

A world map with a blue background and a white grid. The continent of Asia is highlighted in a solid red color. The map is slightly tilted and has a soft, blurred appearance.

Trade and Development Amidst Disruptions: Implications for Asia

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Background

- Asian countries are at different levels of development and demographic composition (China, Thailand aging, Indonesia and India demographic dividends), but all have to address the challenges for the next stage of development:
 - Least developed countries: starting out to modernize, is export oriented industrialization still an option, is there a possibility to leapfrog (digital economy)?
 - Middle level of development: hitting limits with export oriented labor intensive industrialization, maturation of GVCs and disrupted by trade wars, digital economy
 - More developed countries: how to get out of middle income trap, new sources of growth (beyond GVC, services sector, innovation and technology)
- At a time of great disruptions and uncertainty:
 - **Trade tensions**
 - Geopolitical hotspots
 - Technological disruptions
 - Sustainable development – climate change

Emerging Cracks in System pre trade war

- **Issues with MTS** (stalled Doha negotiations, not addressing new issues) and switch to mega regionals:
 - Trans Pacific Partnership (TPP), ASEAN Economic Community (AEC) to East Asia RCEP (Regional Comprehensive Economic Partnership), EU-US TTIP (Transatlantic Trade and Investment Partnership)
 - Effectiveness of the single undertaking and consensus approach questioned
 - Weaknesses: Transparency and monitoring of commitments, updating of rules
- **Emergence of China** (economy grew 6x (2001-2017) and trade 10x to \$1.7 Trillion (1992-2017)) : acceded to WTO, reforms, but:
 - Concerns with ***lack of transparency, trade and investment/market distorting policies*** such as technology transfer regulations, enforcement of IPR, industrial subsidies and fair competition (vis a vis State Owned Enterprises)
 - Economic and Geo-Strategic competition for influence: US vs China

The New Normal: we are at the cross roads

- 2016 was the watershed year, with Brexit in June and election of President Trump in November 2016
 - **Increased protectionism and nationalist policies:** linked to various perceived causes: inequality and blame on globalization and trade, notions of “unfair” competition with China
 - **US no longer defender of public good of global economic order:**
 - leave TPP, focus on trade deficit and unilateralism, safeguard duties on solar panels and washing machines, steel and aluminium tariffs (security grounds),
 - US-China trade war – tariffs and tit for tat
 - No longer the internationalist approach, but using tariffs as a tool
 - EU dealing with its integration issues within EU and attempting to safeguard MTS
 - Indonesia and ASEAN
 - answer is continue regionalism, RCEP and attempt to safeguard the multilateral trading system
 - **Japan increasingly important in its role to champion public good:**
 - played key role in CPTPP despite US exit, supporting continued regional initiatives RCEP and strategic realignments with China
 - Has a key role to as Chair of G20 on WTO Reforms

