REGIONAL ECONOMIC INTEGRATION IN THE POST-PANDEMIC ERA

RSIS Monograph No. 37
August 2022

Edited by
Xue Gong

RSiS S. RAJARATNAM SCHOOL OF INTERNATIONAL STUDIES
Nanyang Technological University, Singapore

NANYANG TECHNOLOGICAL UNIVERSITY SINGAPORE

RSIS MONOGRAPH NO. 37

REGIONAL ECONOMIC INTEGRATION IN THE POST-PANDEMIC ERA

Edited by Xue Gong

S. Rajaratnam School of International Studies

Published by
S. Rajaratnam School of International Studies
Nanyang Technological University
Block S4, Level B3, 50 Nanyang Avenue
Singapore 639798
Telephone: 6790 6982 Fax: 6794 0617
Website: www.rsis.edu.sg

First published in 2022

Produced by **BOOKSMITH**
(chrys2@singnet.com.sg)

ISBN 978-981-18-5350-0

TABLE OF CONTENTS

Executive Summary

Global and regional economic trends over the past several years have given much cause for both optimism and pessimism. On the one hand, the COVID-19 pandemic, US-China strategic competition, as well as nationalist and populist concerns, have unravelled economic cooperation and disrupted supply chains. On the other hand, there is a trend towards multilateralism. For example, mega–free trade agreements (FTAs) such as the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) have entered into force. Also, regional governments have put forward several initiatives to strengthen regional economic institutions and resilience. In light of these developments, this RSIS monograph seeks to examine how regional countries could bolster economic integration in a post-pandemic era and to offer policy recommendations for the way forward.

SUMMARY OF RECOMMENDATIONS

Great power rivalry and COVID-19 pandemic impacts

The US-China strategic competition could be a boon for firms in Southeast Asia as they aim to enhance their economic links with the region:

- It is urgent that governments adopt mitigating policies or technological and financing solutions that will help to transform individual economies and the combined economies of the ASEAN region.
- Engineering a trade war or using subsidies to encourage reshoring is both unnecessary and harmful.

Regional mega–free trade agreements and WTO

Regional mega-FTAs such as RCEP and CPTPP can be used to counter protectionist pressures:

- Governments should reaffirm their commitment to a free and open, rules-based international trading system and step up engagement with WTO reforms.
- Governments need transparent international rules to define products whose trade can be restricted and industries in which inward foreign direct investments (FDI) can be regulated.

Trade and supply chain resilience

- ASEAN needs to carry out meaningful reforms and improve the "software" for foreign investment.
- Mini-regional FTAs such as ASEAN and bilateral FTAs should be considered to fill in such gaps that can improve the mega-FTAs and the multilateral trade regime embodied in the WTO.
- The region should work on innovation policies to construct competitive domestic industries rather than pursue protectionist policies.

Introduction

Xue Gong

This volume is a compilation of the papers presented at a workshop on the theme of "Regional Economic Integration in the Post-Pandemic Era", co-organised by the National Graduate Institute for Policy Studies (GRIPS) and S. Rajaratnam School of International Studies. The workshop, held in Singapore on 16 February 2022, sought to explore the question of how countries in the Indo-Pacific region could bolster economic integration and resilience in a post-pandemic era and to offer policy recommendations for the way forward. In particular, the monograph addresses the following areas:

1. The impact of the COVID-19 pandemic and the US-China strategic competition on the regional economic order;
2. Beyond RCEP and CPTPP: Towards Further Regional Economic Integration; and
3. Strengthening supply chain resilience in the wake of US-China rivalry.

The debate on the impacts of the US-China trade war and decoupling is intensifying as intra-Asian trade grows. The two countries are wrangling in a technological competition towards the next stage of the global economy, one that is increasingly digitalised and data-driven in nature. Despite rising economic nationalism and protectionism across much of the world, the Indo-Pacific region has successfully sustained open regional trade and multilateralism by concluding two mega–free trade agreements (FTAs): the Regional Comprehensive Economic Partnership (RCEP) and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Various expert contributors to this volume contend that US-China competition has engendered tensions for the changing economic order but also new opportunities for multilateral cooperation. Despite the complications brought about by great power competition and rivalry, the volume finds that engagement and cooperation can and should be prioritised by

regional countries, especially the ASEAN countries.

Part I carries three papers on the impact of the COVID-19 pandemic and the US-China strategic competition on the regional economic order. All three aim to address the following questions: How have the pandemic and the US-China strategic competition impacted economic cooperation; how have government responses to these events shaped the regional economic order; and what would a post-pandemic vision of regional trade or economic cooperation look like.

In **Chapter 1**, June Park redefines the post-pandemic economic order accelerated by technological competition in the digital domain and the conflict between the United States and China. The author argues that multilateral efforts have failed considerably on multiple fronts in international trade. Multilateralism will not be the main point of mobilisation of global interest. Instead, multilateral institutions continue to be tainted by politicisation. Reliance on regional trade or economic cooperation will be on a conditional basis, akin to a club membership, based primarily on very strict mutual interests that encompass national security. Therefore, the global economic system is now undergoing a stress test.

Henry Gao in **Chapter 2** discusses how the US-China strategic competition has shaped regional economic cooperation from the Chinese perspective. The strategic competition has not only resulted in a fundamental change in the bilateral relationship but has also significantly altered the course of regional economic integration. In addition, as most countries, including the United States, are ending their COVID restrictions, China's continuing zero-COVID policy will put strains on its domestic economy and lead to further disruptions to supply chains and regional integration efforts. In view of the controversial nature of trade politics in the United States, the recently launched plan for an Indo-Pacific Economic Framework might turn out to be mere rhetoric, making it harder for countries in the region to resist the force of gravity represented by China's economy.

In **Chapter 3**, Sanchita Basu-Das provides an ASEAN perspective of regional economic cooperation in the post-COVID-19 era. She argues that despite rising geopolitical contestation in the region, the logic of cooperation will prevail through various trade agreements. From ASEAN's perspective, deeper economic integration brings greater prosperity and peace. The ASEAN countries will continue to build economic partnerships with

the United States, China and other major economies. Rising geopolitical tensions will give ASEAN the opportunity to continue playing a leadership role in shaping the regional economic order in the future. To achieve this, ASEAN needs to adopt mitigating policies or technological and financing solutions that will help to transform the individual economies and subsequently the entire ASEAN community.

In **Part II**, three papers discuss two regional mega-FTAs — the RCEP and the CPTPP — in terms of how each will bolster international and regional economic integration. Further, the three authors discuss the impacts and implications of these on a future Free Trade Area of the Asia-Pacific (FTAAP) as well as the multilateral trade regime embodied in the World Trade Organization (WTO).

In **Chapter 4**, Piti Srisangnam echoes the other authors' position that the conflict between the two rival powers is likely to change the patterns and characteristics of global value chains and allow regional countries to benefit from those changes. From Thailand's point of view, however, there needs to be caution in signing mega-FTAs. On the one hand, Thailand, together with its ASEAN partners, should focus and prioritise trade agreements and cooperation with countries that form the core of regional value chains (RVCs) and those with international standards and best practices. On the other hand, Thailand and the other ASEAN economies should conduct internal reforms to improve their "software" so that they can establish themselves as the preferred destination for foreign investment.

In **Chapter 5**, Shujiro Urata argues that, despite differences, the two mega-FTAs — CPTPP and RCEP — have been driving forces behind regional economic integration in the Asia-Pacific region and are likely to play a conducive role in forging a future FTAAP. He also argues that the two regional mega-FTAs are able to promote trade liberalisation and provide solutions to handling trade disputes that the multilateral trade regime, the WTO, has not been able to. Urata believes that since the FTAAP represents the only FTA proposal that includes the two great powers — the United States and China — concluding such an agreement would produce substantial benefits to the region and the world in the long run.

In **Chapter 6**, Jeffrey Wilson argues that the Indo-Pacific, by global comparison, is doing exceedingly well in building an open and rules-based trading architecture. However, despite the recent successes of forging two

mega-FTAs in the region, the threats facing the global trade system have not been addressed. Unlike Urata, Wilson argues that RCEP and the CPTPP currently do little to help sustain the integrity of the global trading system. He suggests that regional governments need to participate in global trade debates to advocate open and rules-based trade arrangements and also step up their engagement with WTO reforms.

In **Part III**, three papers address the question of strengthening supply chain resilience in the wake of the US-China rivalry. In particular, they assess the following questions: how the ongoing US-China decoupling has impacted regional economies and international supply chains as well as how countries in the region have been able to strengthen and deepen international supply chains.

Natasha Hamilton-Hart in **Chapter 7** discusses how the rivalry between the United States and China has impacted regional technology supply chains. She notes that new security concerns are creating incentives for the reorganisation of supply chain relationships in the tech sector. But she adds that not all shifts in regional supply chains and firm-level decisions relating to shifting production locations are driven by the US-China conflict. For the largest firms, some moves to improve resilience are consistent with other de-risking initiatives through diversification of supply chain partners and production locations. In some cases, however, security-driven supply chain reorganisation may reduce diversification and resilience against market shocks or disruptions. In such cases, she argues, this security logic is at odds with the economic logic of the global value chain (GVC) revolution.

Yasuyuki Todo in **Chapter 8** provides the Japanese perspective of how resilient and innovative supply chains can be constructed. He argues that supply chains that are geographically diversified across countries are the key to resilience and innovativeness. Addressing tech-related national security concerns, Todo cautions that current industrial policy on semiconductors involving protectionist measures may not be effective. Instead, more emphasis should be placed on innovation policies to construct competitive domestic industries. He also emphasises that China is an important trade and knowledge partner for any country. To alleviate the risks of cooperating and competing with China, governments need transparent international rules to define products for which trade can be restricted and industries in which inward FDI can be regulated.

In **Chapter 9**, Dipinder S. Randhawa discusses the role of services and digitalisation in boosting ASEAN value chain resilience. He points out that supply chains were already undergoing significant changes in response to trends in business and technology, along with the changing geopolitical dynamics in the region. Pointing out distinct trends in GVCs across ASEAN, Randhawa contends that ASEAN is at a juncture where it should not, and need not, align with either great power, but rather deploy its own growing strengths to attract investment and boost trade with all regions. In particular, ASEAN needs to carry out meaningful reforms in two areas — liberalisation and coordination of the services sector, and digitalisation of the region — to project itself as a stable region that is politically independent of vested interests.

CONCLUSIONS AND POLICY SUGGESTIONS

Jayant Menon in **Chapter 10** provides tentative conclusions and policy suggestions based on the three main topics discussed in this monograph. He first highlights the role of the regional mega-FTAs — RCEP and CPTPP — in countering the rise in protectionist pressures. A good starting point for governments is to reaffirm their commitment to a free and open, rules-based international trading system. Menon further points out that since both RCEP and CPTPP are not designed to deal with factor mobility, for instance, labour mobility, mini-regionals such as ASEAN and bilateral FTAs could play the role of filling the gap. Menon also notes that the apparent lack of resilience in supply chains is being employed as a pretext for reshoring. This monograph in general suggests that supply chains may be more resilient than they appear and that there is little basis for the shortening or retrenchment of supply chains that many are proposing. Therefore, engineering a trade war or using subsidies to encourage reshoring is both unnecessary and harmful.

Part I

THE IMPACT OF THE COVID-19 PANDEMIC AND THE US-CHINA STRATEGIC COMPETITION ON THE REGIONAL ECONOMIC ORDER

Redefining the Post-Pandemic Global Economic Order

The US-China Jostling for Power in Technology

June Park

The COVID-19 pandemic has impacted every corner of the globe politically, economically, and socially, underlining the importance of public health policies across jurisdictions. As the pandemic continues, what goes unnoticed is that the acceleration of technological competition in the digital domain and the conflict between the United States and China are reshaping the global economic order for good. This chapter is an attempt to redefine the post-pandemic global economic order beyond public health issues and pandemic governance to gauge where the global economy is headed amid the unfolding of clashes between the two biggest economies in the world, and their impact on the rest of the world in the post-pandemic era.

TWO ELEPHANTS IN THE RING: US-CHINA TECH COMPETITION, POST-PANDEMIC

During the COVID-19 pandemic, strategic competition between the United States and China severely hindered economic cooperation, but divergence between the two countries had begun well before the pandemic. The two did not move an inch towards any cooperative mechanism, but instead went their separate ways to defend their respective interests. When the two countries signed the Phase One Deal under the Trump administration on 15 January 2020, the SARS-CoV-2 virus was already spreading in different corners of the globe. Although the deal was intended to stall the trade war that had been ongoing since 2018, the efforts towards fulfilling the agreement were in vain. More than two years into the pandemic, there is no end to the divergence, and bilateral efforts between the two countries have failed. The two countries are wrangling in a technological competition towards the next stage of the global economy, which is increasingly digitalised and data-driven in nature.

Data — from collection, processing, storage and sale — have become the most critical and valuable asset in the global economy today, and the

accelerated transition to a data-driven economy will be salient coming out of the pandemic. Chip shortages at the global level have laid bare the vulnerability of supply chains to geopolitical risks and mismatched planning for production during the pandemic. Meanwhile the contactless economy progresses in tandem with social distancing policies deployed simultaneously by public health authorities around the world to fight the pandemic. The United States — as the inventor of semiconductors — is determined to dominate the semiconductor industry, but it remains to be seen whether its policies are genuinely catered towards the future of the industry. On chips, the United States is resorting to industrial policy, overturning decades-old policies against government intervention in entrepreneurial economic activities. In so doing, it seeks the use of export controls, while continuing to rely on high-skilled engineers from abroad and encouraging companies from allied countries — essentially TSMC of Taiwan and Samsung of South Korea — to build foundries in the United States. Both companies already have been operating foundries in China for a long time, and it is likely that the US-China competition on chips will hinge on how these foundries are operated in the United States and China in the post-pandemic future. There are, however, uncertainties on whether the CHIPS for America Act of 2021 to enhance the competitiveness of the domestic semiconductor manufacturing industry would be enough, and whether it would be a sustainable policy drive. Just a single glance at the manoeuvres by the American semiconductor company Intel to dominate the funds available under the act shows that the company is on a quest for survival: as major Big Tech companies (i.e., Apple, Google, Amazon) engage in in-house designing or place orders with foreign-owned semiconductor fabrication plants (i.e., TSMC, Samsung), Intel feels compelled to stretch its production capacity by seeking any help it can get (i.e., government subsidies). Meanwhile, China's SMIC looks to incorporating more foreign talent and government subsidies to seize the momentum to play a bigger role in the global semiconductor market.

In all of this, there is not much reliance by countries on multilateralism as multilateral efforts in international trade have failed considerably on multiple fronts (i.e., continued paralysis of the WTO Appellate Body, debates over vaccine patent waivers at the WTO, and the justification of export controls on personal protective equipment — albeit largely lifted as the pandemic progressed). Most nations will find that multilateralism does not serve their national interests as it used to. Instead, multilateral institu-

tions continue to be tainted by politicisation. The United States has not stepped up to salvage multilateralism, and China has continuously utilised multilateral institutions for its own benefit and geopolitical interest.

EXPORT CONTROLS SINCE THE PANDEMIC AND VARIED RESPONSES BY GOVERNMENTS

In dissecting governments' responses to unfolding events in the global economy, it is not difficult for one to notice that export controls have been (and continue to be) at the crux of their economic interactions, mainly spearheaded by the United States (i.e., continuation of the Huawei ban, the US Commerce Entity List). In the wake of the Russian invasion of Ukraine, export controls are now utilised as one of the prime tools of sanctions against Moscow, in tandem with an import ban on Russian oil and gas, and these controls are intended mainly to block the sale of semiconductor-related materials to Russia.

Responses to export controls have been varied and fall largely within three disparate patterns: bandwagoning, petitioning and resisting. Those countries that seek to align fully with US policies have gone beyond acquiescence and bandwagoned (i.e., Australia, Japan); those that have considerable industrial interests have petitioned and asked for waivers but ultimately participated in instituting similar export controls (i.e., South Korea, certain European countries); and those that are the targets of such export controls have fiercely resisted (i.e., China).

Japan has become the main bandwagoning actor, drawing from the Trump playbook to place export curbs on the export of materials used in semiconductor production (hydrogen fluoride, polyimides, photoresist) to South Korea. This step was taken following the South Korean Supreme Court's ruling that individual Korean petitioners had the right to compensation from Japanese companies for forced labour during the Second World War. These export curbs on South Korea have not been lifted thus far, and there are an ongoing series of court-sanctioned asset seizures from Japanese companies in South Korea to compensate the petitioners. South Korea is a vital node in the supply of critical technologies (semiconductors, batteries for electric vehicles, 5G/6G technology), but having had its ability to supply these technologies to China curtailed by virtue of US export controls, South Korean companies petitioned for waivers. As for China, it has resisted US

pressures through internal consolidation, with Huawei and SMIC teaming up for fab construction in mainland China and the country seeking foreign talent for its chip industry.

The varied responses to export controls show that existing trade rules have come under considerable stress during the pandemic, but, more specifically, due to geopolitical tensions that were exacerbated by the turn of events during the pandemic. The stress test is mainly putting pressure on the existing trade rules as laid down by the Marrakesh Agreement, under which the World Trade Organization was established in 1995. In the 1990s, as the Uruguay Round of multilateral trade negotiations was concluded, the trade rules were written with a wide degree of discretion for states, allowing them to use national security as a reason to protect trade. But with the ever-changing geopolitical dynamics today, export controls and their use, legitimised as part of the enforcement of trade rules, have become the baseline scenario. The concern that arises from this trend is that export controls are wielded to the extent that supply chains are weaponised, and they undercut economic interdependence. Back in the 1990s, most of the economies in the global trading system were allies or small markets, and some did not even have access to the rules-based global trading system (i.e., China before 2001 and Russia before 2011), so there were not many reasons to use the national security clause. Moreover, the trade rules were written primarily by the transatlantic players, notably, the United States and key European countries. Export controls are now becoming a policy tool amid geopolitical tensions, and the international economic system is confronted with the reality that the biggest rivals in the security dimension (the United States and China; European Union and Russia) are deeply embedded economically.

GLOBAL AND REGIONAL ECONOMIC ARCHITECTURES POST-PANDEMIC

In the post-pandemic era, groupings of "like-minded" economies are likely to form, but leaving questions open for trade with China, which is inevitably the biggest market. However, as China pushes on with the development of indigenous technologies, many foreign companies will end up exiting China upon political friction or market strategies pursued by the Chinese Communist Party (CCP). Once China's domestic firms get to a certain level of development, they have a tendency of ending partnerships by either cutting off or pushing out foreign companies, citing political reasons. As

much as data would be critical, "splinternet", or a more autarkic form of the Chinese digital economy, may be perceived as well. However, it is not certain whether a complete decoupling would occur, given the US interest in the Chinese market. Reliance on regional trade or economic cooperation will be on a conditional basis, akin to a club membership, based primarily on very strict mutual interests that encompass national security. Because government policy and business interests are not always aligned, countries will be struggling to plan their strategies to retain their businesses. We are witnessing this trend during the unfolding sanctions on Russia.

Existing trade rules also are being rendered outdated by the next stage in innovation, the data-based digital economy. The public sector in democracies is being outplayed by the private sector. Governments are seeking to harness Big Tech, while in China technology firms are effectively under the control of the CCP. There will be attempts again by "like-minded" partners in various groupings to coalesce with a view to agreeing on upgraded trade rules at regional levels or arriving at a digital agreement on data governance, but it would be very difficult to bring varied country interests together in the mode of a single undertaking, as countries already vary considerably in their data policies. A glance at the European Union's General Data Protection Regulation (GDPR), China's Personal Information Protection Law (PIPL), coupled with its Data Security Law, and South Korea's Personal Information Protection Act (PIPA) or Japan's Act on the Protection of Personal Information (APPI) points to the varied approaches on data.

More complications are expected to arise when central banks seek to issue their legal digital currencies — central bank digital currencies (CBDCs) — with a view to protecting central bank independence and maintaining monetary policy discretion (i.e., centralised finance or CeFi) amid the rise of alternatives in decentralised finance (DeFi) such as cryptocurrencies and stablecoins. Faith in the US dollar remains in the fiat currency–driven world, but in a combined world of DeFi and CeFi, China may have the upper hand, although how such a scenario would unfold remains to be seen. In such a world, the dollar's dominance in the global economy may be compromised. While China has outlawed cryptocurrencies, the United States will not do likewise, given the leverage it has on cryptocurrencies and stablecoins. The interoperability of CBDCs will also impact how cross-border transactions are undertaken, and how sanctions are implemented in times of contingency.

All in all, the COVID-19 pandemic has proven that the continuance of the multilateral trading system is not guaranteed. The system has hit a wall in the face of geopolitical and supply chain risks, and it is now undergoing a stress test. Economic autarky may be sought among countries that are on the same side of geopolitics, but, depending on the issues, their alignment may not always be perfect. The widely deployed export controls are reminiscent of the Cold War years, and country groupings based on geopolitical orientation are somewhat akin to the Coordinating Committee for Multilateral Export Controls (COCOM), comprised of the United States and its allies against the former USSR, but ever more challenging in our times owing to the accelerated digital transformation in the post-pandemic era.

Countries will be charting their future paths on their own and they will brace for uncertainties in the global economic order as they go about it. The pandemic has taught that from now on it will be the combination of country and business interests that will decide the fate of the global economy, and vice versa. The challenge is that there is no clear answer; it will be every nation for itself and every company for itself.

A Chinese Perspective

Henry Gao

Many factors have been driving regional economic integration in the Asia-Pacific in the past two decades, but the main driving force in the past decade has been the strategic competition between the two biggest powers in the region — the United States and China. This paper discusses the Chinese perspective of how the US-China strategic competition has shaped regional economic cooperation, along with the disruptions brought by the COVID-19 pandemic. It concludes with some thoughts on post-pandemic economic cooperation in the region.

