as US and Japanese and Korean companies. It would also be an important step towards value-free policies following the autocratic model China is promoting. Keeping regional trade under the auspices of a re-empowered WTO in the interest of all should become an offensive agenda for the EU, filling the void left by US disengagement. In a networked economic diplomacy, the EU would need to work closely with its strategic partners in the Indo-Pacific, in particular Japan, South Korea, and Australia, and strive to get India on board too.

Making use of the recently started dialogue on the Indo-Pacific with the US as well as the Trade and

Technology Council, a common strategic approach needs to be developed associating strategic partners. Over efforts to contain China in the security field, the recognition of the importance of trade and a functioning WTO on security is crucial.

The EU needs to recognise that the lower level of ambition in economic terms of RCEP is overcompensated by its political and strategic value and act accordingly: Whether the EU joins one or both (RCEP, CPTPP), fitting in, sequencing, or modulating the bi-regional FTA with ASEAN, is not only a matter of trade policy but of geopolitical importance. Once a decision is taken after consultation with strategic partners, the necessary resources have to be assigned. As foreign policy starts at home, public support will have to be garnered for new trade initiatives to avoid a repetition of Mercosur's crash landing.

The Indo-Pacific power house has now organised itself around two large regional trade agreements with Chinese participation or aspiration. The EU and the US being absent does not augur well.

Striving to become a more effective and recognised global player necessitates the additional focus on security which the EU is pursuing in developing its own security culture through the Strategic Compass. However, it would be fatal not to make use of the EU's strengths and not to factor in the geo-economic and trade dimension. The analysis of the latest EU policy papers proves that the EU has not lost sight of the importance of regional trade agreements in the Indo-Pacific. Walking the talk is essential for a 'Europe that protects'; the best way to do so is to participate in order to exercise influence.



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