Stick and Carrot Approach of the US

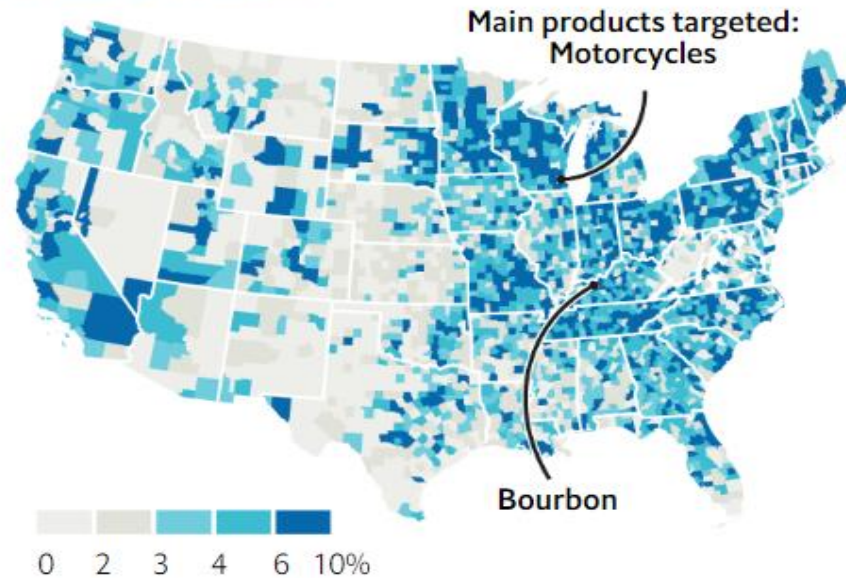
- First - 'Stick': tariff increases on a group of products which can be country specific as in the case of China, or product specific as (washing machines and solar panels, steel and aluminum)
- For developing countries, the US has used the 'stick' of the threat of **withdrawing their GSP** (General System of Preferences) privileges,. On 13 April 2018, USTR began a GSP Country Practice Review toward India, Indonesia and Kazakhstan, later extended to Thailand.
 - The review is based on the concerns of market access and investment impediments faced by the US.
 - The top four countries that have realized imports under GSP in 2017 are India (\$5.6 billion), Thailand (\$4.2 Billion), Brazil (\$2.5 billion) and Indonesia (\$1.9 billion – 9% of exports)
- Second: 'carrot' – exemptions tariff on steel and aluminum.
 - The exemption was given with certain 'deals' being made, for instance with Canada and Mexico related to renegotiations of NAFTA; and with Korea related to the amendments in the Korea US FTA.

EU and China: Retaliatory responses

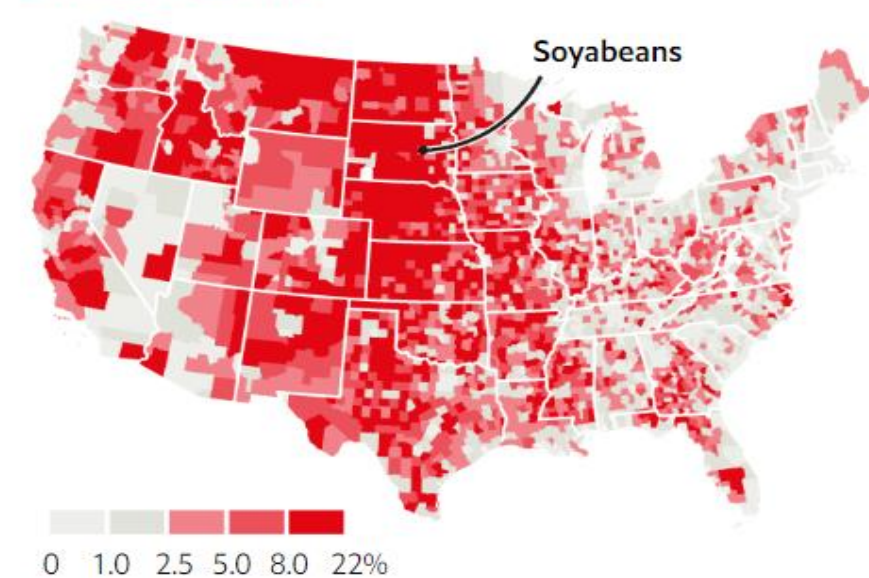
**America's trading rivals have aimed tariffs at Trump voters:
Europe in the Rust Belt, China in the Great Plains**

Share of counties' exports affected by retaliatory tariffs, %

The EU's tariffs



China's tariffs



- EU and China retaliates specifically in counties where Trump won -> a political strategy to hit Trump's credibility

Trade Tensions: not likely resolved soon

- US-China
 - US: Trump and 2020, anti China and trade likely bipartisan
 - China: nationalists vs reformists
- It is here for the long term and complex:
 - **Unfair Trade:** trade deficit in goods and currency manipulation (export subsidy) to justify use of tariffs
 - **National Security:** limit intermediate imports (steel and aluminium), use of technology
 - **Complex:** overlapping US economic, business, technology and security interests in a multipolar world.
 - **Issues:** IPR infringement, transparency, market distorting policies (SOEs/domestic vs foreign), technology transfer, industrial subsidies, & technology competition (Huawei)
 - **Japan-Korea:** Japan using national security to impose tariffs, non economic aim