US-CHINA STRATEGIC COMPETITION

In the history of US-China strategic competition, 2008 was a watershed year. Before then, the United States largely welcomed China's participation in global economic governance as a new member of the WTO and encouraged it to play a bigger role in the multilateral trading system. However, the relationship started to become acrimonious after the WTO mini-ministerial held in July 2008 failed to revive the ill-fated Doha Round of negotiations. When the United States, in an attempt to salvage the round, requested China to provide additional concessions on special products in agriculture and in sectoral negotiations on industrial goods, China declined as the same demands were not made of India or Brazil.[1] The United States subsequently accused China of walking back on the text despite getting "a seat at the big kids' table" as it had requested,[2] which drew an angry retort

1 For details of the US request and China's reaction, see Henry Gao, "From the Doha Round to the China Round: China's Growing Role in WTO Negotiations", in *China in the New International Economic Order: New Directions and Changing Paradigms*, ed. Lisa Toohey, and Jonathan Greenacre (Cambridge University Press, 2015), 79-97.

2 Paul Blustein, "Misadventures of the Most Favored Nations: Clashing Egos, Inflated Ambitions, and the Great Shambles of the World Trade System," (Public Affairs, 2009), 274. See also Gao, "From the Doha Round".

from China's WTO ambassador Sun Zhenyu, who gave a diatribe outlining China's contributions in various areas to the Doha Round as a response to the US "finger pointing".[3]

After the Western world plunged into a financial crisis later that year, China was able to avoid the contagious effects from the global crisis by maintaining its restrictions on foreign exchange and capital flows. This bolstered China's confidence in the so-called Beijing Model, a model of economic growth that relies heavily on government intervention.[4] Its incomplete market reform, long regarded as an embarrassing failure, is now hailed by China as a unique feature of the Chinese system. Moreover, with the country's emergence as the biggest exporter in 2009 despite the 13% contraction in global trade, Chinese leaders started to question the wisdom of more market-oriented reforms.

Concerned over the continued rise of China, the United States announced its "pivot to Asia" and launched negotiations to join the Trans-Pacific Partnership (TPP) to "make sure that the United States — and not countries like China — is the one writing this century's rules for the world's economy".[5] While the TPP does not target China directly, the attacks on China became more blunt after Donald Trump became US president in early 2017. The president's push for "decoupling" from China escalated into a bilateral trade war, with much of the bilateral trade becoming subjected to additional unilateral tariffs. Even with the signing of the Phase One Agreement between the United States and China in 2020, the bilateral trade relationship has not fully recovered.

3 Sun Zhenyu, H.E. Ambassador, Permanent Mission P.R.C. to the WTO, Statement at the Informal Trade Negotiations Committee Meeting (Aug. 11, 2008), cited in Henry Gao, "China's Changing Perspective on the WTO: From Aspiration, Assimilation to Alienation," *World Trade Review* 21, no.3 (2022): 346.

4 For more on the Beijing Model, see Gregory Shaffer and Henry Gao, "A New Chinese Economic Order?" *Journal of International Economic Law* 23, no. 3 (2020): 607–635.

5 White House (archives), "President Obama: 'Writing the Rules for 21st Century Trade'", 18 February 2015, https://obamawhitehouse.archives.gov/blog/2015/02/18/president-obama-writing-rules-21st-century-trade.

IMPACT OF US-CHINA STRATEGIC COMPETITION ON REGIONAL ECONOMIC INTEGRATION

The US-China strategic competition not only resulted in a fundamental change in the bilateral economic relationship, but also significantly altered the course of regional economic integration. For a long time, the contours of regional economic integration in East and Southeast Asia had been largely shaped by the players from within the region. This started with China's courtship of ASEAN in 2000, which led to the launch of negotiations for a free trade agreement (FTA), a first for both parties. China's aggressive FTA strategy[6] resulted in a wave of "competitive regionalism" among ASEAN's neighbours, as all of its external partners started to negotiate FTAs with the 10-country bloc.

As the US-China strategic competition heated up, the United States started to realise the strategic value of the region, a realisation reflected in its new "pivot to Asia" approach. The centre piece of this strategy was the TPP, which was used by the United States as a key instrument to rally allies in the Asia-Pacific. Two features in the TPP are of particular relevance to China.

The first is the rules-of-origin feature. Such rules can be found in every FTA to make sure that the benefits available under it would be enjoyed only by its members. What is different about the TPP, however, is that it contained some of the strictest rules of origin in an effort to ensure that non-members like China would not have a free ride. One example is the notorious "yarn-forwarding rule", which states that a final apparel product would be considered as "originating [from the country concerned] only if such fabrics are both formed and finished from yarn that is formed and finished in the territory of one or more of the Parties."[7] Essentially, this provision was put in place to make sure that China would not be able to piggyback on the preferential access created under the TPP by exporting yarn to TPP members. Even though a short-supply list was later added at the request of Vietnam

6 Henry Gao, "China's Strategy for Free Trade Agreements: Political Battle in the Name of Trade" in *East Asian Economic Integration*, eds. Ross P. Buckley, Richard Weixing Hu, and Douglas W. Arner (Edward Elgar Publishing, 2011), https://www.elgaronline.com/view/edcoll/9781849808682/9781849808682.00012.xml.

7 Government of Canada Website, "Consolidated TPP Text — Annex 4-A — Textiles and Apparel Product — Specific Rules of Origin", n.d., accessed 10 February 2022, https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/04-ad.aspx?lang=eng.

to create an exception for yarn that is not readily available within the TPP countries, the yarn-forwarding rule was widely recognised as having the effect of excluding China from the TPP and artificially cutting it out of the supply chain network in the Asia-Pacific region.

Second, the United States pushed for the inclusion of rules on state-owned enterprises (SOEs), competition, and electronic commerce. These rules answer then president Barack Obama's call to make sure that it is "the United States — and not countries like China — [that] is the one writing this century's rules for the world's economy".[8] Such rules "up the game"[9] for regional economic cooperation by pre-empting the China challenge and informing future discussions on these issues in other regional and global fora such as the WTO.

With the United States reaching across the Pacific to assemble its allies in the TPP to contain China, China started to make its own moves, which involve two components.

The first component is rebuilding the supply chains interrupted by the United States. This was mainly done through the launch of negotiations on the Regional Comprehensive Economic Partnership (RCEP) in November 2012.[10] China had long advocated for regional economic integration between East and Southeast Asia, but its preferred set-up was ASEAN+3, i.e., China, Japan and South Korea. Japan, on the other hand, preferred to add three more countries, i.e., India, Australia and New Zealand, as counterbalances to China. China's willingness to go with the ASEAN+6 model reveals its sense of urgency following the US accession to the TPP, which could severely disrupt China's supply chains in the region with provisions such as the yarn-forwarding rule that makes it difficult for TPP members to use inputs from non-members in the production process.

Moreover, in 2013, China announced two major initiatives: the Silk

8 White House (archives), "President Obama: 'Writing the Rules for 21st Century Trade'".

9 Reuters, "Obama Praises Business Deals, Touts US Enterprise", 28 April 2014, https://www.reuters.com/article/uk-obama-praises-business-deals-idUKBREA3R0DM20140428.

10 ASEAN, "Joint Declaration on the Launch of Negotiations for the Regional Comprehensive Economic Partnership", n.d., https://asean.org/wp-content/uploads/2016/10/SEOM-AFPs-Bali-Annex-4-Joint-Declaration-on-the-Launch-of-Negotiations-for-the-RCEP.pdf.

Road Economic Belt, which connects China with Europe through the Eurasian continent,[11] and the 21st Century Maritime Silk Road, which links China with the Southeast Asian countries, Africa and Europe across the Pacific and Indian Oceans.[12] Later, combined together as the Belt and Road Initiative (BRI), this initiative has since become the centrepiece of President Xi Jinping's foreign policy. Spanning 65 countries in three continents with a total population of 4.4 billion,[13] the BRI reportedly accounts for 29% of global GDP and 23.4% of global merchandise and services exports.[14] By "linking up the interests of China with those of developing countries in Asia, Africa, and Latin America",[15] the BRI helps China to build its own supply chain without direct confrontation with the United States in the Pacific.

Second, contrary to the US approach, which keeps introducing new and stricter rules, China lowers the bar for regional economic integration. The BRI is a good example, as many of the countries in the initiative are low-income developing countries or even least-developed countries that have difficulties meeting even the basic rules under the WTO. Unlike the United States, China adopts an open approach and does not prescribe any conditions for participation in the BRI. This is also reflected in RCEP, where the

11 First suggested by President Xi Jinping in a speech titled "Promote People-to-people Friendship and Create a Better Future" at Kazakhstan's Nazarbayev University on 7 September 2013. See Ministry of Foreign Affairs, PRC, "President Xi Jinping Delivers Important Speech and Proposes to Build a Silk Road Economic Belt with Central Asian Countries", 7 September 2013, http://www.fmprc.gov.cn/mfa_eng/topics_665678/xjpfwzysiesgjtfhshzzfh_665686/t1076334.shtml.

12 First proposed by President Xi in his speech to the People's Representative Council of Indonesia on 2 October 2013. See Wu Jiao, "President Xi gives Speech to Indonesia's Parliament", *China Daily*, 2 October 2013, https://www.chinadaily.com.cn/china/2013xiapec/2013-10/02/content_17007915.htm.

13 www.scio.gov.cn, "Yidai Yilu Tichu de Beijing ji Juti SiluZhanlue de Tichu he Xingcheng [The introduction and implementation of the Belt and Road Initiative]", 14 April 2015, http://www.scio.gov.cn/ztk/wh/slxy/31200/Document/1415297/1415297.htm.

14 For a detailed review of the Belt and Road Initiative, see Gregory Shaffer and Henry Gao, "A New Chinese Economic Order?" *Journal of International Economic Law* 23, no. 3 (2020): 614–20.

15 Xi Jinping, "Tongchou Liangge Daju, Hangshi zou Heping Fazhan Daolu de Jichu [Coordinate Two Grand Schemes and Lay a Solid Foundation for the Path of Peaceful Development]", speech at the third joint study session of the 18th Politburo of the CCP, 28 January 2013, http://www.gov.cn/ldhd/2013-01/29/content_2321822.htm.

rules are diluted to ensure the maximum participation of all countries. For example, the chapter on e-commerce comes with extensive exceptions and is excluded from the dispute settlement chapter. Similarly, China also agreed to the removal of the investor-state dispute settlement (ISDS) mechanism from the investment chapter even though China has shifted from shunning investment disputes to embracing the ISDS in recent years and proposed texts on ISDS during negotiations for the RCEP.

While the US-China strategic competition resulted in disruptions for firms in the United States and China, it could be a boon for firms in Southeast Asia as both countries aim to enhance their economic links with the region. Already, in the midst of the US-China trade war, many Chinese firms started to shift their production to Southeast Asia to evade additional tariffs. However, due to the lack of skilled labour and infrastructure networks in the region, many firms found that the tariff costs they saved were offset by the additional costs of operating from Southeast Asia and some even relocated back to China. However, should the trade tensions grow, many firms may make more permanent moves to the region and start to invest additional resources to upgrade their human resources and infrastructure in the region.

COVID-19 PANDEMIC AND BEYOND

Other than the US-China trade war, the COVID-19 pandemic also has brought "unprecedented disruption to people's lives, the global economy and world trade", as noted by the WTO.[16] What is interesting, though, is that the impact of the pandemic on the two largest economies in the world has been uneven, with China seeing its trade surplus jumping 30% in 2021 from the year before to set a new record of US$676 billion,[17] while the United States recorded a 27% increase in its trade deficit to an all-time high of US$859.1 billion.[18]

16 'WTO, "COVID-19 and World Trade", n.d., https://www.wto.org/english/tratop_e/covid19_e/covid19_e.htm.

17 Stella Yifan Xie, "China's Export Machine Notches New Record as Pandemic Grinds on', *Wall Street Journal*, 14 January 2022, https://www.wsj.com/articles/chinas-export-machine-notches-new-record-as-pandemic-grinds-on-11642150270.

18 Yuka Hayashi and Anthony DeBarros, "US Trade Deficit Hit Record in 2021 as Americans Spent on Computers, Games", *Wall Street Journal*, 8 February 2022, https://www.wsj.com/articles/economic-recovery-pushes-2021-u-s-trade-deficit-to-record-level-11644328979.

What are the reasons for these differences? In a 2018 article in the *Journal of International Economic Law* contrasting Washington and Beijing's approaches to digital trade, I argued that their differing positions can be explained by the different nature of trade, with China focusing on the traditional trade in goods while the United States focuses on trade in digital services.[19] The same explanation also works here. If we look at COVID-related trade restrictions around the world, they tend to be mainly restrictions on the movement of persons while the trade in goods is largely kept free of restrictions. Thus, naturally, the restrictions would affect service-oriented economies like the United States (which rely on movement of persons) more than heavy goods exporters like China.

On the other hand, as most of the Western countries, including the United States, are ending their COVID restrictions, the table might flip for China, which seems set on continuing its zero-COVID policy, at least for the next few months. This may lead to further disruptions to supply chains and regional integration efforts in the region, but there are also signs that China may readjust its position once most of the rest of the world reopens.

Going forward, however, the policy choices made by the two countries, especially those on regional economic integration, will have a bigger impact on their respective trade performances. On the one hand, since the signing of the US-Mexico-Canada Agreement (USMCA) in November 2018, the United States has not negotiated any FTA and currently does not have plans to do so. During the same period, China has signed FTAs with Mauritius and Cambodia, seen the entering into effect of upgrades to its FTAs with Chile (March 2019), Singapore (October 2019), ASEAN (October 2019), and Pakistan (December 2019), signed upgrades to its FTA with New Zealand (January 2021), concluded and launched RCEP, and applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the successor to the TPP after the United States withdrew from it,[20] and the Digital Economy Partnership Agreement, first signed by Chile, New Zealand and Singapore in June 2020.

19 Henry Gao, "Digital or Trade? The Contrasting Approaches of China and US to Digital Trade", *Journal of International Economic Law* 21, no. 2 (June 2018): 297–321.

20 Henry Gao and Weihuan Zhou, "China's Entry to CPTPP Trade Pact is Closer Than You Think", *Nikkei Asia*, 20 September 2021, https://asia.nikkei.com/Opinion/China-s-entry-to-CPTPP-trade-pact-is-closer-than-you-think.

Since coming into office a year ago, the Biden administration has been busy promoting its "worker-centred trade policy", which unfortunately lacks substance. In view of the controversial nature of trade policy in US domestic politics, it is highly unlikely that the United States will be able to make major moves in the next two to three years. Indeed, even the widely anticipated Indo-Pacific Economic Framework could end up more hollow than it sounds as it will reportedly focus on issues including digital trade, supply chains and green technology.[21] Given the well-known resistance to these issues by India, the biggest player among the 12 countries that joined the United States in announcing the launch of the framework in May 2022, the US plan may turn out to be mere rhetoric, making it harder for countries in the region to resist the force of gravity exerted by the Chinese economy.

21 Yuka Hayashi, "US Readies New Asia-Pacific Economic Strategy to Counter China", *Wall Street Journal*, 6 February 2022, https://www.wsj.com/articles/u-s-readies-new-asia-pacific-economic-strategy-to-counter-china-11644148801.

An ASEAN Perspective

Sanchita Basu-Das

INTRODUCTION

Regional integration among the ASEAN member countries has become more crucial than ever. Although the COVID 19 pandemic initially prompted countries to impose restrictive measures, which caused economic damage, it thereafter highlighted the importance of cross-border cooperation in healthcare services, flow of essential goods, and supply chain connectivity. The experience signified the role of trade and investment and highlighted the value of people mobility for post-COVID-19 economic recovery. Most importantly, the pandemic brought to the fore the role of regional cooperation as a means of improving accessibility to vaccines, helping countries to reopen borders, and safeguarding their populations.

Even US-China strategic competition has had the effect of encouraging the countries in Southeast Asia to promote integration among themselves, particularly to leverage ASEAN mechanisms to engage with both the competitors and gain in terms of trade, investment and infrastructure connectivity.

Going forward, ASEAN as a region may not see substantial change in the regional economic order. While the US-China rivalry will continue, there will be some degree of competition between India and China or among the Northeast Asian nations. However, the logic of cooperation will prevail through various trade agreements, such as ASEAN+1 free trade agreements (FTAs), the Regional Comprehensive Economic Partnership (RCEP), the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), and other regional fora such as the East Asia Summit. Initiatives like China's Belt and Road Initiative (BRI) and the Indo-Pacific Economic Framework (IPEF) also will continue to exist and will be discussed by participating member countries in terms of their shared economic and strategic benefits.

Post-pandemic, regional economic cooperation will undergo a shift away from trade in goods to trade in services, driven by digital transformation. Policy coordination and streamlining of cross-border processes will gain greater importance. Improved provision of regional public goods will gain momentum. This chapter discusses each of these points in detail.

THE PANDEMIC AND US-CHINA STRATEGIC COMPETITION ENCOURAGE ASEAN ECONOMIC COOPERATION

As COVID-19 struck the countries of Southeast Asia, governments imposed lockdown measures, restricting movements within and across countries. These resulted in massive economic damage as cross-border trade and movement of people have long been integral to these economies. The pressure of supply chain disruption due to the geographic concentration of production or industries' participation in global value chains (GVCs) brought many economic activities to a standstill.[22] For example, China, the world's largest supplier of face masks, medical goggles and protective gowns in 2019, lowered exports of these essential goods in 2020 as COVID-19 cases rose in its own economy. In another example, the electronics industries that are part of the GVCs in Southeast Asia suffered as 40%–60% of electronics components for production facilities in Indonesia, Thailand, and Vietnam are sourced from China.

These experiences at the peak of the pandemic strengthened the ASEAN countries' conviction that economic cooperation is vital to enhancing their resiliency. To reiterate the need for cooperation, during the course of the pandemic, the 10 countries decided in November 2020 to remove all restrictions on intraregional trade in medicines for at least two years.[23] They are now in the process of recognising each other's vaccine certification[24] so that cross-border movement of people can resume in support of business and

22 ADB, "Asia Pacific Trade Facilitation Report, 2021: Supply Chains of Critical Goods amid the COVID-19 Pandemic — Disruptions, Recovery and Resilience", October 2021.

23 ADB SEADS, "ASEAN Removes Trade Barriers on Medicines and Other Essential Goods", ADB, 28 December 2020, https://seads.adb.org/news/asean-removes-trade-barriers-medicines-and-other-essential-goods

24 ADB SEADS, "ASEAN to Develop One System for Verifying Vaccinated Travelers", ADB, 6 June 2022, https://seads.adb.org/solutions/asean-develop-one-system-verifying-vaccinated-travelers

tourism revival in the region. As recovering from the effects of the pandemic is a priority for all, ASEAN economic cooperation will continue to remain important in the foreseeable future.

The ASEAN countries also acknowledge the importance of regional economic cooperation in the face of US-China strategic competition. While each of these countries prioritises its own national economic interest and accordingly pursues its own foreign policy, it also values ASEAN as a regional platform to engage both the United States and China. Indonesia, for example, has partnered with China more closely in the recent past than with the United States, driven by its interest in building its infrastructure with Chinese assistance. During the period 2015–2018, Chinese investments in Indonesia went up from US$623.3 million to US$1.8 billion (till September). US investments in the country have remained relatively stable, from US$893 million in 2015 to US$1.0 billion in 2018 (till September).[25] Chinese foreign aid for Indonesia in 2015 surpassed the level of aid from the United States (US$1.36 billion vs US$1.02 billion). This does not imply that the United States has taken a backseat in Indonesia's foreign policy priorities; rather, China is seen to have greater capacity to extend economic support.[26] Concurrently, Indonesia through its membership of ASEAN, engages with China and supports ASEAN-led platforms, such as the East Asia Summit and the IPEF to ensure that the United States remains engaged in the region. More particularly, Indonesia led the discussion of the "ASEAN Outlook on the Indo-Pacific", attempting to moderate the strategic competition between the United States and China. It placed "inclusivity" at the core of the outlook and highlighted "cooperation based on mutual trust and dialogue".[27]

25 However, investment per project continues to be higher for the United States (US$2.7 million) than for China (US$1.3 million). Source: Broto Wardoyo (see footnote 26).

26 Broto Wardoyo, "ASEAN in the United States–China Strategic Competition: An Indonesian Perspective", in How Can ASEAN Deal with the United States-China Strategic Competition? NIDS Joint Research Series No. 18 (2020), National Institute for Defense Studies, www.nids.mod.go.jp/english/publication/joint_research/series18/index.html

27 ASEAN 2020, "ASEAN Outlook on the Indo-Pacific", ASEAN Secretariat, https://asean.org/asean2020/wp-content/uploads/2021/01/ASEAN-Outlook-on-the-Indo-Pacific_FINAL_22062019.pdf

Thus, while the economic imperatives of the ASEAN countries drive their policies towards China and the United States as well as the US-China strategic competition, their cooperation mechanisms through ASEAN platforms ensure that both countries stay relevant and economically engaged in the region.

ASEAN'S PERSPECTIVE OF REGIONAL ECONOMIC ORDER

The regional economic order will be shaped by the emerging trends discussed below in addition to the US-China strategic competition and COVID-19 pandemic.

First, the countries in Southeast Asia, either all 10 or a subset of them, are part of the two mega-regionals, namely, the CPTPP and the RCEP agreements. These agreements have their own characteristics and are designed according to the level of development of the member countries. Both of these currently exclude the United States and emphasise the shift in the economic centre of gravity to the east.

Second, China is a growing economic power in the region. It is a leading trade and investment partner for most of the countries in the region. At least till the outbreak of the pandemic, China was also a major source of tourism for these countries. The growing economic relationship acts as a double-edged sword for the ASEAN countries. While they benefit from China's economic might, they also are wary of the spillover effect from economics to security and have therefore taken care to moderate their dependence on China.