TRADE TENSIONS IS CREATING GREAT UNCERTAINTY

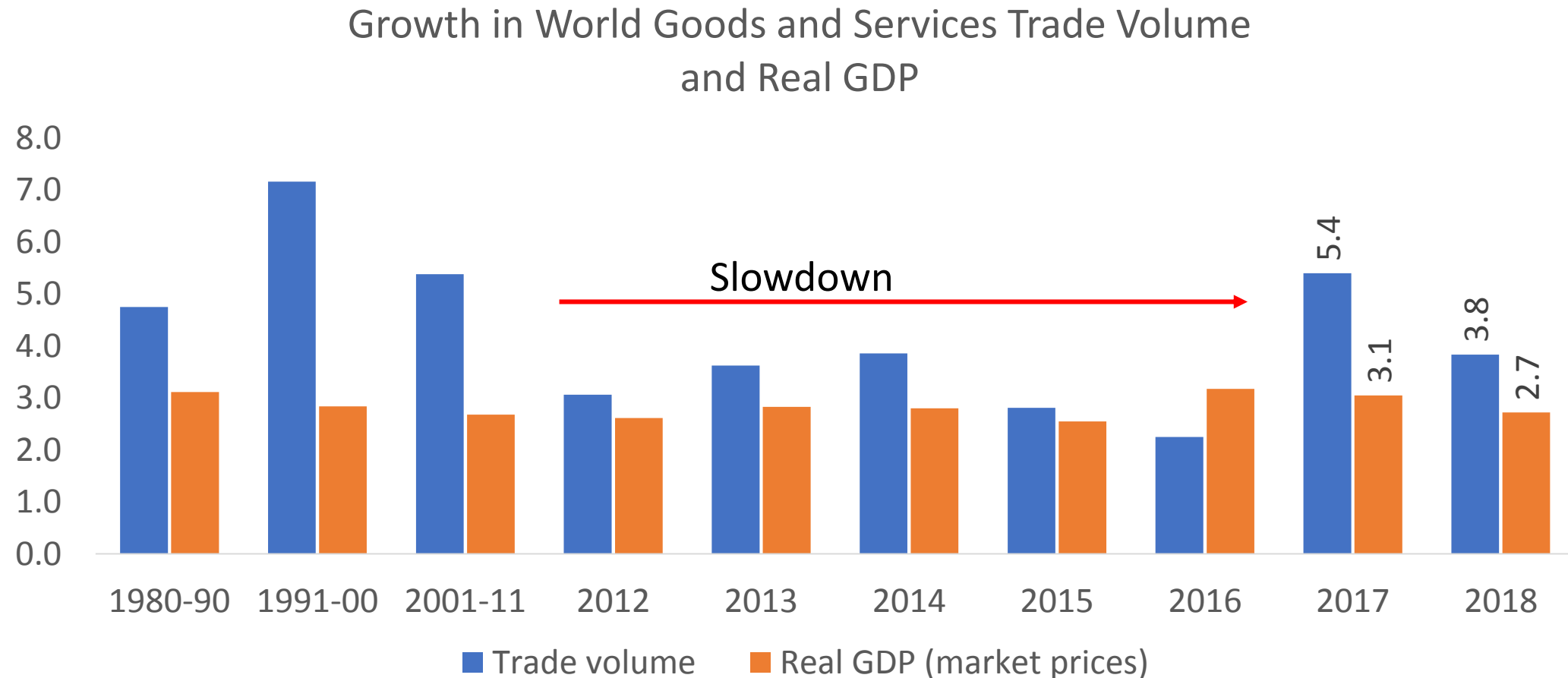
**Trade war creates opportunities and challenges
for Asian countries**

Direct Impact: Global and China Slowdown

Global: Revised downward growth IMF, stock market volatility

China: slowdown already evident (slowest growth this year)