Third, the recent US-led launch of the IPEF with 12 other members gives greater importance to economic cooperation among countries in the Indo-Pacific region. This region forms the core of global trade[28] and energy supply, which underlines the strategic value of the region. Southeast Asian countries (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam) that are part of the IPEF have the role of "bridge builder" among the other members of the grouping (United States, Australia, India, Japan, South Korea, and New Zealand). Given this, it is in the interest of the

28 About 60% of global maritime trade flows through the Indo-Pacific. See Saon Ray, "Commerce and Connectivity for Enhancing Trade in the Indo Pacific", Observer Research Foundation (ORF), 14 December 2021, https://www.orfonline.org/expert-speak/commerce-and-connectivity-for-enhancing-trade-in-the-indo-pacific/

Southeast Asian countries that are also part of ASEAN to have a rules-based system in an "open, free and peaceful Indo-Pacific".

From ASEAN's perspective, assuming that the current situation prevails, with no major shift in any of the trends, it will insist on cooperation for win-win economic benefits. The countries in the region understand that deeper economic integration brings greater prosperity and peace; instability in any one country will have severe economic consequences for all. They will continue to build economic partnerships with the United States, China and other major economies. They will try to economically balance China, while concurrently engaging with it. Economic friction between the ASEAN countries and one of these major economies is possible. It is also conceivable that the economic ties of some ASEAN countries could tilt towards one of these major players to the exclusion of the others but such an economic tilt is not likely to constitute a complete shift in their foreign policy alignment.

Prior to the launch of IPEF, ASEAN's own vision of what an Indo-Pacific free trade arrangement might look like reflected the same concerns. This is reflected in the "ASEAN Outlook on the Indo-Pacific", unveiled in 2019. As noted above, "inclusivity" is an integral part of the outlook, which also highlights the importance of ASEAN centrality as an anchoring factor in the broader region.[29] In addition, the ASEAN outlook proposes the use of the ASEAN-led forum, i.e., the East Asia Summit, as a platform to pursue discussion on Indo-Pacific cooperation.

POST-PANDEMIC ECONOMIC COOPERATION

The COVID-19 pandemic highlighted the issue of coordination as local lockdowns and border controls stalled the flow of essential goods across borders. Access to vaccines became uneven as a limited number of countries produce vaccines but all need to use them. As each government was primarily responsible for vaccinating its own population, it ignored the others. Even the global collaboration effort to pool resources for the equitable distribution of vaccines met with little success. The COVAX scheme, where high-income countries were expected to pay for vaccines for themselves and for low-income countries, saw the big economies buying vaccines directly from the

29 ASEAN 2020, "ASEAN Outlook on the Indo-Pacific".

producers, bypassing COVAX.[30] Even the US-China strategic competition or new groupings such as the Quad, comprising Australia, Japan, India, and the United States, could not help much with equitable vaccine distribution.

Given this situation, ASEAN in the post-pandemic period is likely to increase regional cooperation in areas of strategic and economic interest. ASEAN members are likely to build on the accelerated pace of digital transformation that was witnessed during the pandemic and are likely to seek greater cooperation in the area to ensure a better investment climate in the future. While building connectivity in terms of road and rail networks and trade-enhancing port infrastructure will remain important, building digital infrastructure to narrow the digital divide will also gain importance. Harnessing the benefits from the use of technology and other digital means is likely to gain interest in multiple sectors, including education, healthcare, and tourism.

Education, for example, was hit badly during the pandemic as governments called for partial or full school closures and millions of students had to move to remote learning. While children with access to the internet and digital tools were able to continue learning, children from low-income households with no or limited access to technology suffered. In the case of the ASEAN countries, while the differences in education quantity, quality and output existed prior to the COVID-19 pandemic, these were aggravated in 2020. Consequently, there will be a loss in students' learning capabilities in the long term and hence in their future job prospects and earning potential.[31] However, the unprecedented use of technology during the pandemic also provided opportunities to improve education service delivery as it was possible to reach marginalised populations in remote areas, thus mitigating some of the learning losses in the future. Drawing on this experience, the ASEAN countries will increase cooperation under the rubric of digital transformation to bridge the education gap over time. Priority will be given

30 John Driffill, "Why hasn't COVAX, the Global COVID-19 Vaccine Program, Worked Out as Promised?" Channel News Asia, 3 September 2021, https://www.channelnewsasia.com/commentary/covax-what-happened-donation-vaccines-rich-countries-2151786

31 Sanchita Basu Das and Badri Narayan, "ASEAN Education Cooperation: An assessment of the Education Divide and Measuring the Potential Impact of its Elimination", ADBI Working Paper series, no. 1300, January 2022, https://www.adb.org/sites/default/files/publication/766576/adbi-wp1300.pdf

to policy cooperation to support the institutional basis for cross-border service delivery.

ASEAN will strive for improved provision of regional public goods to increase resilience and support sustainable recovery. The member countries will work together to strengthen access to vaccines, while adopting policies to mitigate climate change and disaster risks.

As the pandemic is far from over, access to vaccines remains a crucial determinant to build immunity and limit casualties against future mutation of the virus. Apart from the production of vaccines, distribution and administration has been highly uneven across less developed countries. ASEAN countries will increase cooperation in this direction. They will strengthen existing institutions and networks for greater information and data flows to ensure that all countries have equal access to information. Doing so will also help them to respond swiftly to future threats.

ASEAN launched its first "State of Climate Change Report"[32] in October 2021, making recommendations for climate change adaptation and mitigation by 2030, and up to 2050. The report proposed a balanced approach, taking into account the ASEAN countries' development status and their long-term goals under the Paris Agreement. While the report stipulates a mitigation goal of net-zero greenhouse gas emissions as early as possible in the second half of the 21st century, individual countries have similar targets or even shorter time horizons; notably, Malaysia has a target of achieving carbon neutrality by 2050, Indonesia by 2060, and Singapore soon after 2050. The report has also highlighted the ASEAN countries' interest in attaining higher adaptive capacity and building resilience by improving the quality of life, reducing poverty, improving climate resiliency and adapting smart industrial activities. Even the ASEAN Comprehensive Recovery Framework, with the strategic pillars of healthcare, human capital, greater trade and investment, and digital transformation, adds a green recovery aspect going forward. These proposals indeed reveal ASEAN's sense of urgency to adopt mitigating policies or technological and financing solutions that will help to transform the individual economies and subsequently the entire ASEAN community.

32 ASEAN, "ASEAN State of Climate Change Report", ASEAN Secretariat, 2021.

Part II

BEYOND RCEP AND CPTPP — TOWARDS FURTHER REGIONAL ECONOMIC INTEGRATION

Regional Economic Integration in the Post-Pandemic Era

Piti Srisangnam

INTRODUCTION

Changes in the new world order are essentially disruptions to the power equilibrium between various nations. Such shocks to the existing balance of power are likely to be too dynamic and too complex for any one country to manage by itself. The outbreak of the COVID-19 pandemic is one of the main factors that have changed the world order. Along with the pandemic, we see that the United States is facing a decline in terms of its global power, whereas China is steadily rising in both economic and security capacities to challenge the former's long-held hegemonic position. The most heated theatre of conflict between the two rival powers is likely to be the Indo-Pacific region, centred on the Southeast Asian region.

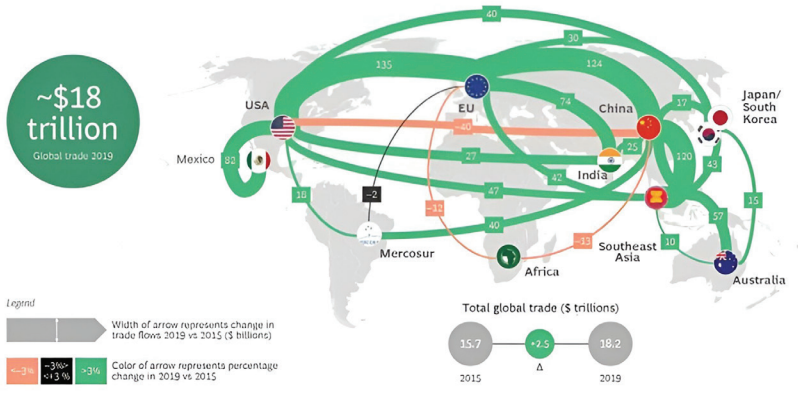
In addition, many other major trends will come into play, such as sudden technological disruptions in the age of the Fourth Industrial Revolution, social shocks caused by demographic shifts, the repercussions of climate change, exacerbating environmental crises, novel and previously absent threats such as pandemics and the emergence of new and devastating pathogens (most evidently, the COVID-19 pandemic). All of these influential factors will emerge swiftly and will affect the global economy very strongly across all dimensions.

CHANGES IN GLOBAL VALUE CHAINS

There are signs of recovery in the global value chains from the bottom point they reached in 2021 amid the global outbreak of COVID-19, which hint at the prospects for continued growth in 2022 and 2023.

Exhibit 1 - Global Trade Generally Enjoyed Booming Growth in 2015–2019

Change in volume of traded goods in major corridors from 2015 through 2019 ($billions)

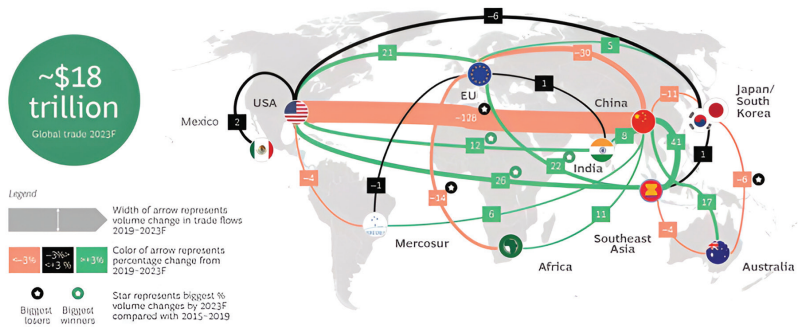


Source: UN Comtrade; OECD; World Economic Forum; IHS; TradeAlert; BCG analysis.

Note: Corridors represent ~30% of global trade. Not included are: intra EU = ~20%; intra NAFTA = ~8%; China (including Hong Kong) = 4%; intra Southeast Asia = 3%; rest of world = ~35%.

Exhibit 2 - Even If Trade Recovers by 2023, Expect Flows Between Blocs to Shift Dramatically

Change in volume of goods traded in major corridors from 2019 through 2023 under baseline scenario ($billions)



Source: BCG Trade Finance Model 2020; UN Comtrade; OECD; World Economic Forum; IHS; TradeAlert; BCG analysis.

Note: Baseline scenario assumes a U-shaped global economic recovery by 2023. Corridors in the map above represent ~32% of global trade. Intra EU = ~20%; intra NAFTA = ~8%; China (including Hong Kong) = 4%; intra Southeast Asia = 3%, rest of world = ~32%.

Exhibits 1 and 2, based on an evaluation by the Boston Consulting Group (BCG) using its Trade Finance Model, together with international trade statistics from UN Comtrade, OECD and the World Economic Forum,

show that the pre-COVID value of international trade was approximately US$18 trillion. This value plummeted during 2020–2021 due to the pandemic but was expected to begin its recovery process in the latter part of 2021, before gradually recovering towards the former level of US$18 trillion in 2023.[33]

When looking at the currents of international trade flows, however, we can observe that in the pre-COVID global economy, global value chains (GVCs) were formed from the rapid expansion of trade between China, the European Union and the United States during the 2015–2019 period (represented by the lines in green in Exhibit 1).

But after the emergence of COVID-19 (Exhibit 2), the linkages in trade value between China, the European Union and the United States have significantly shrunken, as represented by the orange lines, denoting sharp contraction. This shift marks the fundamental change in GVC patterns and characteristics, and it is expected that some manufacturing and investment activities will relocate to ASEAN member states, which would form an emerging and important hub. This hub may become a key component in linking the ASEAN region with China, Europe and the United States, as well as Australia. This shift may be a noteworthy driving force that allows the economies of multiple countries to grow again, somewhat compensating for the impacts of contraction caused earlier by the global outbreak of COVID-19.

FURTHER ECONOMIC INTEGRATION

Looking at the situation from Thailand's vantage point, the country would need to be mindful of its capacity for participating in this expanding recovery momentum in GVCs. Ideally, it should be able to revitalise its domestic economy towards positive growth again through recovering trade flows. Needless to say, when compared with other ASEAN members, Thailand only has trade advantages in relation to its other Asian and East Asian part-

33 Aylor, DeFauw, Gilbert, Knizek, Lang, Koch-Weser, and McAdoo, "Redrawing the Map of Global Trade", Boston Consulting Group, 20 July 2020, https://www.bcg.com/publications/2020/redrawing-the-map-of-global-trade; Aylor, DeFauw, Gilbert, Knizek, Lang, Koch-Weser, and McAdoo, "Designing Resilience into Global Supply Chains", 3 August 2020, https://www.bcg.com/publications/2020/resilience-in-global-supply-chains.

ners through the Regional Comprehensive Economic Partnership (RCEP) involving ASEAN, China, Japan, South Korea, Australia and New Zealand.

For now, however, Thailand does not have any trade advantage when it comes to connecting Asia's regional value chains (RVCs) with US-led RVCs. Currently, there is only a single linking bridge in this regard, which is the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) agreement, whose advantages are also enjoyed by Vietnam, Malaysia, Singapore and Brunei. In the case of Vietnam, it has free trade agreements (FTAs) that serve to link it, and promote trade and investment advantages, with the European Union and the Eurasian Economic Union (EaEU). This means that Vietnam is able to trade freely with as many as 53 economic zones around the world, despite having the same number of trade agreements in force — i.e., 14 — as Thailand, which can only enjoy unrestricted trade with a total of 18 economic zones.[34]

From this comparison, it becomes evident that Thailand is running the risk of losing the benefits from the momentum of economic recovery, where GVCs and RVCs recover and close the gap without Thailand being an important participant. This is likely to be the case if Thailand forgoes its opportunity to participate in and be part of various ongoing FTAs. Thailand would need to seriously and urgently consider taking an active stance in comprehensive and high-standard FTAs, such as the CPTPP — which comprises 11 member economies, namely, Malaysia, Singapore, Brunei, Vietnam, Japan, Canada, Mexico, Chile, Peru, Australia and New Zealand — as well as reach out to other important FTAs and regional integrations like the EaEU, which comprises Belarus, Kazakhstan, Kyrgyzstan, Armenia and Russia, or the European Union and the United Kingdom. In addition, Thailand would need to initiate FTAs with new emerging markets, such as the South Asian countries.

POLICY RECOMMENDATIONS

It would be in the best interests of Thailand and the other ASEAN member states to quickly establish strategic plans on trade and expedite their trade agreements. Doing so will allow Thailand and ASEAN to benefit fully from

34 Asia Regional Integration Center, "Data Center: Free Trade Agreement", Asian Development Bank, https://aric.adb.org/database/fta.

the recovering GVCs and allow all the Southeast Asian countries to adjust quickly to a new international trade climate where countries are setting up new forms of unilateral protectionist barriers, due to the de-globalisation sentiments arising from the COVID-19 pandemic.

In seeking trade agreements, ASEAN and Thailand must focus on and prioritise cooperation with countries and regions that form the core of the various RVCs, and those that are the arbiters of international standards and best practices in various dimensions, such as labour protection, environmental conservation, intellectual property, e-commerce, and government procurement. The kind of agreements and collaborative frameworks that will be worthy of consideration include the CPTPP, the European Union, the European Free Trade Association (EFTA), the EaEU, as well as various trade and investment agreements with the United States and the United Kingdom. Trade negotiations with these countries or regions should be comprehensive and must have high standards. In the past, Thailand and ASEAN as well as their dialogue partners (China, Japan, South Korea, Australia and New Zealand) successfully utilised the RCEP negotiation framework in realising and implementing the partnership to its conclusion stage, and this template can serve as a strategic guideline for future agreements.

The second group of countries and regions that warrant similar attention are the groupings of emerging economies and markets. Such markets are characterised by large populations and sizeable consumer pools, vast supplies of natural and human resources, and high economic growth rates. Countries in this category include the members of the Bay of Bengal Initiative Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) and of the Gulf Cooperation Council (GCC), a Middle Eastern economic cooperation initiative. Separately, bilateral agreements could be considered between Thailand and its trade partners in South Asia, the Middle East, and Africa.

A third course of action to consider is revising, amending and expanding Thailand's 14 existing trade agreements so that these cover more aspects that will prove beneficial to the Thai economy and its citizenry.

Apart from negotiating and upgrading FTAs, reform of the domestic "software" of trade is also needed for Thailand and the ASEAN member states. This refers to the need for regulatory reforms, collectively known as "regulatory guillotine". Having prudent laws, rules and regulations, and internationally accepted standards, along with good regulatory practices

(GRP), is one of the most vital factors for establishing Thailand as a preferred destination for foreign investment and a successfully growing economy.

The term "GRP" covers measures such as "regulatory impact analysis" — the study of impacts of the drafting and enforcement of various laws and regulations and the formulation of impartial, non-subjective laws. Such reforms will benefit a country in many ways, both by enhancing the prospects of economic, trade and investment attainments in the global economy, and raising the country's standards, recognition, and reputation in the global community (which corresponds to the aforementioned vital national interest in terms of the dignity of the state and nation). Important indexes that will be used in evaluating a country's attractiveness are, for example, the Corruption Perceptions Index (CPI), the Global Competitiveness Index, and the Ease of Doing Business Index. By gaining high ranking in these competitiveness evaluations, Thailand will benefit in the long run from attaining a more attractive economic climate, better reputation, and, subsequently, better economic opportunities and the capacity for expansion.

As such, the existing rules, regulations and laws would need to be updated to fit the changing global environment. The "regulatory guillotine", is comprised of four processes: (i) "Cut" — the removal of outdated regulations and laws and those that depend on subjective decisions and judgements; (ii) "Collect" — the bundling into one "location" of previously scattered rules, laws and regulations that were assigned to different agencies while essentially serving the same functions; (iii) "Continue" — the perpetuation and continuation of well-functioning, appropriate and useful laws and regulations; and (iv) "Create" — the creation of laws and regulations in areas previously unaddressed, or where there were gaps, loopholes and grey areas previously. According to Thailand's "Simple and Smart Licensing" guidelines, this is intended to establish and formulate new laws that are fair, equitable, facilitating, not cumbersome or obstructive, and compliant to internationally accepted standards.[35]

Such a regulatory guillotine exercise has been started in Thailand, with some progress, but has since been stagnating. The process began with the revisions undertaken under the aforesaid Smart and Simple Licensing

35 Thai Publica, "Thailand's Simple and Smart Licensing #2", 2018, https://thaipublica.org/2018/11/thailand-law-reform-simple-smart-licence-02/

Project (under the supervision of the Prime Minister's Office of Thailand). An example of a successful and commendable regulatory guillotine that Thailand and the ASEAN member states could draw a lesson from is that undertaken by Vietnam, where the procedures began under its "Project 30" initiative in 2008 and were successfully completed with the "Resolution 19" edict in 2015. The result of this improvement was the removal of approximately 30% of the government's redundant rules, regulations and laws, resulting in a reduction of business-related costs of over US$1.4 billion per year.[36]

36 Vo Tri Thanh and Cuong Van Nguyen (2016), "Regulatory Coherence: The Case of Vietnam", in The Development of Regulatory Management Systems in East Asia: Country Studies, eds. D. Gill and P. Intal, Jr., ERIA Research Project Report 2015–4, pp. 259–391", https://www.eria.org/RPR_FY2015_No.4_Chapter_8.pdf.

Two-Step Approach to FTAAP and WTO Reform

Shujiro Urata

INTRODUCTION

The Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP) entered into force in December 2018 and January 2022, respectively. Both are called mega–free trade agreements (FTAs) as they include a large number of members, 11 countries for the CPTPP and 15 for the RCEP. The CPTPP and RCEP are considered pathways to a Free Trade Area of the Asia-Pacific (FTAAP), an eventual goal of regional economic integration in the Asia-Pacific region. Processes leading to an FTAAP can contribute to a reform of the World Trade Organization (WTO), which is currently faced with serious problems.

This chapter begins with a review of developments leading to the formation of the CPTPP and RCEP, following which the achievements and challenges of these two partnership arrangements are discussed. The chapter then proposes an approach to establish an FTAAP and finally examines ways of pursuing WTO reform through FTAs and plurilateral agreements.

CPTPP AND RCEP: DRIVING FORCES BEHIND REGIONAL ECONOMIC INTEGRATION[37]

The CPTPP and RCEP have been driving forces behind regional economic integration in the Asia-Pacific region and are likely to continue to play that role in the future until an FTAAP is established. The move towards institutionalised regional economic integration developed along two tracks: one

37 A detailed analysis of the processes of the formation of the CPTPP and RCEP is provided in Shujiro Urata, "Trends of FTAs in East Asia from the 1990s to the 2010s: Defensive and Competitive Regionalism", in *East Asian Integration: Goods, Services and Investment*, eds. Lili Yan Ing, Martin Richardson and Shujiro Urata (Routledge, 2019), 6–24.

involving East Asian countries and the other, countries in the wider Asia-Pacific, and these two tracks evolved over time to establish the RCEP and CPTPP through interactions between one other.[38]

RCEP: East Asia Track

The move towards institutionalised regional economic integration in the East Asian region was triggered by the Asian currency crisis of 1997 and 1998. East Asian countries that suffered serious economic consequences from the currency crisis recognised the need for regional economic cooperation to recover and to avoid a recurrence. They considered an East Asian Free Trade Agreement (EAFTA) involving ASEAN, China, Japan, and South Korea (ASEAN+3) as one form of regional economic cooperation. Discussions for the EAFTA began in 2005, with China taking the lead. In 2006, Japan proposed the Comprehensive Economic Partnership in East Asia (CEPEA), which would consist of ASEAN+6, namely, the ASEAN+3 countries and Australia, New Zealand, and India. It was clear that the backdrop to the EAFTA and CEPEA was the rivalry between Japan and China to lead regional economic integration in East Asia.

Feasibility studies for the EAFTA and CEPEA were conducted in parallel until 2011, when Japan and China proposed establishing a joint working group to accelerate the discussions. The joint proposal created a sense of crisis for the ASEAN countries, which had a strong interest in playing a central role in regional integration. ASEAN then proposed RCEP in 2011 to counter the moves by Japan and China. RCEP is an ASEAN-centred framework in which any country that has concluded an FTA with ASEAN can participate, rather than a framework that fixes the member countries, as in EAFTA and CEPEA. Negotiations for RCEP began in November 2012 and the partnership agreement was concluded in November 2020.

CPTPP: Asia-Pacific Track

Discussions for the formation of a framework for economic integration that would encompass the wider Asia-Pacific region began in the 1990s, with

38 On the shift from market-driven to institution-driven regional economic integration in East Asia, see Shujiro Urata, "The Shift from 'Market-led' to 'Institution-led' Regional Economic Integration in East Asia in the late 1990s", RIETI Discussion Paper Series 04-E-012, 2004, https://www.rieti.go.jp/jp/publications/dp/04e012.pdf.

several countries participating in the Asia-Pacific Economic Cooperation (APEC) forum, which was established in 1989. APEC's main objective is to achieve economic growth by promoting regional economic integration through trade and investment liberalisation. Due to differences in the approaches and priorities of APEC members, movement towards trade and investment liberalisation did not progress as hoped. Then, in 2006, Chile, Singapore, New Zealand, and Brunei established the P4 (which later became known as the Trans-Pacific Strategic Economic Partnership Agreement, TPP) to create a free and open business environment and to help realise APEC's goal of achieving a free and open environment for trade and investment.

In March 2008, the P4 members began negotiations to expand the scope of the agreement to include financial services. The United States then decided to participate in the expanded P4 negotiations. Negotiations for an expanded TPP comprising eight countries — Brunei, Chile, New Zealand, Singapore, Australia, Peru, the United States, and Vietnam — began in March 2010. Four more countries, Malaysia, Canada, Mexico, and Japan, joined after the start of negotiations. The negotiations reached an agreement in October 2015. The TPP agreement was signed in February 2016 and the 12 countries began the process of ratifying the agreement. However, the TPP did not enter into force as President Trump withdrew the United States from the TPP.

After the US withdrawal, the remaining TPP countries decided to establish the TPP11. Negotiations were completed in a short period of time and the agreement was signed in March 2018. TPP11 entered into force in December 2018 as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Since its enactment, the CPTPP has been attracting considerable attention, as evidenced by an application for membership by the United Kingdom in February 2021, followed by applications from China and Taiwan in September 2021.

CPTPP AND RCEP: ACHIEVEMENTS AND CHALLENGES

The CPTPP and RCEP share the common goal of economic growth, but there are important differences. The RCEP focuses on economic development, not just economic growth, and it emphasises the importance of economic cooperation in achieving inclusive and sustainable growth. It

includes countries at the early stages of development, such as Cambodia, Lao PDR, Myanmar, and Vietnam, and emphasises economic cooperation because the economic development of these countries is important for narrowing the development gap and achieving sustainable development and social stability. Accordingly, RCEP allows for special and differential treatment of countries in the early stages of development. The CPTPP, on the other hand, treats all members equally and does not provide for special treatment. It emphasises the importance of active private sector involvement in achieving economic growth.

Achievements

One of the most important achievements of the CPTPP and RCEP is the establishment of free trade agreements involving many countries, thereby creating a rules-based common and consolidated market. This was made possible by lowering tariff rates and adopting a common set of rules of origin, which determines the national source of a product and thus the eligibility for free trade among members.

Both the CPTPP and RCEP include more comprehensive provisions than the WTO (see table below). However, they differ in the issues they cover. Like typical FTAs, both agreements cover many issues, such as market access for trade in goods and services, trade facilitation, and intellectual property rights, but they differ on important issues. The issues addressed in the CPTPP but not in RCEP are government procurement, state-owned enterprises and designated monopolies, labour, environment, regulatory coherence, transparency, and corruption. While these issues are important to developed countries such as Japan and Australia, developing countries find them difficult to accept. For example, the CPTPP does not allow preferential policies for state-owned enterprises, a ruling that is difficult for some developing countries where government involvement in the economy is significant. Importantly, the CPTPP includes rules that protect and promote workers' rights.

Some provisions are common to both agreements but differ in content and degree of discipline. One clear example of this is in the liberalisation of trade in goods (market access), where the CPTPP eliminates almost all tariffs on all products (100% tariff elimination rate), with a few exceptions. In RCEP, tariff elimination varies among countries and the average rate is

roughly 90%, lower than in the CPTPP. There is also a major difference in the area of e-commerce, which is attracting attention as it regulates the international movement of data, which is becoming increasingly important in the global economy. The CPTPP includes provisions that are more liberal in this respect than RCEP.

Challenges

Both agreements face some common challenges. Members of both must implement their commitments and the rules must be enforced. To achieve these objectives, monitoring is important, indicating the need for an effective, fair, and dependable institutional setting.

Another common challenge is to expand the membership. For FTAs, the larger the membership, the better are the prospects for promoting free trade. This is because when membership is expanded, the trade creation effect is likely to be greater and the negative impact of trade diversion is likely to be smaller. In the case of the CPTPP, the United Kingdom, China and Taiwan have applied for membership, as noted above. These applications would have to be examined strictly to make sure that the applicants satisfy all the necessary requirements. South Korea, Thailand, Indonesia, and the Philippines have shown an interest in joining. Although the United States does not seem interested in returning to the CPTPP, US involvement is important, not only because it is a large trading country but also because it is an influential country in many aspects. For RCEP, the first priority is to include India, which dropped out from the negotiations in the final stage. Accepting other countries from South Asia such as Bangladesh should be explored.

For RCEP, the level of liberalisation and quality of the rules must be upgraded. The level of tariff elimination committed by RCEP member countries should be increased. RCEP also needs to expand the coverage of rules and upgrade the level of commitment in some items such as investment and e-commerce so that a free and open trade and investment environment can be realised.

FROM RCEP TO CPTPP AND THEN TO FTAAP: A TWO-STEP STRATEGY

In 2010, APEC leaders agreed in Yokohama, Japan, that the goal of regional integration in the Asia-Pacific region would be the establishment of an FTAAP. The leaders reaffirmed this goal in the APEC Putrajaya Vision 2040, which was launched in 2020. In Yokohama, APEC leaders agreed that an FTAAP should be pursued by building on regional undertakings such as ASEAN+3, ASEAN+6, and the TPP. Since then, the ASEAN+3 and ASEAN+6 initiatives were merged to become RCEP, and the TPP was transformed and realised as the CPTPP.

Now that both the CPTPP and RCEP have entered into force, two pathways towards an FTAAP have been set. It is time to think about how to proceed towards the goal of establishing an FTAAP. Considering that the CPTPP is more comprehensive and has a higher level of commitment to open trade and investment, it is natural to move from RCEP to the CPTPP, and then to an FTAAP.[39] In other words, those countries/economies that cannot commit themselves to the requirements for the CPTPP would join or remain (in the case of those who are already members) in RCEP and utilise its economic cooperation arrangements in order to upgrade their capacity for meeting the CPTPP's higher requirements. These countries/economies would then join the CPTPP when they are ready. The CPTPP will become an FTAAP when all APEC member economies become members. Since the CPTPP is open not only to APEC members but also to non-members, an FTAAP may include not only the 21 APEC member economies but also non-APEC members.

WTO REFORM AND FTAAP

It has been a while since two main functions of the WTO stopped working: (i) promotion of trade liberalisation through negotiations, and (ii) handling of trade disputes. The latest round of trade liberalisation under the WTO, the Doha Development Agenda or the Doha Round, began in 2001. Although it is still under way officially, some observers argue that it is dead as very

39 For detailed discussions on this approach, see Shujiro Urata, "A Stages Approach to Regional Economic Integration in Asia Pacific: The RCEP, TPP, and FTAAP", in *New Directions in Asia-Pacific Economic Integration,* eds. Tang Guoqiang and Peter A. Petri (East-West Center, Hawaii, 2014), 119–130.

little progress has been made. The dispute settlement mechanism under the WTO practically stopped functioning when the Appellate Body, the final court of appeal in the two-tier system, became unable to handle disputed cases because of the shortage of members (or judges) in December 2019.

A major reason for these problems lies in the WTO's system of consensus decision-making. It is almost impossible to reach a consensus on any issue among its 164 members. For many years, differences in opinion between developed and developing members have been obstacles in the functioning of the WTO. To deal with the impasse, many members have adopted new approaches with like-minded countries. For trade liberalisation, basically two types of approaches have been adopted: FTAs and plurilateral agreements. FTAs typically involve a limited number of countries and have comprehensive coverage of issues, as shown in the table below. RCEP and CPTPP are major FTAs which cover a large number of countries and issues. If an FTAAP is established, it would be a huge FTA, covering more than 60% of world GDP in 2020.

Plurilateral agreements are those involving a large number of countries but for specific issues. A representative case is the information and technology agreement (ITA), intended to eliminate import tariffs on high technology products on a most-favoured nation (MFN) basis. It was enacted by 29 participants in 1996. Since then, the number of participating countries has increased. Currently, negotiations/discussions for plurilateral agreements on several issues including digital trade are under way. As to the dispute settlement mechanism, a group of WTO members led by the European Union reached a plurilateral agreement in April 2020 concerning an interim alternative arrangement titled "Multi-Party Interim Appeal Arbitration Arrangement" (MPIA).

An expansion of these two approaches, FTAs and plurilateral agreements, in terms of country and issue coverage would contribute to an establishment of free and open trade at the global level, effectively resulting in an overall reform of the WTO.[40] As such, the establishment and broadening of mega-FTAs and plurilateral agreements should be pursued, along with various initiatives such as the joint statement initiatives (JSIs) adopted by

40 On the relationship between mega-FTAs and the WTO, see Shujiro Urata, "Mega-FTAs and the WTO: Competing or Complementary?" *International Economic Journal* 30, no. 2 (June 2016): 231–242.

groups of WTO members who seek to negotiate on specific issues without being encumbered by the WTO's consensus decision-making process, the Ottawa Group, a small group of WTO members led by Canada to address the question of WTO reform, and the Trilateral Meeting of Trade Ministers of the United States, the European Union and Japan.

Table. A Comparison of the Characteristics of CPTPP, RCEP and WTO

	CPTPP	RCEP	WTO
Market Access for Goods	●	●	●
Rules of Origin and Origin Procedures	●	●	●
Textiles and Apparel	●	●	●
Customs Administration and Trade Facilitation	●	●	●
Trade Remedies	●	●	●
Sanitary and Phytosanitary Measures	●	●	●
Technical Barriers to Trade	●	●	●
Investment	●	●	▲
Cross-border Trade in Services	●	●	●
Financial Services	●	●	●
Temporary Entry for Business Persons	●	●	▲
Telecommunications	●	●	●
Electronic Commerce	●	●	
Government Procurement	●	●	▲
Competition Policy	●	●	
State-Owned Enterprises and Designated Monopolies	●		
Intellectual Property	●	●	●
Labour	●		
Environment	●		
Cooperation and Capacity Building*	●	●	
Competitiveness and Business Facilitation	●		
Development	●		
Small and Medium-Sized Enterprises	●	●	
Regulatory Coherence	●		
Tranparency and Anti-corruption	●		
Administrative and Institutional Provisions	●	●	
Dispute Settlelement	●	●	●
Note: ●indicates the issue is covered, ▲ is partially covered.			
* in RCEP, economic and technical cooperation			
Sources: CPTPP and RCEP texts			

Indo-Pacific Solution for Global Trade Problems

Jeffrey Wilson

Regional economic integration in the Indo-Pacific finds itself in surprisingly good health. On 1 January 2022, the 15-member Regional Comprehensive Economic Partnership (RCEP) entered into force. The world's largest regional trade agreement by GDP, RCEP finally provides the Indo-Pacific an integrated instrument covering almost all major economies. And after four years of quiet operation, the 11-member Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) has begun its expansion phase: during 2021, the United Kingdom commenced formal accession negotiations; China, Taiwan and Ecuador submitted accession applications; and South Korea declared an intent to soon do the same.

The Indo-Pacific's trade successes are all the more surprising when viewed against the challenges currently facing the global trading system. Protectionism has accelerated in the wake of the COVID-19 pandemic. The US-China trade war remains unresolved after five years. Coercive trade practices have become unfortunately common, as geopolitical rivalries between the major powers spill over into the economic domain. The WTO has struggled to conclude new agreements, while its dispute settlement mechanism is currently non-functional. By global comparison, the Indo-Pacific is doing exceedingly well in building an open and rules-based trading architecture.

But it would be a mistake to assume that the Indo-Pacific's trade future is secure. Despite recent successes, the threats facing the global trade system augur poorly for a region that contains many of the world's most open and trade-exposed economies. RCEP and the CPTPP currently do little to protect the Indo-Pacific from global trade headwinds. The region therefore needs to take its commitment to open and rules-based trade embodied in these agreements and articulate it into broader fora that have the capacity to address global-level trade problems. The ultimate test of RCEP and the CPTPP is not what they can do for the Indo-Pacific, but how their principles can help sustain the integrity of the global trading system.

THE LOGIC OF REGIONAL TRADE BLOCS: LIBERALISATION, HARMONISATION AND RULE-MAKING

The CPTPP and RCEP are widely viewed as competing models for the Indo-Pacific economic architecture. This is a natural response, given their differing memberships, objectives and provisions. It is also reinforced by geostrategic commentary: particularly claims by the Obama administration that the original TPP would allow the United States to "write the economic rules of the road" in the region,[41] and PRC-propagated claims that RCEP is a "China-led" agreement.[42] However, this is grossly misleading. Far from being in competition, the CPTPP and RCEP offer distinct but complementary models for the next phase of regional economic integration.

Multilateral trade agreements are not solely about achieving "free trade". Rather, they can promote one of three distinct policy objectives:

1. *Liberalisation*: Reducing conventional trade barriers — tariffs, quotas and customs procedures — between members.
2. *Harmonisation*: Providing a consistent set of trade rules among a group of countries, particularly where multiple (and inconsistent) bilateral free trade agreements (FTAs) already exist.
3. *Rule-making*: Establishing new disciplines in "trade-related" areas of economic regulation not currently covered by WTO provisions.

The principal purpose of RCEP is *harmonisation*. Architecturally, it takes five of the existing "ASEAN+1" FTAs and integrates them into a single overarching agreement. Its rules-of-origin (RoOs) provisions provide an illustrative example. By establishing a single and integrated RoOs framework for the bloc, including highly permissive cumulation rules, RCEP will greatly improve trade facilitation relative to the status quo ante of the "noodle bowl" of overlapping bilaterals in the region.[43] Euler Hermes has estimated that RoOs harmonisation alone could create an additional US$90 billion

41 The White House, "Statement by the President on the Signing of the Trans-Pacific Partnership", 3 February 2016, https://obamawhitehouse.archives.gov/the-press-office/2016/02/03/statement-president-signing-trans-pacific-partnership.

42 Jeffrey Wilson, "Who's Afraid of the RCEP?" *9DashLine*, 4 October 2021, https://www.9dashline.com/article/whos-afraid-of-the-rcep.

43 Parmila Crivelli and Stefano Inama, "Making RCEP Successful Through Business-Friendly Rules of Origin", ADB Blog, 12 February 2021, https://blogs.adb.org/blog/making-rcep-successful-through-business-friendly-rules-origin.

of trade between its members annually.[44] Harmonised minimum standards for investment, services and e-commerce all perform a similar function.

By contrast, the CPTPP is primarily a *rule-making* agreement. Its stated purpose — to establish a trade agreement for the "21st century" economy[45] — specifically targets the creation of new rules which advance beyond WTO disciplines. Many "WTO-plus" issues are included, such as services, investment, intellectual property, anti-corruption, environment, e-commerce, state-owned enterprises (SOEs), telecommunications, financial services and labour standards. Not only does the CPTPP set a regulatory high-water mark for the Indo-Pacific, but it can also function as a model for other regional and global trade negotiations. For example, the negotiations for the 2020 US-Mexico-Canada (USMCA) agreement borrowed heavily from the TPP, copying 57% of its text, according to one analysis.[46]

Thus, there is a complementary division of labour between the Indo-Pacific's two mega-regional trade agreements. RCEP establishes an integrated and inclusive trade architecture among all major economies, while the CPTPP allows the more ambitious members to break new ground on WTO-plus rule-making. While neither agreement is strongly liberalising — an objective already achieved by the region's bilateral FTAs — they nonetheless make a positive contribution by filling missing bilateral links. Modelling by the Peterson Institute suggests the CPTPP will add US$147 billion to global GDP by 2030, and RCEP US$186 billion, largely accruing to their respective members.[47]

44 Euler Hermes, "RCEP: Common Rule of Origin Could Boost Regional Trade by around USD90bn Annually", 17 November 2020, https://www.eulerhermes.com/en_global/news-insights/economic-insights/RCEP-common-rule-of-origin-could-boost-regional-trade-by-around-USD90bn-annually.html.

45 CPTPP Commission, "Comprehensive and Progressive Agreement for Trans-Pacific Partnership Ministerial Statement", Tokyo, 19 January 2019, https://www.dfat.gov.au/sites/default/files/19-jan-2019-cptpp-ministerial-statement.pdf.

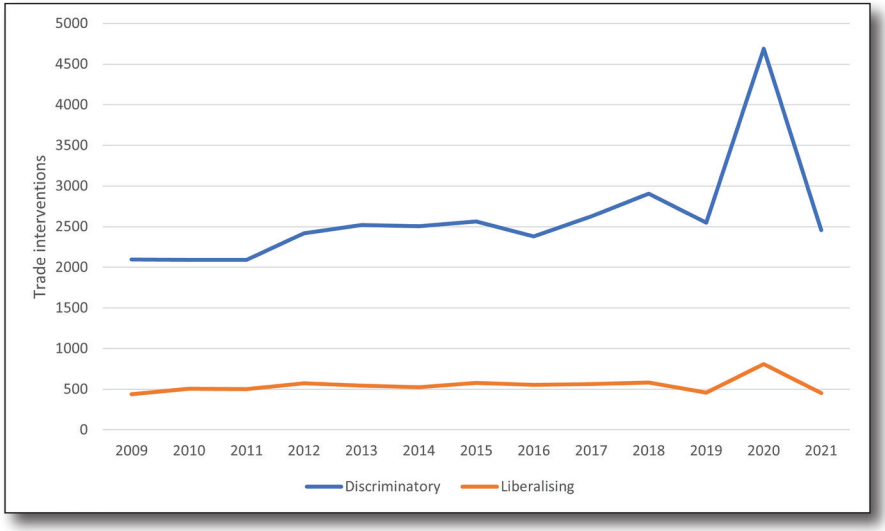
46 Wolfgang Alschner and Rama Panford-Walsh, "How much of the Transpacific Partnership is in the United States-Mexico-Canada Agreement?", Ottawa Faculty of Law Working Papers, No. 2019–28, 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3410658.

47 Peter A Petri and Michael G. Plummer, "East Asia Decouples from the United States: Trade War, COVID-19, and East Asia's New Trade Blocs", Peterson Institute for International Economics Working Papers, 20–9, 2020, https://www.piie.com/system/files/documents/wp20-9.pdf

THE CRISIS IN THE GLOBAL TRADING ENVIRONMENT

Good progress in the CPTPP and RCEP unfortunately runs against the prevailing winds of the global trade system. Since the global financial crisis of 2008, there has been a marked turn towards protectionism around the world. As data from Global Trade Alert reveals, in the last decade governments have enacted discriminatory trade measures at five times the rate of liberalising ones, with a major peak in 2020 in response to the COVID outbreak (see Figure 1). While this pattern is observed across almost all countries, the United States, China, India, United Kingdom and EU members account for the largest shares of the global total. While the Indo-Pacific pushes ahead with trade integration through ambitious mega-regional agreements, the rest of the world appears to be returning to protectionist settings.

Figure 1. Global Trade Interventions per Year, 2009–2021



Source: Global Trade Alert.[48]

Those who subscribe to the "bicycle theory" of trade liberalisation will attribute blame to the inability to finalise new multilateral trade negotiations.

48 Global Trade Alert, "Global Dynamics Database", https://www.globaltradealert.org/global_dynamics.

While the General Agreement on Tariffs and Trade (GATT), the forerunner of the WTO, completed eight major "rounds" of negotiations during its history, the WTO has been unable to complete a single comprehensive round since 1995. Nor has its record in sectoral agreements proven better, delivering only the 1996 Information Technology Agreement and the 2017 Trade Facilitation Agreement. Longstanding negotiations on environmental goods, fisheries subsidies and dispute settlement reform are in deadlock, while significant member divisions remain over emerging issues such as carbon pricing in trade and a trade-related intellectual property rights (TRIPS) waiver for COVID vaccines. After three decades of underperformance in its negotiating function, expectations for new rule-making from Geneva are very low.

Perhaps the greatest challenge is the crisis over dispute settlement, the principal mechanism of the WTO's enforcement function. To simplify the challenge greatly, the controversy is over whether the Appellate Body (AB) is acting in a way that exceeds its official mandate. While many countries have concerns with AB performance, the United States has led demands for change[49] and is blocking appointments to the AB in order to force reform. As a result, the AB became inquorate in December 2019, allowing members to circumvent adverse outcomes through a tactic known as the "appeal into the void".[50] The AB crisis has left the WTO without an effective and depoliticised enforcement mechanism.

Compounding matters, there is also the challenge from coercive trade practices. It involves the arbitrary application of trade measures with the deliberate intent of economically harming a trade partner during a (non-trade) diplomatic dispute. Trade coercion has become more common in recent years, particularly from both China and the United States, who have deployed it against many countries.[51] It is also a serious threat to the global

49 Marianne Schneider-Petsinger, "Reforming the World Trade Organization Prospects for Transatlantic Cooperation and the Global Trade System", Chatham House, 2020, https://www.chathamhouse.org/2020/09/reforming-world-trade-organization.