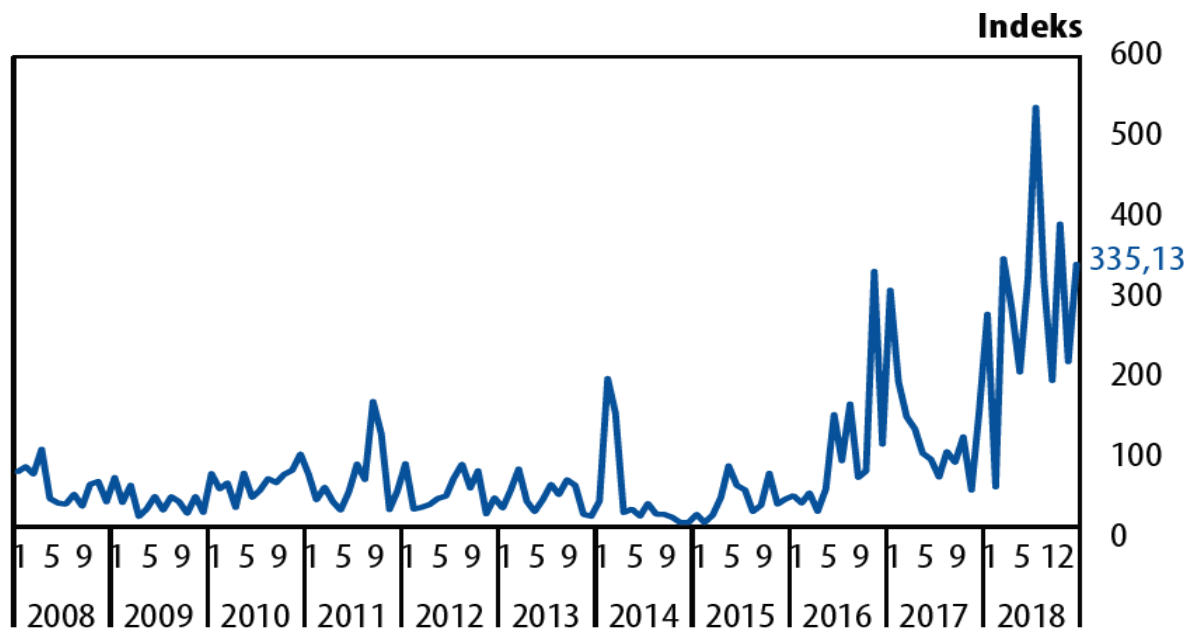
Global trade slowdown: weak demand, changing GVC and uncertainties?



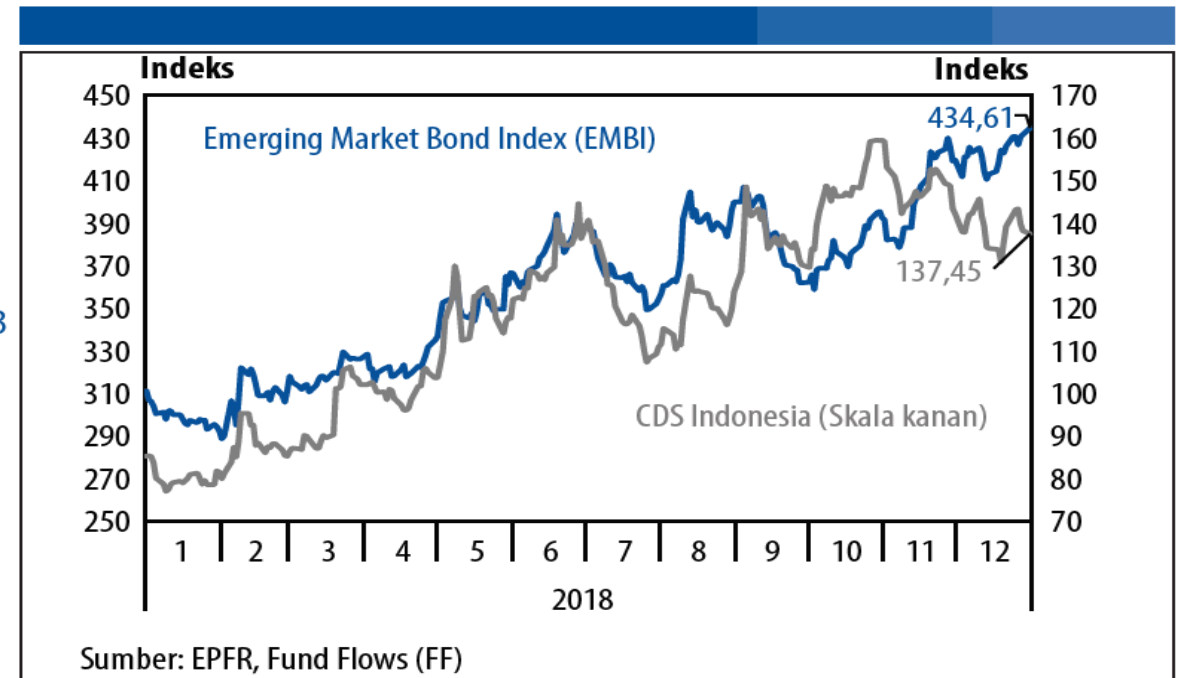
Uncertainties felt more by emerging countries