50 So called because, while the Appellate Body is inquorate and unable to hear cases, any appeal of a panel ruling disappears "into the void" of a backlog of unheard AB cases.

51 Jeffrey Wilson, "'NATO for Trade': A Bad Answer to a Good Question?" Hinrich Foundation, 13 July 2021, https://www.hinrichfoundation.com/research/article/sustainable/nato-for-trade/.

trading system. It breaches core WTO principles of non-discrimination, asymmetrically affects small and medium economies, and cannot be effectively addressed by existing dispute mechanisms.[52] The re-emergence of politicised trade augurs extremely poorly for confidence in and the integrity of a rules-based global trading system.

INDO-PACIFIC TRADE AGREEMENTS TO THE RESCUE?

For a highly trade-exposed region like the Indo-Pacific, these global trade problems are a serious threat. Most countries in the region have openness built in to their economic structures, utilising high levels of foreign direct investment to build export industries oriented to world markets. While this open economic model has performed exceptionally well, it is also premised on a liberal and rules-based global trading environment. As this comes under increasing threat, so too do the region's development strategies. Can the Indo-Pacific's new trade agreements offer protection against these global threats?

Unfortunately, RCEP's structure means it is unlikely to do so. Its key strengths are its inclusivity (achieving near-universal regional membership) and its harmonisation effects. But its reach is purely regional and does not include extra-regional players who might champion its approach globally. The absence of India, which left the negotiations in 2019,[53] also deprives the bloc of a powerful voice in Geneva. And RCEP's comparatively lower ambition — its regulatory provisions are far more modest than those of the CPTPP — means it will not function as a template for other global-level trade negotiations. While it is a powerful tool for fostering economic integration in the Indo-Pacific, it is simply not configured to be projected beyond the region.

By contrast, the CPTPP suffers an inverse problem: an exclusive, and controversial, membership. Its regional coverage is very patchy, and at present lacks many important economies. Questions remain over how smoothly its forthcoming accessions may work. There will be significant controversy

52 Wendy Cutler et al., "Responding to Trade Coercion: A Growing Threat to the Global Trading System", Asia Society Policy Institute and Perth USAsia Centre, 2021, https://asiasociety.org/policy-institute/responding-trade-coercion-growing-threat-global-trading-system-0.

53 Surupa Gupta and Sumit Ganguly, "Why India Refused to Join the World's Biggest Trading Bloc', *Foreign Policy*, 23 November 2020, https://foreignpolicy.com/2020/11/23/why-india-refused-to-join-rcep-worlds-biggest-trading-bloc/.

over China and Taiwan's applications, given complex geopolitical issues of Taiwan's status and international recognition.[54] Ongoing bilateral tensions between Japan and South Korea may threaten the latter's forthcoming application. Until these membership issues are resolved, the CPTPP cannot be effectively projected out into the global trading system.

Meanwhile, major trade powers are largely ignoring what is happening in the Indo-Pacific. After a year in office, the Biden administration is yet to take any meaningful trade policy actions. It also retains most of the destructive policies of the Trump era, particularly the distortive "Phase One" managed trade agreement with China and the AB appointment veto. China continues to deploy coercive trade practices, targeting Australia (an RCEP and CPTPP member) in 2020[55] and Lithuania in 2021.[56] For its part, the European Union has unilaterally pushed ahead with developing rules for carbon pricing in trade despite concern from many trading partners. There is little evidence that the major players in the global trade system are adjusting their outlooks or policies in light of the positive example set by the Indo-Pacific.

REGIONAL ADVOCACY FOR GLOBAL PROBLEMS

Indo-Pacific governments cannot rely on regional instruments to shape the global trade agenda. Rather, they must now tackle global trade challenges at the locus of the problem. Regional governments need to participate in global trade debates and advocate in support of open and rules-based trade arrangements. This approach to trade diplomacy would see the Indo-Pacific draw on the content of its new regional agreements and project these values and ideas into global economic fora. There are three immediate ways the region can "go global" with its trade diplomacy.

54 Natasha Kassam and Jeffrey Wilson, "China v Taiwan Dilemma for Trade Pact", *Australian Financial Review*, 1 October 2021.

55 Jeffrey Wilson, "Australia Shows the World What Decoupling from China Looks Like", *Foreign Policy*, 9 November 2021, https://foreignpolicy.com/2021/11/09/australia-china-decoupling-trade-sanctions-coronavirus-geopolitics/.

56 Jonathan Hackenbroich, "Coercion with Chinese Characteristics: How Europe Should Respond to interference in its Internal Trade", 24 January 2022, https://ecfr.eu/article/coercion-with-chinese-characteristics-how-europe-should-respond-to-interference-in-its-internal-trade/.

First, put trade issues squarely on the agenda of key global fora. Indo-Pacific governments have a unique window to do this, given the hosting schedule for upcoming global summitry. Indonesia hosts the G20 Summit in 2022 and will become the ASEAN chair in 2023, while Japan will host the G7 Summit in 2023. This presents an opportunity to elevate trade on the agenda of three core summits and articulate the region's commitment to a global audience. The Indo-Pacific's four OECD members should support this agenda through advocacy in Paris, while the Asia-Pacific Economic Cooperation (APEC) and the East Asia Summit provide fora for the region as a whole to engage the United States on trade issues.

Second, regional governments need to step up engagement with WTO reform. While there is a temptation to view the AB dispute as a narrowly US-EU issue, the lack of a global trade umpire is a global problem and cannot be left to the United States and European Union to resolve. Indo-Pacific governments need to actively lobby the protagonists on the need for a speedy resolution. More importantly, lobbying needs to be done beyond normal trade diplomacy channels in Geneva, taken directly and bilaterally as a matter of serious concern. As both the European Union and United States seek to court regional governments with their recent "Indo-Pacific" strategies, this provides an opportunity to press for the importance of a functioning global trade umpire.

Finally, regional governments need to get active in the emerging "plurilateral" space. This modality — where a "reform-ready" subset of WTO members negotiate in a specific sector — appears to offer a viable path for rejuvenating the negotiation function.[57] Plurilaterals will be especially important for making rules in 21st century economy domains. Ongoing plurilateral negotiations over environmental goods and e-commerce will prove critical, while the recently completed plurilateral on Domestic Services Regulation should create movement for further services negotiations. While Indo-Pacific economies often participate in these plurilaterals, they should be accorded high priority, given that they are the most likely vehicle for global-level rule-making today.

57 Gary Clyde Hufbauer, "Focused Trade Agreements Can Sustain the WTO in Time of Economic Nationalism", 12 April 2021, https://www.piie.com/blogs/realtime-economic-issues-watch/focused-trade-agreements-can-sustain-wto-time-economic.

Part III

STRENGTHENING SUPPLY CHAIN RESILIENCE IN THE WAKE OF US-CHINA RIVALRY

Supply Chain Reconfiguration and Structural Change

The Tech Sector and US-China Rivalry

Natasha Hamilton-Hart

Rivalry between the United States and China is having an effect on regional technology supply chains. Technologies and companies considered sensitive from a security perspective are subject to an increasing array of controls. Affected technologies are not limited to small sets of military-use technologies or end-users, but include artificial intelligence capacities, quantum computing, advanced semiconductors, telecommunications infrastructure and digital platforms. Civilian users and technologies embedded in everyday commercial products are thus affected by security competition between the United States and China.

This chapter first reviews incentives for limited decoupling and reconfiguration of supply chains, with attention to a new security logic that is shaping regional trade and investment decisions. This logic works in opposition to the economic logic of the supply chain revolution that has supported regional growth and integration for 30 years. The second section provides some evidence on the ways companies caught by restrictions in the tech sector are responding with adjustments to their supply relationships and production decisions.

I. INCENTIVES FOR DECOUPLING: DIVERGENT SECURITY AND ECONOMIC LOGICS

New security concerns are creating incentives for reorganisation of supply chain relationships in the tech sector. Both the United States and China have come to view each other as strategic competitors and potential security threats, and both have come to view economic transactions as having

security implications.[58] Former Vice President Mike Pence accused China of "economic aggression", and a 2018 report to Congress by the US-China Economic and Security Review Commission asserted that, "China's state-led, market-distorting economic model presents a challenge to US economic and national security interests". Despite less inflammatory rhetoric, the Biden administration has not stepped back from this basic reorientation.[59]

Chinese perceptions have also changed. China's drive for technological advancement has long included ambitions to enhance its autonomous technological capacities. Faced with the Trump administration's escalation of pressure, China accelerated efforts to decrease vulnerability.[60] Chinese actors are increasingly concerned about the vulnerabilities arising from interdependence.[61] China's "dual circulation" policy was affirmed in 2021, underlining its drive to "upgrade its manufacturing base through the integration of information technology to improve productivity, increase the indigenous content of higher-end technology products, reduce reliance on foreign inputs and become more self-sufficient technologically".[62]

The new security logic is at odds with the economic logic of the global value chain (GVC) revolution that had driven economic growth and integration in the region since the 1990s. This GVC revolution fragmented production across national boundaries, as supply chain firms took advantage of gains from specialisation, economies of scale and efficiencies from agglomeration.[63] By 2015, China accounted for 31% of global information

58 David Capie, Natasha Hamilton-Hart, and Jason Young, "The Economics-Security Nexus in US-China Trade Conflict: Incentives for Decoupling and Dilemmas for Third Countries", *Policy Quarterly* 16, no. 4 (2020): 28–29; Joseph Biden, "Interim National Security Strategic Guidance", The White House, 3 March 2021, https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/03/interim-national-security-strategic-guidance/.

59 Joseph Biden, "Interim National Security Strategic Guidance".

60 Capie et al. "The Economics-Security Nexus".

61 Julian Gewirtz, "The Chinese Reassessment of Interdependence", *China Leadership Monitor*, 1 June 2020, https://www.prcleader.org/gewirtz.

62 Bates Gill, "Endorsing 'Self-reliance', Beijing Raises the Geopolitical Stakes", *The Interpreter*, 9 March 2021, https://www.lowyinstitute.org/the-interpreter/endorsing-self-reliance-beijing-raises-geopolitical-stakes.

63 Geoffrey Garrett, "Why US-China Supply Chains are Stronger than the Trade War", 5 September 2019, https://knowledge.wharton.upenn.edu/article/trade-war-supply-chain-impact/.

and communications technology exports.[64]

Despite the costs of disrupting this interdependence, policymakers have proved willing to impose restrictions. In 2018 the United States passed the Foreign Investment Risk Review Modernization Act (FIRMA), which gave the Treasury Department's Committee on Foreign Investment in the United States (CFIUS) enhanced powers to block acquisitions on the grounds of national security. The United States has taken actions against specific Chinese firms, as well as their suppliers and partners. While a raft of charges against Huawei, which was excluded from US communications networks in 2018, have been the most prominent example of this targeted action, a much larger group of firms have been added to the "Entity List" since 2019. This list designates countries and specific firms subject to export, licensing and investment restrictions, many of which apply globally. More than 100 "entities" have been added to the list, many of them prominent Chinese companies, including Semiconductor Manufacturing International Corporation (SMIC) and its affiliates, as well as other Chinese technology, construction and shipbuilding firms. All were designated as entities that "are involved, or pose a significant risk of being or becoming involved in activities that are contrary to the national security or foreign policy interests of the United States".[65] Section 889 of the 2019 National Defense Authorization Act acts as an additional block on some Chinese firms.

The United States is also moving towards a more active technology policy in response to a perceived threat from China's increasing capacities.[66] The Defense Innovation Unit, established in 2016, is tasked with maintaining and protecting the US advantage in military technologies. Its new head in 2021 spoke of the need to maintain the country's "commitment to being

64 China Briefing, "Asia's Share of Global ICT Exports, 200–2015", 2019, https://www.china-briefing.com/news/wp-content/uploads/2019/01/Asia%E2%80%99s-Share-of-Global-ICT-Exports-2000-2015.jpg.

65 US Federal Register, "Addition of Entities to the Entity List, Revision of Entry on the Entity List, and Removal of Entities from the Entity List", Department of Commerce, Bureau of Industry and Security, 22 December 2020, https://public-inspection.federalregister.gov/2020-28031.pdf.

66 Working Group on Science and Technology in US-China Relations, *Meeting the China Challenge: A New American Strategy for Technology Competition*, 21st Century China Center and Asia Society, 16 November 2020.

pre-eminent in science and technology" in the "tech race" with China.[67] In early 2021, industry leaders and members of the US foreign policy community issued a report on China's rapidly developing technological capacities, which it described as threatening to US national security, and called for some decoupling as well as enhanced US R&D investments.[68] Early in 2021, Biden initiated a review of potential weaknesses in the US supply chain for high tech and sensitive products. The White House reported in 2022 that the review "found our over-reliance on foreign sources and adversarial nations for critical minerals and materials posed national and economic security threats" and announced "major investments" to increase domestic supply.[69] The US Senate has also initiated legislation that would provide for over $250 billion in spending under the US Innovation and Competition Act of June 2021, which was further advanced with the America Competes Act of 2022.

In response, China has scaled up its own investments in domestic technological capacity, including in advanced semiconductor design and production. In 2019, a news report claimed that "Beijing has ordered all government offices and public institutions to remove foreign computer equipment and software within three years". A Chinese brokerage reportedly estimated the directive would require 20 to 30 million pieces of hardware to be replaced, citing a Communist Party Central Office directive issued earlier in 2019. China's so-called "3-5-2 policy" was part of a policy to ensure that "government agencies and critical infrastructure operators to use 'secure and controllable' technology, as enshrined in the country's Cyber Security Law passed in 2017".[70]

67 Bryan Bender, "Competition with China a Tech Marathon, Not an Arms Race, says US Defence Innovation Unit Director Michael Brown", *South China Morning Post*, 17 March 2021, https://www.scmp.com/news/world/united-states-canada/article/3125718/competition-china-tech-marathon-not-arms-race-says.

68 Bethany Allen-Ebrahimian, "Former Google CEO and Others Call for US-China Tech 'Bifurcation'", *Axios*, 26 January 2021, https://www.axios.com/scoop-former-google-ceo-and-others-call-for-us-china-tech-bifurcation-46fa8ca1-a677-4257-8b22-5e7fe1b7e442.html.

69 The White House, "Fact Sheet: Securing a Made in America Supply Chain for Critical Minerals", 22 February 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/22/fact-sheet-securing-a-made-in-america-supply-chain-for-critical-minerals/.

70 Yuan Yang and Nian Liu, "Beijing Orders State Offices to Replace Foreign PCs and Software", *Financial Times*, 9 December 2019, https://www.ft.com/content/b55fc6ee-1787-11ea-8d73-6303645ac406.

China strongly condemned the US move in May 2020 to tighten restrictions on Chinese firms on its Entity List, stating that China would take "whatever measures are necessary" to defend the interests of Chinese enterprises.[71] In January 2021, the Ministry of Commerce issued a "blocking order" which "threatens to subject companies from third-party countries that comply with US export controls and secondary sanctions to civil compensation claims in Chinese courts".[72]

II. TECH SECTOR RESPONSES: RECONFIGURATION OF SUPPLY CHAINS FOR GREATER RESILIENCE

Overall, US imports from China have been relatively robust. After a significant decline in 2019 and 2020, American imports from China picked up in 2021, driven by demand for consumer goods, although they remained below the level seen in 2018.[73] Confirming industry reports of shifts in firm-level sourcing to avoid the impacts of US tariffs on Chinese products, US imports from alternative manufacturing locations increased markedly in 2018–2021, with imports from Vietnam doubling, along with a smaller increase in imports from Mexico.

Tech sector firms in particular are shifting investments and cutting some partnerships to avoid tariffs and blacklists. Huawei and other targeted companies are focused on stepping up their own efforts to develop capacities that do not rely on non-Chinese semiconductors and other inputs. These companies have not been completely cut off from US design technology — the US commerce department reportedly had granted more than US$103 billion in export licences for supplies to Huawei and SMIC from 9 November 2020 to April 2021.[74] Nonetheless, Huawei has suffered from being unable to

71 Orange Wang, "Beijing Says Will Take 'Whatever Measures Necessary' to Defend Chinese Firms Added to US Entity List", *South China Morning Post*, 5 June 2020, https://www.scmp.com/economy/china-economy/article/3087788/beijing-says-will-take-whatever-measures-necessary-defend.

72 Rhodium Group and US Chamber of Commerce, *Understanding US-China Decoupling Macro Trends and Industry Impacts*, China Center, US Chamber of Commerce, 2021, p. 5.

73 United States Census Bureau, "Trade in Goods with China", https://www.census.gov/foreign-trade/balance/c5700.html.

74 Song Jung-a, "South Korean Chip Companies Step up US Lobbying Efforts", *Financial Times*, 3 January 2022, https://www.ft.com/content/62c12877-4594-478d-b0cc-ae6158ba71ad.

access advanced chips, with smartphone sales down significantly in 2020 and 2021.[75] In 2021, Huawei lost to Apple its number one share of smartphone sales in China.[76] The company has announced the launch of its own operating system to avoid reliance on Google's Android, while SMIC is pursuing major investments in developing autonomous capacity.[77]

Company statements sometimes acknowledge security-related pressures on their supply relationships and investment decisions. A report on the relocation from China of Taiwanese companies, for example, cited Delta Electronics (a company with revenues of US$10 billion which produces components for Apple and Tesla) as saying "Our target in China is to reduce the direct labour force by 90%. We are not quite there yet. We have reduced [it] by 40%." The company had relocated some production to Thailand and Taiwan in 2019 in response to US tariffs. It is also building four "large" factories in India, its chairman explaining such moves with the comment that, "For China the problem is, even without the US-China conflict, China is no longer a good place for manufacturing."[78]

Taiwanese company Hon Hai, better known as Foxconn, is also shifting some production out of China. After not making good on its 2017 announcement to open an LCD flat panel production centre in Wisconsin, USA, the company said in March 2021 that it was choosing between Wisconsin and Mexico as the location for a new push into EV production.[79] The same report claimed that "Most contract manufacturers have moved server production from factories in China to plants in Taiwan, Mexico and the United States in response to security concerns from their customers.

75 James Kynge, "Huawei Records Biggest Jump in Patent Ownership in 2020", *Financial Times*, 16 March 2021, https://www.ft.com/content/614c6149-2f6e-482f-b64a-97aa2496ac7f.

76 Counterpoint, "China Smartphone Market Share: By Quarter", 15 February 2022, https://www.counterpointresearch.com/china-smartphone-share/.

77 Arjun Kharpal, "Huawei Launches its Own Operating System on Smartphones in Challenge to Google Android", CNBC, 2 June 2021, https://www.cnbc.com/2021/06/02/huawei-harmonyos-operating-system-launched-on-smartphone-smartwatch.html.

78 Kathrin Hille, "Taiwanese Apple and Tesla Contractor Cuts China Headcount by Almost Half", *Financial Times*, 19 March 2021, https://www.ft.com/content/194de653-608f-480b-9871-3ebdfb6bcbbb.

79 Kathrin Hille, "Foxconn Weighs up Making Electric Vehicles in Wisconsin from 2023", *Financial Times*, 17 March 2021, https://www.ft.com/content/2920cf0b-9a7c-40ed-a2cc-50b8d13d3bb2.

Two people familiar with the situation said Foxconn was making servers for Google in Wisconsin."

Taiwan Semiconductor Manufacturing Company (TSMC) is a focal company for global semiconductor supply chain reconfiguration. Together with Samsung, it dominates the global market for the most advanced semiconductors. Under pressure from the fallout of American restrictions, it has announced large investments in new plants in the United States and Japan.[80] TSMC's reporting on its major customers implies that Apple is its largest customer, accounting for a quarter of revenues. Analysts believed its second largest customer in 2020 was Huawei, accounting for around 12% of revenue before the impact of TSMC's halt on shipping products to Huawei from September 2020.[81]

Not all shifts in regional supply chains and firm-level decisions relating to shifting production locations are driven by the US-China conflict. Some moves by Taiwanese companies are responsive to Taiwan's own security concerns.[82] Taiwan has also tightened controls on the flow of human resources and technology to China.[83] Japan's announced pledge of US$2.2 billion to help its manufacturing firms move production out of China was at least in part a reaction to coronavirus-related disruptions to supply chains.[84] Some shifting of investment out of China is also driven by rising labour costs and increasing automation.

80 Editorial, "The Economic Costs of Geopolitics", *The Taipei Times*, 22 February 2022, https://www.taipeitimes.com/News/editorials/archives/2022/02/22/2003773528.

81 "TSMC's Largest Customer Makes Up 25% of Revenue", *The Taipei Times*, 9 March 2021, https://www.taipeitimes.com/News/biz/archives/2021/03/09/2003753477.

82 Yin-wah Chu, "Democratization, Globalization, and Institutional Adaptation: The Developmental States of South Korea and Taiwan", *Review of International Political Economy* 28, no. 1: 59–80.

83 Che Pan, Iris Deng, and Ann Cao, "US-China Tech War: Taipei, Washington on Same Page When It Comes to Curbing Beijing's Semiconductor Expansion", *South China Morning Post*, 24 February 2022, https://www.scmp.com/tech/big-tech/article/3168117/us-china-tech-war-taipei-washington-same-page-when-it-comes-curbing?module=lead_hero_story&pgtype=homepage.

84 Bloomberg, "Japan to Pay Firms to Leave China, Relocate Production Elsewhere as Part of Coronavirus Stimulus", *South China Morning Post*, 9 April 2020, https://www.scmp.com/news/asia/east-asia/article/3079126/japan-pay-firms-leave-china-relocate-production-elsewhere-part.

Nonetheless, companies along the supply chain in advanced technology products, particularly leading edge semiconductor manufacturers, are developing supply chain structures with the aim of building resilience against security-motivated disruptions. They are also developing political connections as one element of their strategies for resilience in the face of risks arising from worsening US-China relations.[85]

CONCLUSION

For the largest firms, some moves to improve resilience in the face of security-driven disruptions are consistent with other de-risking initiatives through diversification of supply chain partners and production locations. In some cases, however, security-driven supply chain reorganisation may reduce diversification and resilience against market shocks or disruptions by narrowing the range of partners and moving to production locations with less developed technology ecosystems. In such cases, the logic of de-risking supply chains for security-related reasons directly challenges the economic logic that has driven regional integration.

85 Song Jung-a, "South Korean Chip Companies Step up US Lobbying Efforts", *Financial Times*, 3 January 2022, https://www.ft.com/content/62c12877-4594-478d-b0cc-ae6158ba71ad.

Towards More Resilient and Innovative Supply Chains

Yasuyuki Todo

INTRODUCTION

Global supply chains, particularly those in the semiconductor industry, are currently undergoing substantial reorganisation for two major reasons: (i) the policies undertaken by the United States, Japan, and the European countries to decouple their economies from the Chinese economy for national security concerns; and (ii) the supply-chain disruptions experienced during the COVID-19 pandemic. This chapter discusses how resilient and innovative supply chains can be constructed, mostly from the perspective of Japan.

ROLE OF GEOGRAPHIC DIVERSITY IN RESILIENCE

In the wake of the COVID-19 pandemic, the world economy has experienced the propagation of negative production shocks arising from infections and lockdowns. The propagation can be both upstream, i.e., from customers to suppliers because of shortages of demand, and downstream, i.e., from suppliers to customers because of supply shortages. The downstream propagation is partly enhanced by the difficulty of substitution for disrupted suppliers.[86] One way to promote supplier substitutability is diversification, particularly geographic diversification, of supply-chain partners, as suggested by a study using data for global supply chains of major companies around the world.[87] The study finds that companies that have diverse partners internationally can mitigate the propagation of economic shocks because they can find substitutes relatively easily by selecting from their existing partners or using their international information networks.

86 Jean-Noël Barrot and Julien Sauvagnat, "Input Specificity and the Propagation of Idiosyncratic Shocks in Production Networks", *The Quarterly Journal of Economics* 131 (2016): 1543–1592.

87 Yuzuka Kashiwagi, Yasuyuki Todo, Petr Matous, "Propagation of Economic Shocks through Global Supply Chains: Evidence from Hurricane Sandy", *Review of International Economics* 29 (2021): 1186–1220.

This finding holds during the ongoing COVID-19 pandemic. According to a study using firm-level data collected in the ASEAN countries and India during the pandemic, firms facing a decline in the volume of transactions with one supplier or customer could increase the volume with another supplier or customer when it is linked with partners in many foreign countries.[88]

DIVERSITY ALSO PROMOTES INNOVATION

Furthermore, geographically diversified supply chains are more innovative because companies can pick up new technologies, knowledge, and information from their foreign partners. In fact, supply-chain links with distant partners are found to promote productivity and innovation.[89] In addition to global supply chains, international research collaboration is shown to raise the quality of innovation at the firm level substantially more than domestic collaboration, possibly because knowledge often differs from country to country and there is not much overlap.[90] International research collaboration was also quite effective during the COVID-19 pandemic. The OECD states that "(c)ollaboration lies at the heart of science, technology and innovation response to COVID-19, where national and international collaborative platforms for technology are revolutionising vaccine design and production".[91]

In summary, supply chains that are geographically diversified across countries are the key to their resilience and innovativeness.

88 Yasuyuki Todo, Keita Oikawa, Masahito Ambash, Fukunari Kimura, and Shujiro Urata, "Robustness and Resilience of Supply Chains During the COVID-19 Pandemic: Findings from a Questionnaire Survey on the Supply Chain Links of Firms in ASEAN and India", ERIA Discussion Paper Series, No. 407, Economic Research Institute for ASEAN and East Asia, 2021.

89 Yasuyuki Todo, Petr Matous, and Hiroyasu Inoue,"The Strength of Long Ties and the Weakness of Strong Ties: Knowledge Diffusion through Supply Chain Networks", *Research Policy* 45 (2016): 1890–1906.

90 Takashi Iino, Hiroyasu Inoue, Yukiko U. Saito and Yasuyuki Todo, "How does the global network of research collaboration affect the quality of innovation?" *Japanese Economic Review*, 72 (2021): 5–48.

91 OECD, *OECD Science, Technology and Innovation Outlook 2021: Times of Crisis and Opportunity* (OECD Publishing, 2021), p. 122.

CURRENT SITUATION OF GLOBAL SUPPLY CHAINS

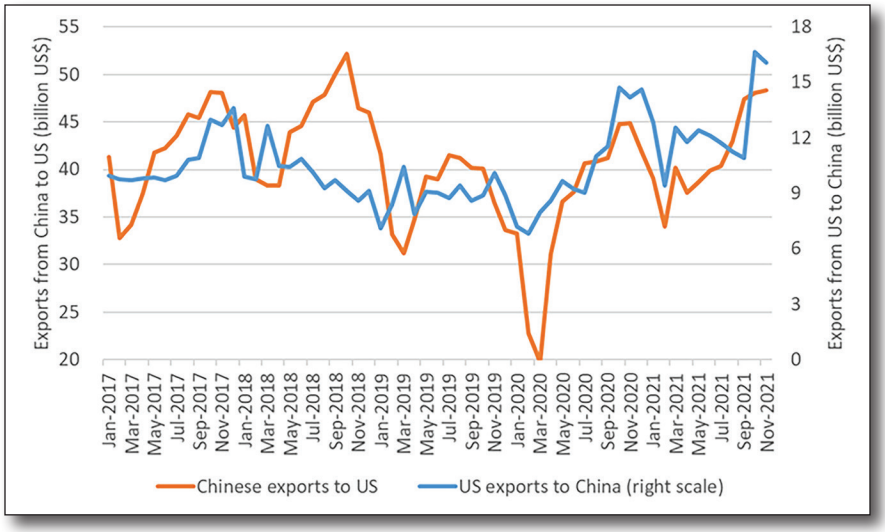
The US-China Decoupling and Its Impact on Trade

One major force behind the changes in global supply chains is the US-China decoupling trend. The US government has restricted exports of high-tech products and the transfer of sensitive technologies to some Chinese companies, including Huawei, since 2019 because of national security concerns. In addition, the United States has heavily regulated foreign direct investment (FDI) inflows in high-tech sectors since 2018, targeting FDI from China. More recently, the US government announced the importance of building resilient supply chains of strategic products for national security reasons. The large subsidies that it provided for this purpose successfully attracted TSMC, Samsung, and Intel, the global giants in the semiconductor industry, to set up production plants in the United States.

The Japanese government has emulated the strategies of the United States, restricting high-tech exports and FDI inflows. Subsidies are provided to companies that relocate their overseas production plants to Japan for "reshoring" or set up their production facilities in ASEAN for supply-chain diversification. The Japanese government also attracted TSMC's production plant to Japan. The modified budget for the fiscal year 2021 allows the government to provide subsidies of up to 620 billion yen (approximately US$4.6 billion) to attract semiconductor plants.

However, it should be emphasised that despite these policies by the United States and Japan to decouple from the Chinese economy, their trade volumes with China have not necessarily shrunken, except in the case of a limited number of strategic products. As shown in Figure 1, both exports from the United States to China and from China to the United States were on a decline in 2018 and 2019, most likely because of the restrictions mentioned earlier. However, both picked up and trended upwards after March 2020.

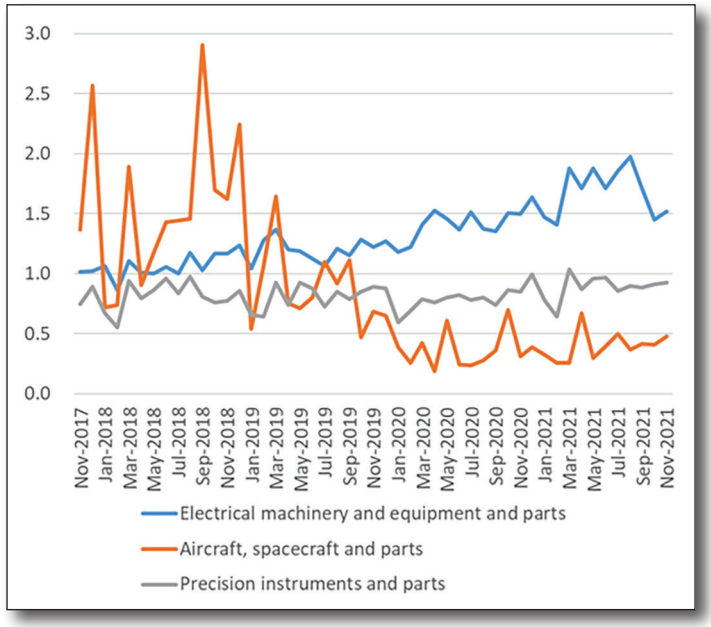
Figure 1. Trade between the United States and China (monthly, January 2017–November 2021)



Source: United States Census Bureau, "Foreign Trade", 2022, https://www.census.gov/foreign-trade/balance/c5700.html

Figure 2 specifically presents high-tech exports from the United States to China using more disaggregated classifications, i.e., the harmonised system (HS) code at the two-digit level. Exports of electrical machinery and equipment, including parts (HS code: 85), which are the major target of the US-China decoupling, have been in fact increasing drastically since 2018, whereas exports of another set of targets, precision instruments and parts, including optical and medical instruments (90), are stable. In contrast, exports of aircraft, spacecraft and parts have been clearly decreasing since 2019.

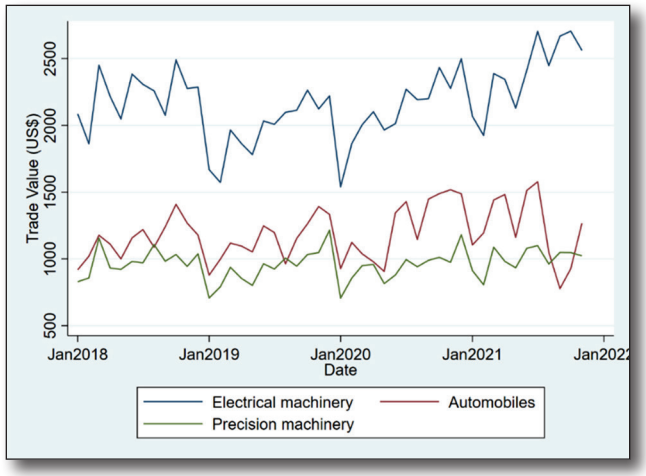
Figure 2. High-Tech Exports from the United States to China



Source: UN Comtrade Database, 2022, https://comtrade.un.org/data/, 2022

The changes in exports of major products from Japan to China are presented in Figure 3. Similar to exports from the United States, Japanese exports of high-tech products to China have been increasing (electrical machinery and automobiles) or stable (precision machinery).

Figure 3. Exports of Major Products from Japan to China



Source: UN Comtrade Database, 2022, https://comtrade.un.org/data/, 2022

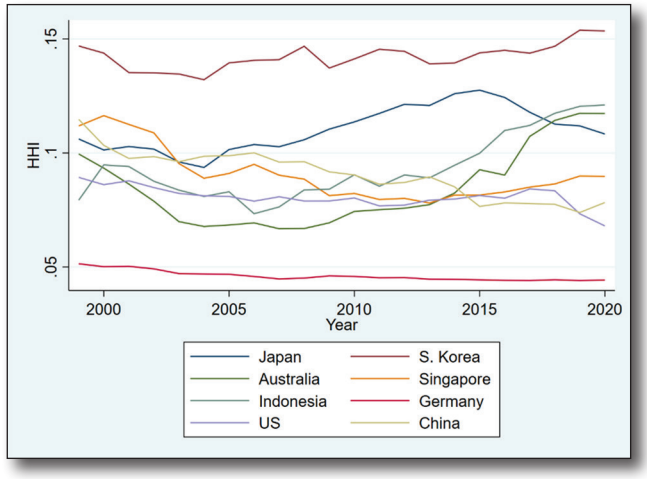
TRENDS IN GEOGRAPHIC DIVERSIFICATION OF SUPPLIERS

We now turn to the degree of geographic diversification of suppliers in global supply chains for selected countries in the Asia-Pacific region and Germany for a comparative evaluation of their resilience. Figure 4 illustrates the Herfindahl-Hirschman Index (HHI) of selected countries, a common measure of market concentration, for imports of parts and components defined by the Broad Economic Categories of the United Nations. The HHI is derived by the sum of the squared share of each trade-partner country in the focal country's total imports. A larger HHI indicates a higher concentration or lower diversification of trade partners. Figure 5 shows the share of China in the imports of parts for each country.

Several findings are worthy of note. First, South Korea, Australia, and Indonesia have raised their reliance on China and, accordingly, the geographic concentration of suppliers of parts, measured by the HHI for the last decade. Second, Japan's reliance on China and HHI were quite high in 2015, comparable to that of South Korea, but these have declined slightly since then. This finding implies that Japanese companies lowered their reliance on China as parts suppliers a few years before the US-China decoupling and the COVID-19 pandemic and continued this procurement strategy during these events. Third, the United States also has lowered its reliance on China

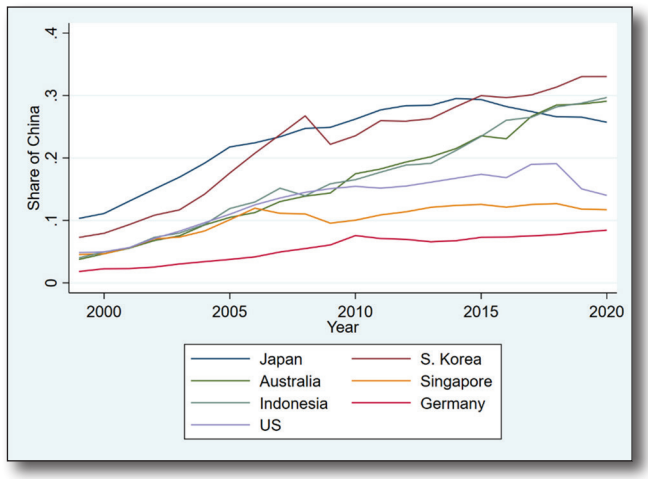
and its HHI since 2019, the initial year of the US-China decoupling. Finally, China drastically reduced its HHI, implying that China successfully diversified its supply chains geographically.

Figure 4. Herfindahl-Hirschman Index of Imports of Parts (1999–2020)



Source: UN Comtrade Database, 2022, https://comtrade.un.org/data/, 2022

Figure 5. Share of China in Imports of Parts (1999–2020)



Source: UN Comtrade Database, 2022, https://comtrade.un.org/data/, 2022

We evaluate these features of supply chains in the following discussion, judging from the claim in the previous section that geographically diversified supply chains are more resilient and innovative. First, the suppliers for some countries may be too concentrated, particularly in China. Although it is difficult to determine the "best" HHI for resilient and innovative supply chains, the HHI for South Korea, Australia, Indonesia, and Japan are possibly too high compared with that for Germany, China, Singapore, and the United States. Second, Japan and the United States recently lowered their reliance on China as suppliers and thus the degree of supply-chain concentration. During the same period, their overall trade volumes with China, particularly their exports to China, were not shrinking but rather on an increasing trend. These facts imply that the current policies of Japan and the United States that try to construct resilient supply chains have been successful in diversifying supply-chain partners and thus lowering the risks of disruptions without harming their overall trade with China. Finally, despite Japan's success, its reliance on China and degree of concentration are still high. Therefore, there is room for further reduction.

POLICY SUGGESTIONS FOR MORE RESILIENT AND INNOVATIVE SUPPLY CHAINS

As we saw above, the current policies of Japan to reconstruct global supply chains can be justified. However, there are still several concerns about these policies, and thus this final section provides four suggestions.

1. Not reshoring, but diversifying supply chains across countries

Some of Japan's policies are intended to attract supply chains to the domestic economy, using a large amount of subsidies. However, large-scale reshoring is harmful to the resilience of supply chains because concentration of supply chains in the domestic economy is contrary to the logic of diversification and thus raises risks of supply-chain disruptions. In addition, large subsidies for relocation of production plants do not necessarily promote productivity growth in the target region. The current subsidies for reshoring may also attract semiconductor plants that use obsolescent technologies while plants using frontier technologies remain in their home countries, such as Taiwan and South Korea.

Therefore, policies for supply chain resilience should not focus only

on reshoring to the domestic economy, but rather aim for more geographic diversification of supply-chain partners across countries. Because public support for information sharing and business matching through export and investment promotion agencies is found to be effective,[92] this type of policy should be utilised more than relocation subsidies. Further, information sharing and business matching could consider utilising the existing multilateral frameworks among low-risk countries, such as the Quadrilateral Security Dialogue (Quad) and the Free and Open Indo-Pacific (FOIP).

2. No industry targeting

Another concern is the current policies' narrow targeting of industries, particularly their focus on the semiconductor industry. Within the policy-making arena and among academics, the targeting policy is supported by the resurgence of industrial policy as an effective approach for economic growth. However, we need to carefully interpret the re-evaluation of industrial policy in the economic literature because the definition of "industrial policy" varies. Industrial policy, narrowly defined as targeting a particular industry and trying to promote it by protectionist measures, is not supported even by the current pro-industrial policy arguments advanced by economists such as Aiginger and Rodrik[93] In addition, although the pro-industry policy arguments are often founded on China's high growth, which seems to be promoted by its industrial policy, quantitative studies found that industry targeting was not the only factor that promoted China's growth although it did promote growth when combined with competition policy.[94]

These arguments and empirical findings suggest that the current industrial policy targeting the semiconductor industry through protectionist measures, including subsidies for reshoring, may not be effective. Instead, targeting of the semiconductor industry should be at least associated with policies to promote openness and competition. Therefore, policies for

92 Ryo Makioka, "The Impact of Export Promotion with Matchmaking on Exports and Service Outsourcing", *Review of International Economics* 29 (2021): 1418–1450.

93 Karl Aiginger and Dani Rodrik, "Rebirth of Industrial Policy and an Agenda for the Twenty-first Century", *Journal of Industry", Competition and Trade* 20 (2020): 189–207.

94 Philippe Aghion, Jing Cai, Mathias Dewatripont, Luosha Du, Ann Harrison and Patrick Legros, "Industrial Policy and Competition", *American Economic Journal: Macroeconomics* 7 (2015): 1–32.

supply-chain diversity should cover broader industries and promote competition among industries and companies.

3. Promoting innovation networks

Contemporary global supply chains, i.e., networks of companies involving transactions of materials and parts, are often associated with networks involving knowledge transactions, e.g., research collaboration. Given that technologies are increasingly complex, research collaboration between companies and between companies and universities is an important channel of innovation by learning from each other. Therefore, policies to support such collaboration should be encouraged.[95] More generally, policies to promote innovation are needed to maximise social welfare, and thus the importance of innovation policy is often emphasised in both pro- and anti-industrial policy arguments.[96]

In practice, promoting R&D activities and international research collaboration in high-tech sectors, including the semiconductor industry, is already incorporated into the recent policy packages of Japan and the United States. For example, the US Innovation and Competition Act proposes R&D subsidies in the semiconductor industry and these are combined with an additional US$29 billion for R&D in high-tech fields. Japan successfully attracted not only TSMC's plants for semiconductor production but also its R&D centre to Japan for research collaboration with Japanese companies and research institutions. In the long run, more emphasis should be placed on such innovation policies to construct competitive domestic industries than on protectionist policies.

4. Alleviating national security concerns

Finally, it should also be emphasised that China is an important trade and knowledge partner for any country, so trade and knowledge links with China should not be contracted drastically. However, it is quite risky for Japanese, US, and European companies to link with China at the moment because of national security concerns and possible future economic restrictions on

95 OECD, *OECD Science, Technology and Innovation Outlook 2021: Times of Crisis and Opportunity* (OECD Publishing, 2021).

96 Karl Aiginger and Dani Rodrik, "Rebirth of Industrial Policy".

China. Because of these risks, companies outside China hesitate to trade with, conduct research collaboration with, and invest in China.

To alleviate these risks, we need transparent international rules to define products for which trade can be restricted and industries in which inward FDI can be regulated for national security concerns. Currently, such national security exceptions are defined by the World Trade Organization, but the definition in GATT Article 21 is quite vague and has rarely been discussed in the WTO's Dispute Settlement Body.[97] Therefore, such international rules should be alternatively initiated in other bilateral or multilateral trade frameworks.

97 Daria Boklan and Amrita Bahri, "The First WTO's Ruling on National Security Exception: Balancing Interests or Opening Pandora's Box?", *World Trade Review* 19 (2020), 123–136.

The Role of Services and Digitalisation in Boosting ASEAN Value Chain Resilience

Dipinder S. Randhawa

Since their heyday that lasted from the mid-1980s until the onset of the global financial crisis (GFC) in 2007, global trade and value chains have been in gradual decline. Lower barriers to trade and foreign direct investment, domestic deregulation, falling transport costs, and the rise of computing, all had contributed to a massive increase in international trade and investment as businesses split up manufacturing of components across countries where they could be produced most efficiently. The GFC, however, resulted in a sustained slowdown in trade as firms sought to rationalise their hyper-stretched value chains.[98]

The shock delivered by the abrupt imposition of tariffs and bans on investments by President Trump injected uncertainty into corporate investment plans and policy frameworks across the world. However, prior to this development, supply chains were already undergoing significant changes in response to trends in business and technology. As labour costs rose in China, manufacturers relocated production facilities to lower cost locations in Southeast Asia and elsewhere. In early 2020, the COVID-19 pandemic struck even sharper blows to value chains, triggered by localised shutdowns in manufacturing centres, breakdowns in logistics, labour shortages at ports, and imbalances that cropped up as economies embarked on a hesitant and sputtering recovery from the pandemic. The effects of these setbacks persist two years later, as expectations of a revival in trade and investment in early 2022 were belied by repeated COVID-19 outbreaks in China and parts of Europe.