Risk factors from trade war and geopolitical issues between US-Iran felt more by emerging countries

Economic Policy Uncertainty (EPU) Trade Policy AS



Sumber: Bloomberg; Data s.d. 31 Desember 2018

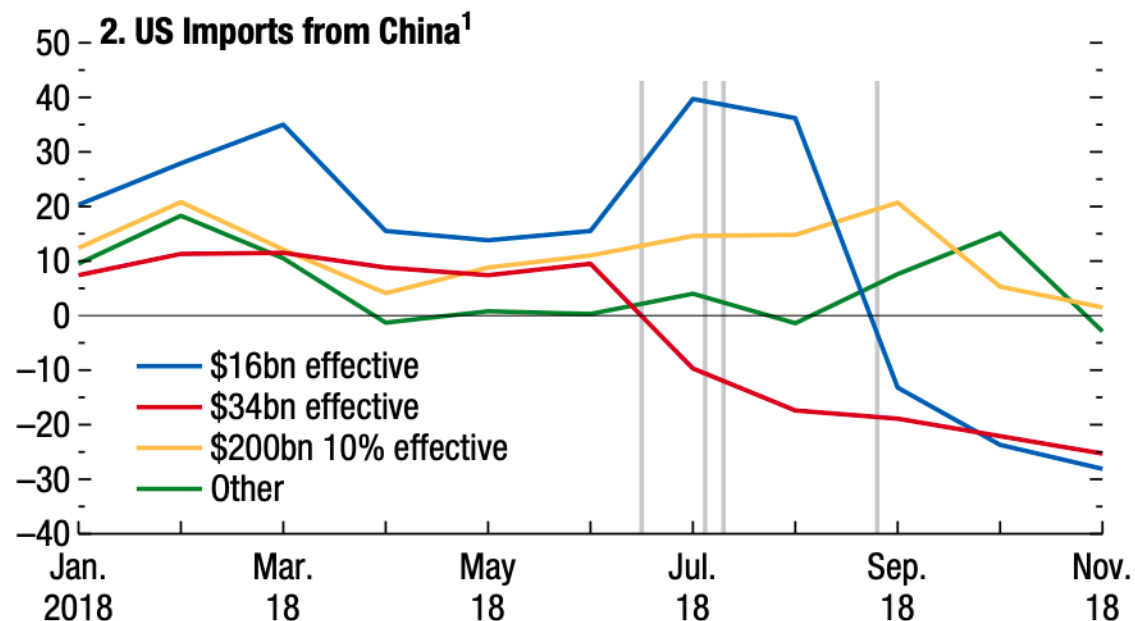


Sumber: EPFR, Fund Flows (FF)

Grafik 2.15 Ketidakpastian dan Risiko Negara Berkembang



Negative Impact on trade and investment^{1,2}



Source: IMF WEO Apr 2019

¹ The vertical bars correspond to the timing of tariff increases: \$50bn list announced June 15, 2018; \$34bn effective (of \$50bn list) July 6, 2018, and \$16bn effective (of \$50bn list) August 23, 2018; \$200bn list announced July 10, 2018, with 10 percent tariff on \$200bn effective September 24, 2018. The series show the evolution of US imports of goods in the various tariff lists. bn = billion.

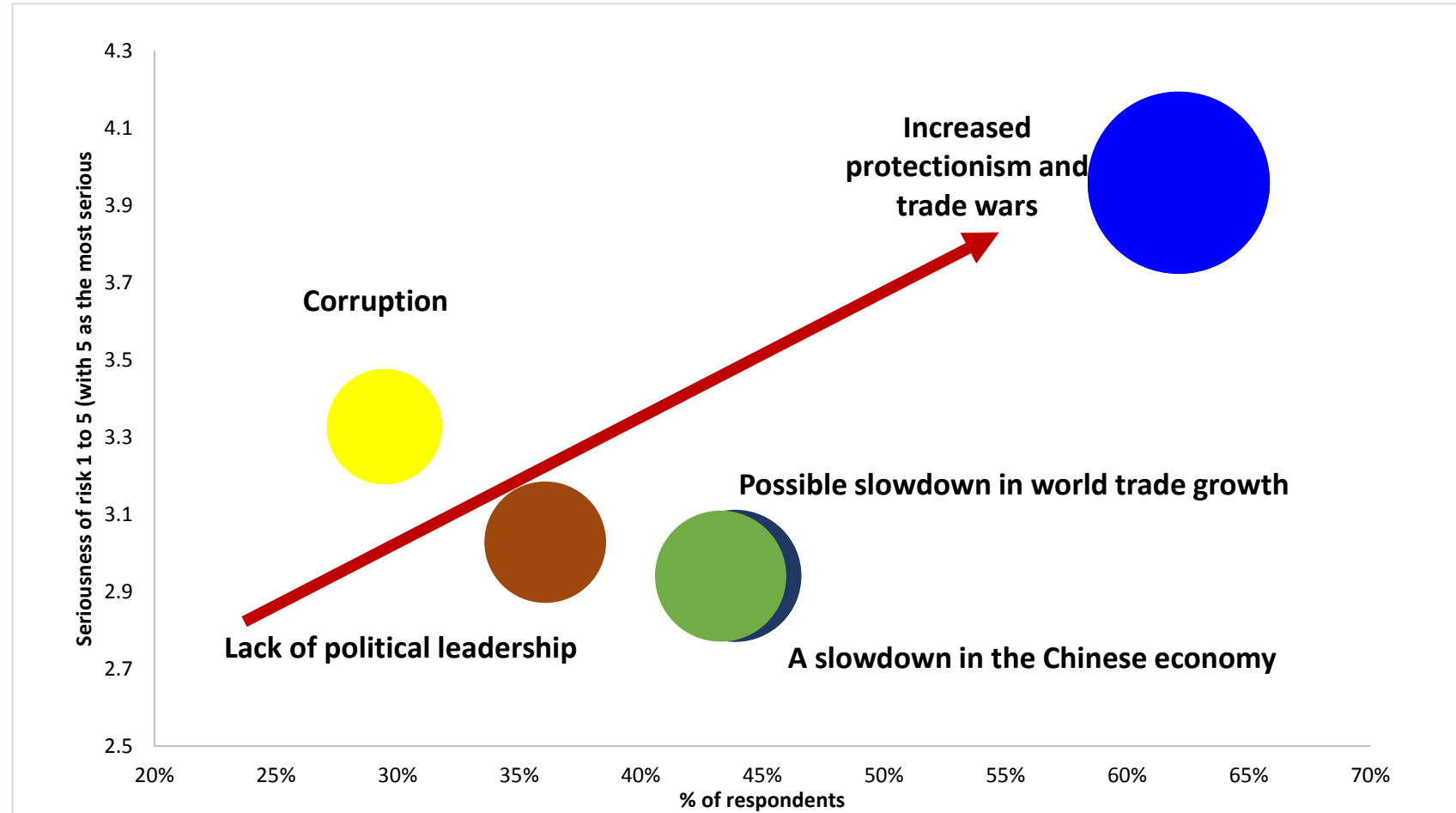
Lower China's demand and the impacted Asia's exports



Source: World Bank

IMPACT OF UNCERTAINTITIES TOWARD INVESTMENT AND TRADE

Top 5 Risks to Growth: PECC, State of Region, November 2018



Question: Please select the top five risks to growth for your economy over the next 2-3 years.