The Russian invasion of Ukraine and the sanctions subsequently imposed on Russia severely exacerbated disruptions to both manufacturing and services in ways that could not have been anticipated in any risk

98 Pol Antras,"De-Globalisation? Global Value Chains in the Post-COVID-19 Age", NBER Working Paper, 28115, November 2020.

management calculus. Supply bottlenecks in a growing list of commodities, including foodgrains, oil, gas, aluminium, and fertilisers have resulted in severe inflationary pressures, raising concerns about stagflation and social instability, and, potentially, a lost decade for debt-ridden emerging market economies.

Looking ahead, firms will confront the risks arising from climate change, reflected in the growing frequency of floods, drought, fires, severe storms, and other weather disruptions, such as those witnessed in Thailand, Germany, Australia, the United States, the United Kingdom, and elsewhere, as well as the challenges stemming from the introduction of technologies of the Fourth Industrial Revolution (4IR), some of which are being increasingly deployed across Southeast Asia by large multinational firms as well as some local firms at the cutting edge of technological change. Firms unprepared to deal with the risks arising from climate change or to cope with the demands of new technologies risk being sidelined from international supply chains, impairing the region's prospects for sustainable growth.

All of these factors call for a recalibration of the approach towards risk management, and the imperative of developing supply chains that are less stretched and fragile, or conversely, more resilient. With multiple existential threats to competitiveness and a breakdown in multilateralism, how can ASEAN design a strategy to boost its resilience while sustaining its competitive edge in supply chains?

TRENDS AMONG GLOBAL VALUE CHAINS

Global value chains (GVCs) across ASEAN and elsewhere are demonstrating some distinct trends:

1. Firms are increasingly abandoning the "just-in-time" model and shifting away from decisions based purely on cost conditions to near-shoring, with longer term contracts with suppliers from geopolitically "safer" regions;
2. Through near-shoring and consolidation of suppliers, value chains are shortening;[99]
3. Firms that were manufacturing in China for the Chinese market will

99 ADB, WTO, et al "Global Value Chain Development Report: Beyond Production", November 2021

reinforce local operations, but production for markets outside China is shifting to locations elsewhere;
4. Where feasible, firms are deploying new technologies, including smart factories and robotics, to boost resilience and even diversify production centres. The use of digitalisation, including that of data, is an increasingly important contributor to productivity;
5. The servicification of manufacturing, with services accounting for a growing share of value added in manufacturing,[100] is reshaping supply chains. In short, supply chains are endeavouring to become smarter, shorter, faster, and safer, and to reduce their carbon footprint.

THE IMPACT ON ASEAN

One of the fastest growing regions of the world over the past five decades, ASEAN has a large growing market, a robust manufacturing sector that is steadily moving up the value chain, a rapidly expanding economy, and a favourable demographic profile. Growth across Southeast Asia has been shaped by close trading relationships with all major economic regions across the world. Over the past two decades, China's engagement with the region increased rapidly through both trade and investments, and increasingly, through value chains. Less obvious is ASEAN's inexorable growth in significance for all major economic regions, both in terms of trade and as a destination for foreign direct investments (FDI). With 650 million people and a combined GDP of US$3 trillion, which is expected to double before 2040, ASEAN is projected to be the fourth-largest single market by 2030, after the European Union, United States and China. US investments in ASEAN exceed its cumulative investments in China, India, Japan and South Korea. China and ASEAN are each other's largest trading partners. The European Union's trade and investment in ASEAN have grown impressively in recent years, but substantial untapped potential remains. And, all of this while intra-ASEAN liberalisation is at a formative stage, indicative of the untapped capacity and scope for growth.

The pandemic and the war in Ukraine revealed new fault-lines in hitherto unaffected areas: semiconductors, other advanced chips, food

100 The "servicification of manufacturing". UNCTAD conducts extensive research on trends in this area. See https://unctad.org/topic/trade-agreements/services.

security, access to vaccines, energy security, and the manifold risks posed by climate change. These challenges have served as a wake-up call signalling the vulnerabilities as well as the substantial possibilities ahead. This chapter contends that ASEAN is at a juncture where it should not, and need not, align with either the United States or China, but deploy its own growing strengths to attract investment and boost trade with all regions, albeit, as a strong regional grouping.

WHAT LIES AHEAD FOR ASEAN

Southeast Asia stands at the threshold of major changes. Despite remarkable progress in recent decades, ASEAN cannot be sanguine about its prospects in the current environment. The longer term implications for ASEAN are clear: without a strong and coordinated drive towards trade and investment integration, ASEAN risks losing its pre-eminent status in a new world order. The Regional Comprehensive Economic Partnership (RCEP) and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) provide a promising start. However, these will not suffice for sustaining ASEAN's long-term relevance and competitiveness. The trajectory of value chains indicates that services and technological prowess, buttressed by increasing digitalisation, will play a crucial role in value chains, their evolution, and choice of location for investment.

Intra-ASEAN collaboration is guided by the ASEAN Economic Community Blueprint 2015, with ongoing efforts including operationalising the ASEAN Single Window (ASW), a trade facilitation initiative. Work on digitalisation under the ASEAN Trade in Goods Agreement (ATIGA) and ASEAN-wide Self Certification, which would make it easier for exporters to enjoy preferential tariffs, is at its final stage. But these measures are not enough for the times. ASEAN needs to look beyond its ambivalence towards regional integration to offer a cohesive picture to potential investors.

ASEAN has demonstrated the capacity to respond to crises in the past and come together for mutual good. Following the Asian financial crisis of 1997, ASEAN members developed mechanisms through the Chiang Mai Initiative to build defences against speculative attacks. These involved establishing currency swaps and developing local currency bond markets to diversify funding sources and reduce currency risks. This effort served ASEAN well subsequently during the GFC.

Many of the challenges that ASEAN faces, such as climate change, the risks of another pandemic, and the challenge of proliferation of technologies of the 4IR, require cross-border solutions. ASEAN's record on economic integration, at best, has been modest. ASEAN members, however, have responded to past crises with reforms, if not through direct coordination, at least by discussing policy responses and through mutual learning. The current set of challenges requires substantially greater coordination than ASEAN has achieved thus far. There is an increasing realisation across ASEAN capitals that in order to maintain its standing as a resilient and stable investment destination, the regional grouping needs to achieve far greater coordination than in the past.

A PROACTIVE AND COHESIVE ASEAN

So, how should ASEAN respond to the looming challenges from climate change, the 4IR, surging inequality, and geopolitical uncertainty, all of which pose fundamental risks to its standing as a pre-eminent and stable investment location, and prepare for the challenges that lie ahead? ASEAN's responses to the current and imminent challenges will shape the region's growth prospects in the years ahead.

On both climate change and new technologies, a few independent government and private sector initiatives across countries offer hints of convergence and complementarity of policy responses, albeit, on a piecemeal basis. As an illustration, combating the effects of climate change would call for pooling of resources and assigning specific mandates to member states. ASEAN member states have embarked on such endeavours to mitigate the local effects of climate change.

ASEAN states are constrained in responding individually because of limitations of capacity, capabilities and resources. To kickstart collective action, the ASEAN-6, namely, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam, countries that are to varying degrees embedded in global manufacturing chains, need to execute tangible reforms and increase coordination well beyond what we have seen thus far. Acting in concert has the potential to yield substantial network effects. While some reforms will be relatively low hanging fruit, others will call for extensive mutual consultations.

RESPONDING TO CHANGE

To secure its standing, ASEAN would need to carry out urgent, meaningful reforms and a degree of harmonisation of reforms that goes well past MoUs of the past. Urgent coordination is needed in two areas: (i) liberalisation and coordination of the services sector, and (ii) digitalisation of the region.

Reforms in the services sector. Notwithstanding its impressive track record on trade liberalisation, ASEAN's record on liberalising services leaves much to be desired.[101] Trade in services is hard to liberalise as it calls for harmonising regulations. With the exception of Singapore, the ASEAN member states continue to shelter their services sector behind nontariff barriers and other restrictions to entry of outsiders. Coordinated liberalisation of the services sector can substantially reduce costs for investors and boost intra-ASEAN trade, as well as trade within RCEP. ASEAN members have made considerable progress on trade facilitation, but much remains to be done. The highest cost savings are in paperless trade measures, which also would catalyse the entry of small and medium enterprises into international markets. Digital trade facilitation initiatives, an area in which substantial gaps in regional infrastructure persist, offer substantial cost savings. The sustained surge in shipping and logistics costs has further underlined the importance of reforms in trade facilitation to enhance competitive advantage in value chains.

Services account for an increasing part of value chains, a trend that will continue into the foreseeable future. They are integral to near-shoring and imparting resilience to supply chains. Services will increasingly be the factor that determines competitiveness. ASEAN members would need to shed their reservations if the region wants to attract investments and stay competitive.

Digitalisation across ASEAN. This is an essential concomitant of the servicification of manufacturing but it differs across member states. The ASEAN Digital Masterplan 2025 provides a useful template for developing the digital economy. The focus is primarily on provision of digital infrastructure. Developments in FinTech and related fields have underscored the need to expedite initiatives and broaden the quest to include regulatory and harmonisation measures to catalyse the growth of the private sector across the region. For ASEAN as a whole, a great deal needs to be done, starting with

101 See the OECD's STRI Index (Services Trade Restrictiveness Index).

the imperative of coordination in fundamental areas: developing uniform codes and norms for digitalisation and agreeing to share data for common good, interoperability across platforms and databases, with the design of commensurate regulation, and digitalisation of basic protocols, including customs procedures and protocols at ports and airports, would expedite trade and cut trade costs by reducing administrative costs. Developing data collection, collation and interpretation is essential for monitoring the response to policy initiatives and can help boost efficiency of public sector expenditure as well as that of the private sector.

A developing services sector, coupled with digitalisation across the economy, will also boost demand for skilled labour at a time when employment opportunities are increasingly scarce. ASEAN can meaningfully collaborate on skills development, including persuading companies investing in the region to nurture skills development programmes that could eventually be passed on to locals for management. Singapore's Economic Development Board offers a successful template for this.

These initiatives will also help ASEAN reap maximum benefits, and not just from RCEP, but also diversify and boost trade and investment, including from Japan and South Korea. A number of EU and American companies located in the region are at the forefront of these changes.

Over the longer term, ASEAN needs to step up investment coordination in the region, expedite the establishment of common data standards, develop regulatory capabilities and capacity and coordinate regulatory initiatives across the region. Coordination with multilateral agencies and entities such as the European Union will offer useful insights.

CONCLUDING OBSERVATIONS

To maintain its relevance and standing in the world, and, most importantly, to retain its attractiveness as a dynamic, adaptive investment destination, ASEAN has to credibly project itself as a competitive region in its own right, and not be beholden to either major power. It is also clear to both the United States and China that the region is not there for the picking; more pertinently, Southeast Asia has been growing into an increasingly prominent destination for trade and investment, steadily moving up the value chain.

To reiterate the obvious, regional economies will continue to compete with each other in export markets and in attracting investments. But there

are externalities that can be generated that benefit the region as a whole without compromising any country's competitive potential, let alone, sovereignty. The focus is on industry that deploys technologies of the 4IR, something that is already under way at firms in many countries, and in sectors ranging from manufacturing and consumer services to agriculture and pisciculture. These initiatives do not require ASEAN member states to compromise on intra-ASEAN competition to attract investment. They can, however, help to boost the collective and individual attractiveness of member states as a destination for investment as the global economy adapts to the changing landscape.

ASEAN today has opportunities to not just sustain its relevance, but also to consolidate its status as one of the most attractive, secure, cohesive, competitive and neutral investment locations prepared for technological change, and offering access to a large growing market. It can project itself as a region with agency and politically independent of vested interests while offering stability and cost advantages.

POLICY RECOMMENDATIONS

How Should Policy Makers Respond?

Jayant Menon

INTRODUCTION

The preceding three parts of this monograph dealt with the impact of global (COVID-19 pandemic) and regional (US-China trade war) shocks on the regional economic order and regional economic integration operating through the network of supply chains. In this chapter, the lessons for policy are drawn out, highlighting what governments should consider in responding to the shocks in the adjustment phase and in the longer term. These include dealing with the rise in anti-globalisation sentiment, which has been exploited and accelerated during the pandemic.

The role that mega-regionals, the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), can play in countering the rise in protectionist pressures is examined in section one of this chapter. Much of the protectionist pressures has been expressed in the form of an increase in barriers to factor mobility more so than to trade in goods. Since both RCEP and CPTPP are not designed to deal with factor mobility, mini-regionals such as ASEAN and bilateral free trade agreements (FTAs) such as the India–Singapore Comprehensive Economic Cooperation Agreement (CECA) can play the role of filling the gaps. This is considered in section two.

Finally, there has been a lot of discussion relating to the need to increase the resilience of supply chains following both global and regional shocks — the pandemic and the US-China trade war, respectively. Anti-globalisation forces are employing the apparent lack of supply chain resilience as a pretext to advocate reshoring. The evidence suggests that supply chains may be more resilient than they appear and there is little basis for the shortening or retrenchment of supply chains that is being proposed. Engineering a trade war or using subsidies to encourage reshoring is both unnecessary and harmful, as discussed in section three.

I. THE ROLE OF MEGA-REGIONALS: RCEP AND CPTPP

The pandemic is providing political fodder for nationalists who favour greater protectionism and immigration controls, which could end up slowing or reversing trade liberalisation actions or curtailing labour and capital mobility at a time when these are needed the most.[102]

Anti-globalisation forces are exploiting the need to increase supply chain resilience to advocate reshoring or near-shoring. More concerning is the re-emergence of unabashedly nationalist industrial policy platforms such as Indian prime minister Modi's *Atmanirbhar Bharat* or "self-reliant India" and US president Biden's "Make in All of America" initiatives.[103] In fact, leaders as disparate as Emmanuel Macron of France and Xi Jinping of China are calling for greater self-reliance. These retreats come in the wake of the pandemic, which is also having impacts that will directly increase the costs of such actions. In this respect, the pandemic is likely to have a lasting impact in reinforcing other trends that are already undermining globalisation.

What should governments do to stem the rise in anti-globalisation sentiment turning into changes in policy settings? A good starting point is to reaffirm their commitment to a free and open, rules-based international trading system. The best way to do this is to agree to a set of binding trade-related commitments. This happened most recently in December 2020 when 15 countries from the Indo-Pacific region finally signed the RCEP agreement, creating the largest free trade area in history. The commitment was reaffirmed when nine members ratified the agreement so that it could enter into force from 1 January 2022.

Mega-regionals such as RCEP and the CPTPP, which came into force on 30 December 2018, can tie the hands of member countries and prevent them from succumbing to protectionist pressures. They can also further the trade liberalisation agenda by tackling difficult WTO-plus and WTO-minus issues in an environment where the WTO has been ineffectual (see Urata,

102 See, for instance, Philippe Legrain, "The Coronavirus Is Killing Globalization as We Know It", *Foreign Policy,* 12 March 2020, https://foreignpolicy.com/2020/03/12/coronavirus-killing-globalization-nationalism-protectionism-trump/.

103 In addition to dealing with perceived inequities associated with globalisation at home, Biden's embrace of industrial policy is undoubtedly also a response to the rise in China's economic clout and an attempt to stay ahead in the technology race.

Chapter 5 of this monograph). Furthermore, as Srisangnam points out in Chapter 4, RCEP can help prepare the less developed member countries for other more complicated trade negotiations such as CPTPP and a future Free Trade Area of the Asia-Pacific (FTAAP) comprising all 21 members of the Asia-Pacific Economic Cooperation (APEC) forum.

The interests of members and the broader region will be best served if these agreements are open and outward-looking. They should be open to future members joining with relative ease and minimise discrimination against non-members. While the accession requirements for RCEP appear somewhat complicated (Wilson, Chapter 6), the CPTPP has already received applications from the United Kingdom, China, Taiwan and Ecuador. Urata (Chapter 5) also raises the prospect of a merger between RCEP and CPTPP as a way of moving towards the FTAAP. Since the FTAAP would represent the only FTA proposal that includes both the United States and China, concluding such an agreement would produce substantial benefits to the region and the world. The road towards the FTAAP is long and winding, however, and it is still at a very early stage of discussion. The sanctions imposed by several APEC members on Russia following its invasion of Ukraine have further diminished the prospects of concluding the FTAAP anytime soon.

In the meantime, RCEP remains the most important agreement for ASEAN. ASEAN lies at the heart of RCEP; its centrality was key to RCEP's formation and its ability to strike a geopolitical balance will be key to RCEP's continued existence. If RCEP is unable to prevent a widening of the development gaps within ASEAN, then ASEAN's cohesion and ability to play an effective balancing role will be diminished. Ensuring that both new (Cambodia, Laos, Myanmar and Vietnam, or CLMV) and old (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand or the ASEAN-6) members benefit is important for the future of ASEAN and RCEP.

The ASEAN-6 are better placed to pursue the new issues in RCEP although these will still be a challenge to them. The new issues relate to WTO-plus or WTO-minus commitments and include trade in services, e-commerce, intellectual property rights and competition. CLMV are further behind and still struggle with the old issues. These encompass trade in goods, rules of origin (RoO), customs procedures and trade remedies. With most new issues, it is either impractical or costly to exclude non-members from participating in accords once they are implemented. The difficulty of

preventing free-riding with most of the new issues ensures that discrimination is minimised. This is not true for tariffs, where explicit, voluntary efforts are required to minimise discrimination. RCEP provides an opportunity for CLMV to catch up with the original ASEAN members and clean up their tariff codes.[104]

While the original ASEAN members have multilateralised most of their preferential tariffs under the ASEAN Trade in Goods Agreement (ATIGA) by offering them to non-members on a most-favoured nation (MFN) basis, CLMV have not. Multilateralisation underpins open regionalism and involves reducing and eventually removing the margins of preference (MOP) — the difference between ATIGA and MFN tariff rates. In 2018, the import-weighted MOP for CLMV was around 10%, more than double that of the original members.[105] When preferences are fully multilateralised, trade diversion is minimised while trade creation is maximised. The proliferation of FTAs can encumber trade and work against open regionalism, but multilateralising FTA accords mitigates these adverse effects. It is therefore important that RCEP's technical and economic cooperation agenda includes multilateralisation.

The pandemic is accelerating the move towards a digital economy, which will have both positive and negative consequences. There will be significant disruption to labour markets in the adjustment phase, which could be ameliorated through greater labour and capital mobility. Divergent demographic trends in the region will exacerbate the impact of technologically driven disruption and increase the need for greater cross-border factor mobility.[106] A lot of the barriers to labour mobility, raised in the name of safeguarding health during the pandemic, may not come down as quickly as they went up.

104 Jayant Menon, "The CLMV Countries and RCEP: Will They Grasp the Opportunities?" *Fulcrum,* 18 February 2022, https://fulcrum.sg/the-clmv-countries-and-rcep-will-they-grasp-the-opportunities/.

105 Economic Research Institute for ASEAN and East Asia (ERIA), *Impact of the ASEAN Trade in Goods Agreement (ATIGA) on Intra-ASEAN Trade*, ERIA, 2021, https://www.eria.org/uploads/media/Books/2021-Impact-of-the-ATIGA-on-Intra-ASEAN-Trade/Impact-of-the-ATIGA-on-Intra-ASEAN-Trade.pdf.

106 Jayant Menon, "Pandemic Fallout, Disruptive Technologies, and Divergent Demographics", ISEAS Economics Working Paper 2021-08*,* ISEAS–Yusof Ishak Institute, 2021, https://think-asia.org/handle/11540/14013.

Yet, however difficult and politically sensitive it may be, greater labour mobility will have to play a complementary role if adjustment costs are to be contained and bottlenecks overcome. A 2014 joint ILO and ADB study[107] predicted that, based on trends existing at the time, more than half the skilled job vacancies in 2025 in most of the ASEAN countries would not be filled with adequately qualified workers. The pandemic would have significantly worsened this situation.

II. THE ROLE OF ASEAN AND BILATERAL FTAS

It is unlikely that mega-regionals such as RCEP or the CPTPP will be able to significantly impact labour flows in the region. The labour chapter of the CPTPP concentrates on protecting internationally recognised labour rights and the enforcement of labour laws. Although these issues gain importance during crises, when abuses tend to increase, they do not directly address the need to expand labour movement between participating countries. RCEP does not have a chapter on labour and does not directly address labour movement across borders.

In ASEAN, harmonisation and streamlining of employment visas has been an important initiative in reducing barriers to labour mobility. ASEAN economies have signed several mutual recognition agreements (MRAs) for skilled jobs, but implementation has been stymied by domestic rules and regulations on employment and licensing. Furthermore, these MRAs will have to be more responsive to the rapidly changing skill and labour market conditions as a result of the pandemic and the 4IR. Most of the labour movement within ASEAN relates to low-skilled workers, and a significant but unknown share is undocumented.

A large number of both documented and undocumented workers have been repatriated following the onset of the pandemic, forced to return to economic conditions markedly worse than what they had originally fled. As economic conditions worsen and legal channels for labour movement tighten, the number of undocumented workers is likely to rise again. Policy changes should be undertaken to prevent the potential increase in

107 International Labour Organisation and Asian Development Bank. 2014. *ASEAN Community 2015: Managing Integration for Better Jobs and Shared Prosperity,* Manila: ADB. https://www.adb.org/publications/asean-community-2015-managing-integration-better-jobs-and-shared-prosperity.

undocumented workers: having undocumented workers does not serve the interests of the sending or receiving countries, let alone the risk it carries for the workers themselves.

Even if these agreements cannot promote greater factor mobility in and of themselves by limiting the resort to protectionism and keeping an open trading system for goods and services, they can contribute to greater factor mobility. As demonstrated by Samuelson's factor price equalisation theorem,[108] commodity movements and factor movements can serve as close substitutes in achieving similar outcomes. That is, even when the cross-border movement of labour or capital is restricted, trade in goods and services that are produced using these factors is sufficient to equalise wages and rentals in both countries over time. Kemp demonstrated how Samuelson's limiting two-country case generalised to the many-country configuration under less restrictive conditions, increasing the practical value of the theorem.[109] Therefore, trade liberalisation through regional agreements or other means can serve an important role in achieving the desired outcomes in the adjustment process when increasing factor mobility is difficult or delayed.