Source: Pacific Economic Cooperation Council (PECC), State of the Region, November 2018

Uncertainty in Trade Policy: will affect trade and investment decisions, undo the complex interactions of existing Global Value Chains

Exhibit 34

Executives responding to a McKinsey survey are concerned about changes in trade policy.

%

Over the next 12 months, which of the following globalization-related challenges are of the greatest concern for your company?
n = 1,021

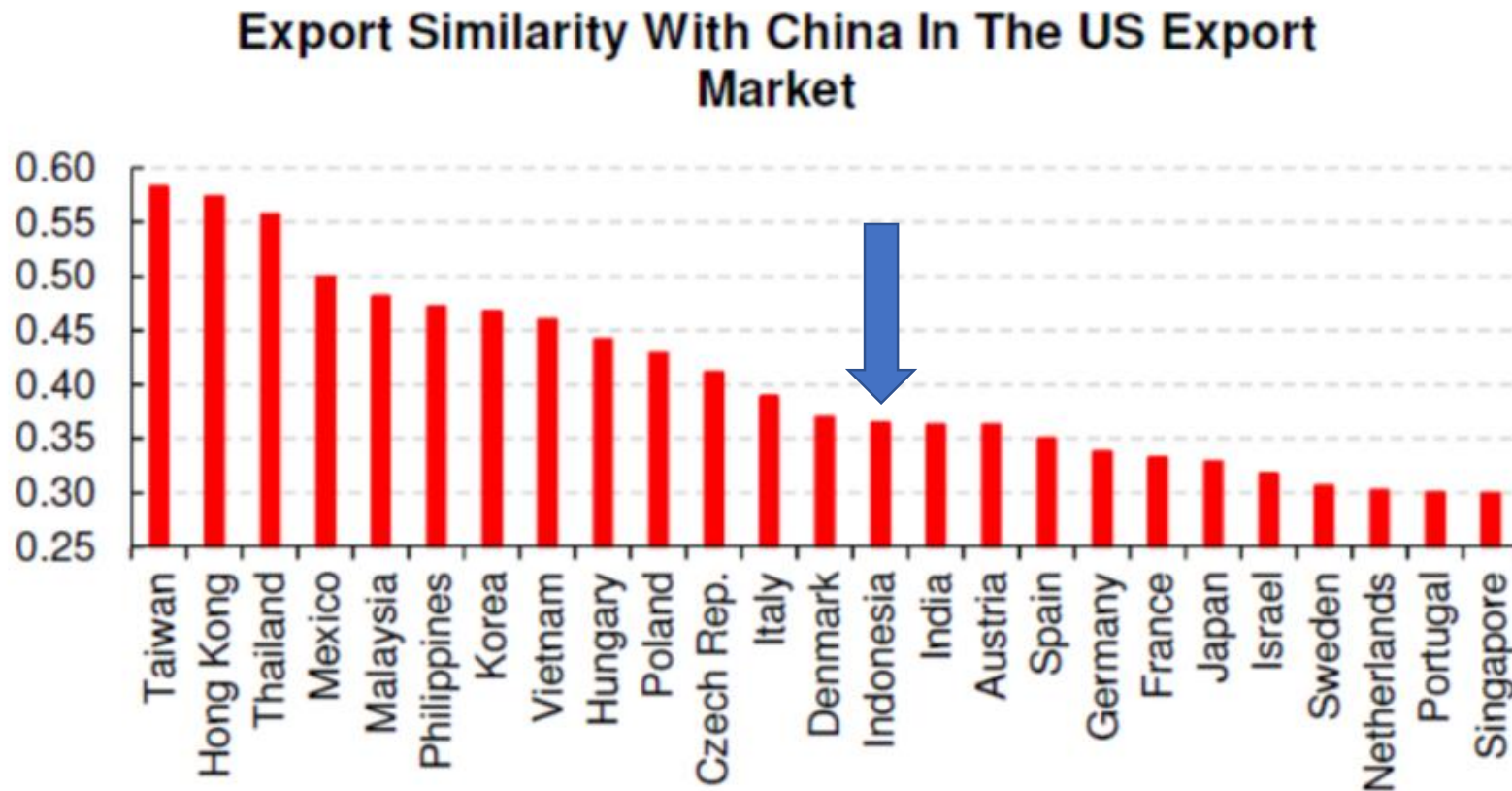


How do you expect your company's globalization strategy to change over the next three years?
n = 770