While trade can help with the adjustment process, it is not a perfect substitute for factor mobility. Given the sensitivities involved with labour mobility in particular, bilateral agreements may end up being more feasible than regional ones.[110] The aforementioned CECA between India and Singapore is one such bilateral deal that has enabled short- and long-term employment visas, ranging from two months to three years, for nationals of both countries. Despite some of the issues being politicised in Singapore, in particular, leading to concerns over losing jobs to foreigners, the long-run

108 Paul A. Samuelson, "International Trade and the Equalisation of Factor Prices", *Economic Journal*, June 1948, pp. 163–184.

109 Murray C. Kemp, "Factor Price Equalization in a World of Many Trading Countries", *Review of International Economics,* 14, no. 4 (2006), pp. 675–677.

110 Similarly, a different but related set of sensitivities underlies the preference for starting with the small numbers approach — either bilateral or trilateral — towards governance and rule-making for digital trade in the region, such as the Australia–Singapore Digital Economy Agreement and the *Digital Economy* Partnership *Agreement* (DEPA) between *Singapore, Chile* and New Zealand. See Shiro Armstrong, Rebecca Sta Maria, and Tetsuya Watanabe, T*owards an Asia-Pacific Digital Economy Governance Regime* (Research Institute of Economy, Trade and Industry, Tokyo, 2021).

benefits outweigh the costs to both countries.[111] Similar agreements involving other ASEAN countries would be of mutual benefit. Bilateral rather than regional arrangements are also the more feasible route towards addressing the perennial problem of undocumented migrant workers.

In short, policy reform will be critical in liberalising international factor flows at a time when the momentum is in the opposite direction as a result of the fallout from the pandemic. Unless this momentum can be arrested and policy can shift direction, the region faces a difficult and painful adjustment period during and after the pandemic.

III. SUPPLY CHAIN RESILIENCE AND THE CASE FOR RESHORING

"Resilience" is one of the new buzzwords that have emerged from the pandemic. When used in relation to supply chains, it usually refers to their ability to sustain shocks. That is, a supply chain is deemed robust or resilient if it can continue operating at pre-shock levels, producing an unchanged level of output at the same location. In this respect, there is an operational and locational dimension to supply chain resilience. The two are related because disruption to supply chain operations is being used as a pretext for reshoring of production. The reshoring prerogative is so strong that it was one of the drivers for the United States initiating a trade war with China, while Japan has been offering generous subsidies to affiliates of its multinationals to return home from China.[112] That is, the apparent lack of resilience of supply chains is being used as a basis to shorten or retrench supply chains. Is this justification valid, and has it worked?

To answer these questions, it is important to first determine whether

111 Sanchita Das, 2018. "ASEAN-India Economic Relations: Low Base, Large Potential", *ISEAS Perspective No. 58,* (2018), https://www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2018_68@50.pdf; and Tommy Koh, "Free trade agreements and Singapore", *The Straits Times,* 23 November 2019.

112 In April 2020, the Japanese government announced that it would spend some US$2bn to help Japanese multinationals leave China and set up shop at home or elsewhere in Southeast Asia. In a similar vein, former White House National Economic Council Director Larry Kudlow said the US could "pay the moving costs of American companies from China back to the US" in order to encourage reshoring. See Week in China. Globalisation in Retreat: Will the Pandemic Reshape China's Position in the Supply Chain? April 17 2020, https://www.weekinchina.com/2020/04/globalisation-in-retreat/.

supply chains are indeed as vulnerable as claimed, at least to policy-induced price rather than exogenous quantity disruptions. In assessing resilience, it is useful to separate shocks that are country or region specific from those that are general or global in nature, as noted earlier. The lockdowns associated with the COVID-19 pandemic are an example of a general or global shock, while the US-China trade war exemplifies a more specific one.

The pandemic-induced lockdowns disrupted production in almost all countries, irrespective of whether they were heavily engaged in global supply chains or not. As long as lockdowns were introduced in the countries involved, it did not matter whether goods were produced from start to end in one of those countries or in several of them. To the contrary, the pandemic illustrated how resilient supply chains can be when production bounced back so quickly after lockdowns were eased. This was particularly true in Southeast Asia, where trade was about 30% above pre-pandemic levels by late 2021.[113] This outcome is remarkable given that Southeast Asian supply chains remain largely China-centred and China has persisted with its lockdowns in line with its zero-COVID policy.

The vulnerability of supply chains is related to country- or region-specific shocks, such as the 2011 floods in Thailand or the 2011 Fukushima earthquake in Japan. This is where disruption to just one segment of production reverberated throughout the supply chain, leading to a collapse in final output. The US-China trade war is another country-specific shock because discriminatory tariffs are applied only to each other's trade. It is also a policy-induced price rather than quantity shock, the latter being associated most recently with the disruption of energy and food supply chains affected by the war in Ukraine and associated sanctions on Russia.

Even though the bilateral tariffs are relatively small, ranging from 10 to 25%, their impact on competitiveness is much greater. This is because while the tariff is applied to the total value of the product, it can be negated simply by removing the value share added in the offending country. An example would illustrate the point.

In 2018, the domestic value added of Chinese total manufacturing exports to the United States was estimated at just 30%. Therefore, transferring supply chain activities out of China to avoid a 25% tariff makes sense

113 Asian Development Bank, *Asian Development Outlook Update,* ADB, 2021.

as long as competitor locations can carry them out at less than 80% (25/0.3) more than it currently costs in China. For example, a 25% tariff on a US$100 made-in-China shirt is really a US$25 tax on the US$30 value added in China; if Vietnam can add the same value for less than US$55, production should shift there.

This multiplier effect is termed the effective rate of spillover protection (ERSP) because it creates a magnified (effective) and unintended (spillover) advantage to all competitors, not just the United States.[114] It also explains why relocation of supply chains could in theory take place even with a relatively small tariff if it is discriminatory and the value-added share is small.

In practice, however, we observe that supply chains have remained remarkably resilient to price rather than quantity disruptions.[115] While there have been shifts in supply chains out of China and into neighbouring countries such as Vietnam, Thailand and Malaysia, this has been largely confined to the so-called footloose, labour-intensive industries such as textiles, clothing and footwear. The key industries that dominate supply chain production and trade, such as electronics, machinery and transport equipment, have not seen much relocation despite these multiplier effects.

While ERSP is a reliable indicator of the protection provided to countries that compete for the same supply chain activities, it ignores factor proportions and the technologies employed. The main supply chain industries are generally capital-intensive, where the share of fixed costs is high relative to variable costs. The technologies employed in these industries are generally less divisible such that fewer segments of the supply chain can be separated and transferred across borders.

In other words, complex production processes operate within an ecosystem that is both less divisible and more difficult to recreate elsewhere. The need to hire and train new workers and develop relationships with

114 Jayant Menon, "How Trade Wars Disrupt Global Supply Chains: The Effective Rate of Spillover Protection", Presentation to ARTNeT, UNESCAP, 5 November 2020, https://www.unescap.org/events/artnet-webinar-how-trade-wars-disrupt-global-supply-chains-effective-rate-spillover.

115 ASEAN+3 Macroeconomic Research Office (AMRO), *Global Value Chains in the Post-Pandemic "New Normal"*, AMRO, 2021, https://www.amro-asia.org/wp-content/uploads/2021/03/AMRO-AREO-2021_Highlights2-Global-Value-Chains-in-the-Post-Pandemic-New-Normal.pdf.

new suppliers of inputs adds substantially to the costs of relocating supply chains across borders. The high share of fixed and other transfer costs and the low level of divisibility of the technologies employed may explain the locational resilience of the majority of supply chains, despite the multiplier effects of the ERSP. [116]

There is little evidence to suggest that the trade war has resulted in any significant reshoring of production back to the United States or China. The minimal amount of relocation that has occurred has mostly involved the transfer of supply chain activities to third countries in the Southeast Asian region. If punitive tariffs have failed at reshoring production, then direct subsidies have not fared any better, for similar reasons. Unlike trade war tariffs, however, subsidies can be better targeted because they can be tied to reshoring directly, avoiding the spillover to third countries. Yet, the evidence from Japan is that firms that availed themselves of the subsidies to reshore were quick to return to China after observing a grace period of sorts, diminishing their long-term impact.

Efforts to improve the ability of supply chains to withstand shocks such as through increased digitalisation should be welcomed, as documented by Randhawa (Chapter 9).

Digitalisation not only increases resilience but reduces the cost of distance, thereby diminishing the case for reshoring or near-shoring. As Todo highlights in Chapter 8, geographic diversification of supply chains increases, not reduces, resilience. Using resilience as a pretext to engineer reshoring of production is not only misplaced but can incur costs, even if successful.

116 Jayant Menon, "Supply Chain Resilience and the Trumped-up Case for Reshoring", *Fulcrum,* ISEAS-Yusof Ishak Institute, 1 April 2022, https://fulcrum.sg/supply-chain-resilience-and-the-trumped-up-case-for-reshoring/.

Biographies

EDITOR

Xue Gong is Assistant Professor and Deputy Coordinator of the Master of Science Programme in International Political Economy at the S. Rajaratnam School of International Studies, Nanyang Technological University, Singapore. Her current research interests include China's economic diplomacy, and Asian regionalism and governance. She has contributed to peer-reviewed journals such as *World Development*, *International Affairs*, *Pacific Review*, *Contemporary Southeast Asia*, and *Harvard Asia Quarterly*. She is the co-editor of two books on China's Belt and Road Initiative. She has also published several book chapters on China's economic statecraft, China's corporate social responsibility, and the Belt and Road Initiative in Southeast Asia. She has contributed op-ed articles to various media outlets.

CONTRIBUTORS

Sanchita Basu-Das is an economist at the Regional Cooperation and Integration Division of the ADB's Economic Research and Regional Cooperation Department. Her core research interests include regional cooperation and initiatives related to them, such as trade, logistics, industrial corridors, tourism, digital economy, and institutions. Sanchita joined ADB in November 2018 and served as an economist in the South Asia Regional Department. Prior to joining ADB, Sanchita was the lead researcher for economic affairs at the ASEAN Studies Centre of ISEAS–Yusof Ishak Institute, Singapore. She was concurrently a fellow of the Regional Economic Studies Programme, coordinator of the Singapore APEC Studies Centre and a co-editor of the *Journal of Southeast Asian Economies* (JSEAE), all housed under the same institute. Sanchita has published in international journals including the *Singapore Economic Review* and the *Journal of World Trade and Asia Pacific Economic Literature*, authored/edited books and book chapters, and written for the media. Sanchita earned her PhD in international political

economy from Nanyang Technology University, Singapore, and her master's degrees in economics and in business management from the University of Delhi and the National University of Singapore, respectively.

Henry Gao is a senior fellow at the Centre for International Governance Innovation (CIGI) and a law professor at Singapore Management University. With law degrees from three continents, he started his career as the first Chinese lawyer at the WTO Secretariat. Henry has been an adviser on trade issues for many national governments as well as the WTO, United Nations, World Bank, ADB, APEC, ASEAN, European Union and the World Economic Forum. His papers have appeared in journals such as the *International and Comparative Law Quarterly*, *Journal of International Economic Law*, *World Trade Review*, *Harvard International Law Journal*, and the *Journal of World Trade*. His works have been cited in government reports as well as the World Trade Report by the WTO and the Digital Economy Report by UNCTAD. Henry sits on the advisory board of the WTO Chairs Programme, which was established by the WTO Secretariat in 2009 to promote research and teaching on WTO issues in leading universities around the world. He is also a member of editorial boards of the *Journal of International Economic Law* and *Journal of Financial Regulation*, both published by Oxford University Press.

Natasha Hamilton-Hart is Professor in the Department of Management and International Business at the University of Auckland Business School and Director of the New Zealand Asia Institute at the University of Auckland. Her research covers regional integration in East Asia, business–government relations and property rights institutions. She has published extensively on business in Southeast Asia and the region's relationships with China and the United States. Her recent publications include articles in *Review of International Political Economy*, *Development and Change*, *Asian Studies Review*, *Journal of Contemporary Asia*, case studies of New Zealand companies, and an examination of NZ Inc support for international business growth. Natasha gained her BA (Hons) from the University of Otago and her PhD from Cornell University. Prior to joining the University of Auckland she held positions at the Australian National University and the National University of Singapore.

Jayant Menon joined the ISEAS–Yusof Ishak Institute as Senior Fellow to continue his work on trade and development in the Asian region, following his early retirement from the ADB in 2020. His last post at the ADB was Lead Economist in the Office of the Chief Economist. He began work life as an academic in Australia, spending almost a decade at the Centre of Policy Studies at Monash University, one of the leading centres for computable general equilibrium modelling. He has worked at several academic institutions including the University of Melbourne, Victoria University, the American University in Washington, DC, and the ADB Institute in Tokyo. He has served as a Board Director of CDRI, Cambodia, and on the advisory board of the University of Nottingham, Malaysia. He holds adjunct appointments with the Australian National University, University of Nottingham, UK, and IDEAS, Malaysia. He has authored/edited 15 books, 40 book chapters and 80 articles in peer-reviewed journals.

June Park is a 2021–22 Fung Global Fellow of the Princeton Institute for International and Regional Studies (PIIRS) at Princeton University. In 2022, she was selected as an inaugural International Strategy Forum Asia Fellow by Schmidt Futures. She is a political economist by training and works on trade, energy, and tech conflicts, analysing different policy outcomes as a response to pressures based on governance structures — domestic institutions, leaderships, and bureaucracies — that shape the policy formation process. Her current work pertains to post-pandemic geoeconomic conflicts in data governance and emerging technology. She is concurrently pursuing the publication of her first book manuscript, *Digital Trade Wars & Currency Conflict: China, South Korea and Japan's Responses to US Protectionism since COVID-19*, under a National Research Foundation of Korea book grant. Outside academia, she advises public and private sectors with analyses at global, regional, and domestic levels. June earned her BA and MA in political science from Korea University, and her PhD in Political Science from Boston University as a Fulbright Fellow.

Dipinder S. Randhawa is a Senior Fellow at the S. Rajaratnam School of International Studies, Nanyang Technological University. His research and publications are in the areas of development economics, finance and banking, policy formulation and analysis, technologies of the Fourth Industrial Revolution, and the economic consequences of the pandemic. His current

focus is on the effects of the COVID-19 pandemic on ASEAN, prospects for the region as it confronts a volatile geopolitical environment, the risks arising from climate change, and the proliferation of new technologies. Earlier, Dipinder held research positions at the Institute of South Asian Studies and the Risk Management Institute, both at the National University of Singapore. He has taught at Syracuse University, the National University of Singapore and the Singapore University of Social Sciences and held visiting appointments at universities in China and Thailand. Dipinder received a master's in economics from the Delhi School of Economics and his PhD from the Whitman School at Syracuse University.

Piti Srisangnam holds a PhD in economics from the University of Melbourne and an MA in international economics and finance from Chulalongkorn University, Thailand. He was Deputy Director for Academic Affairs at the Centre for European Studies, Chulalongkorn University, from 2010 to 2012. In 2012, he was appointed Deputy Director for Academic Affairs at the ASEAN Studies Center, also at Chulalongkorn University, before becoming Director of the centre a year later. He was selected for the 2019 Rising Star Royal Thai Government Scholarships Association award. In 2021, he spent a semester as a visiting scholar at Peking University under the Dongfang Scholarship programme. He has published several journal articles and book chapters, for instance, on economic development in Southeast Asia, trade in services among ASEAN member states, ASEAN economic integration, EU economic integration, economic reform and SME development in Thailand, and on ASEAN-India, ASEAN-China, ASEAN-Japan and ASEAN–South Korea relations. Apart from academic work, he hosts three radio programmes related to current issues in ASEAN.

Yasuyuki Todo, holder of a PhD in economics from Stanford University, has been a Professor at the Graduate School of Economics, Waseda University, since 2014, after serving as the Department Head at the Department of International Studies, University of Tokyo. He is also a Faculty Fellow at Japan's Research Institute of Economy, Trade and Industry. His research fields are international economics, development economics, and applied micro-econometrics. He is currently focusing on the role of social and economic networks in economic growth and resilience based on firm- and household-level data from various countries. He has published more than

60 academic papers in refereed journals including *Nature Sustainability*, *The Journal of Industrial Economics*, the *Journal of Regional Science*, *Ecological Economics*, *Research Policy*, and *World Development*. He has served in a number of policy advisory committees in Japan's national and local governments, including the Committee for Japan's Future under the Council on Economic and Fiscal Policy of the Cabinet Office, the Industrial Structure Council of the Ministry of Economy, Industry and Trade, and T20 Japan 2019, the research and policy advice network that supported Japan when it chaired the G20.

Shujiro Urata is Professor Emeritus, Waseda University. He was Professor of International Economics, Graduate School Asia-Pacific Studies, Waseda University. He is currently Senior Research Advisor, Economic Research Institute for ASEAN and East Asia (ERIA), Faculty Fellow at the Research Institute of Economy, Trade and Industry, Specially Appointed Fellow at the Japanese Centre for Economic Research (JCER), Visiting Fellow, Asian Development Bank Institute (ADBI), and Distinguished Senior Fellow at the Institute of Developing Economies (IDE-JETRO). Professor Urata received his BA in economics from Keio University, and his MA and PhD in economics from Stanford University. He was formerly a research associate at the Brookings Institution and an economist at the World Bank. He specialises in international economics and has published a number of books and articles on international economic issues. His recent books include *Achieving Inclusive Growth in the Asia Pacific* (co-editor), Australian National University Press, 2020; *Enhancing SME Participation in Global Value Chains* (editor), Asian Development Bank Institute, 2021; and *Globalization and Its Economic Consequences: Looking at APEC Economies* (co-editor), Routledge, 2021.

Jeffrey Wilson is the Research Director of the Perth USAsia Centre, an independent think-tank dedicated to fostering stronger relations between Australia, the United States and the wider Indo-Pacific region. He provides leadership and strategic direction in developing and managing the centre's research programmes across its publications, policy and dialogue activities. Prior to joining the centre, he was an Associate Professor at the Asia Research Centre, Murdoch University, Australia.

The RSIS Monograph Series

Monograph No.	Title
1	**Neither Friend Nor Foe** Myanmar's Relations with Thailand since 1988
2	**China's Strategic Engagement with the New ASEAN**
3	**Beyond Vulnerability?** Water in Singapore-Malaysia Relations
4	**A New Agenda for the ASEAN Regional Forum**
5	**The South China Sea Dispute in Philippine Foreign Policy** Problems, Challenges and Prospects
6	**The OSCE and Co-operative Security in Europe** Lessons for Asia
7	**Betwixt and Between** Southeast Asian Strategic Relations with the U.S. and China
8	**Fading Away?** The Political Role of the Army in Indonesian Transition to Democracy, 1998–2001
9	**The Post-Tsunami Reconstruction of Aceh and the Implementation of the Peace Agreement**
10	**Post-Suharto Civil-Military Relations in Indonesia**
11	**People's ASEAN and Governments' ASEAN**
12	**Forgetting Osama Bin Munqidh, Remembering Osama bin Laden** The Crusades in Modern Muslim Memory
13	**Do Institutions Matter?** Regional Institutions and Regionalism in East Asia
14	**Population Movements and the Threat of HIV/AIDS Virus at the Bangladesh-India Border**
15	**Collaboration under Anarchy** Functional Regionalism and the Security of East Asia
16	**Pandemic Preparedness in Asia**
17	**The 2008 Mumbai Terrorist Attacks** Strategic Fallout
18	**Islamic Education in Malaysia**

Monograph No.	Title
19	**Practising Strategic Foresight in Government** The Cases of Finland, Singapore and the European Union
20	**A Decade of Combating Radical Ideology** Learning from the Singapore Experience (2001–2011)
21	**From 'Boots' to 'Brogues'** The Rise of Defence Diplomacy in Southeast Asia
22	**ASEAN-China Free Trade Area** Challenges, Opportunities and the Road Ahead
23	**India-Japan Relations** Drivers, Trends and Prospects
24	**Climate Change, Migration and Human Security in Southeast Asia**
25	**Demilitarising the State** The South and Southeast Asian Experience
26	**Offshore Oil and Gas Safety and Security in the Asia Pacific** The Need for Regional Approaches to Managing Risks
27	**National Security Decision-Making in India**
28	**India-ASEAN Defence Relations**
29	**Pemuda Rising** Why Indonesia Should Pay Attention to its Youth
30	**The 13th Malaysia Elections** Issues, Trends and Future Trajectories
31	**Military Modernisation and Buildup in the Asia Pacific** The Case for Restraint
32	**Navigating the Indo-Pacific Arc**
33	**ASEAN and the Indian Ocean** The Key Maritime Links
34	**Resilience in the Face of Disruptions**
35	**Financial Cooperation in East Asia**
36	**Non-Traditional Security Concerns in the New Normal**
37	**Regional Economic Integration in the Post-Pandemic Era**

Global and regional economic trends over the past several years have given much cause for both optimism and pessimism. On the one hand, the COVID-19 pandemic and US-China strategic competition, as well as nationalist and populist concerns, have unravelled economic cooperation and disrupted supply chains. On the other hand, there is a trend towards multilateralism. Mega–free trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) have entered into force. Also, regional governments have put forward several initiatives to strengthen regional economic institutions and resilience. In light of these developments, this RSIS monograph seeks to examine how regional countries could bolster economic integration in a post-pandemic era and to offer policy recommendations for the way forward.

9 789811 853500

RSiS S. RAJARATNAM SCHOOL OF INTERNATIONAL STUDIES
Nanyang Technological University, Singapore

NANYANG TECHNOLOGICAL UNIVERSITY SINGAPORE