SOURCE: McKinsey Economic Conditions Survey, September 2018; McKinsey Global Institute analysis

Taiwan and Hongkong will be the most potential alternative exporters besides China in US market, based on the similarity of the export basket



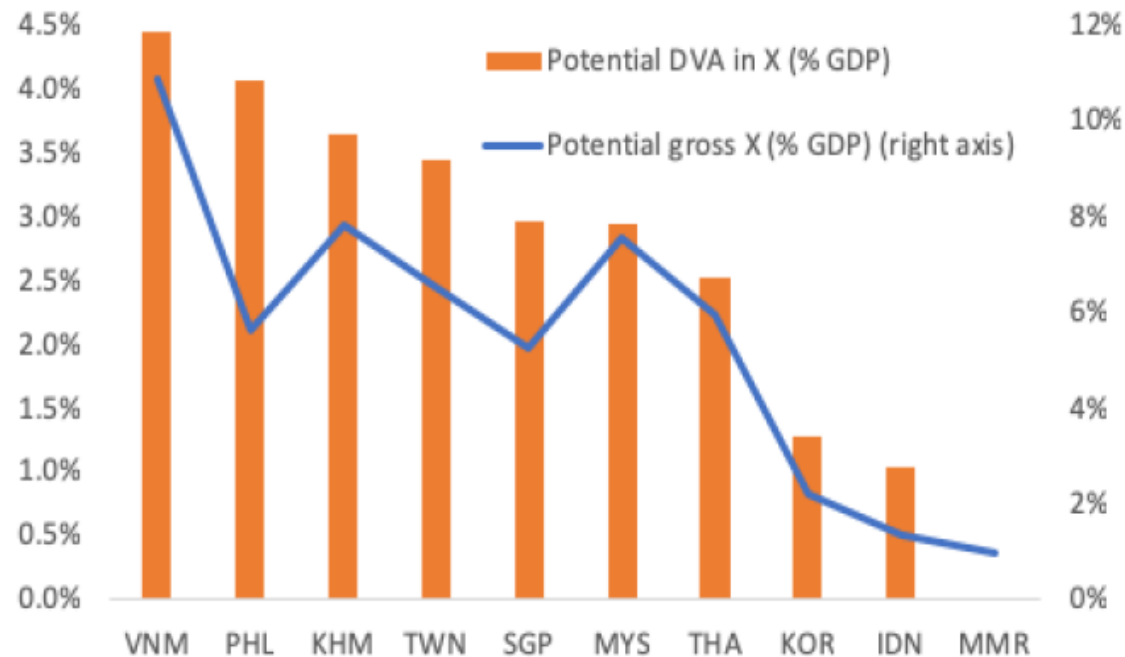
Great potential trade diversion from trade war

Country	Total Potential (million US\$)
Bangladesh	336
India	23,530
Indonesia	9,283
Thailand	22,780
Turkey	6,898
Vietnam	18,650

*Calculated from value of exports to US in 8 digit HS codes that are affected by any of the section 301 tariffs against China in 2018

Potential reallocation depends on capacity to replacement

Replacement potential by countries (% of GDP)

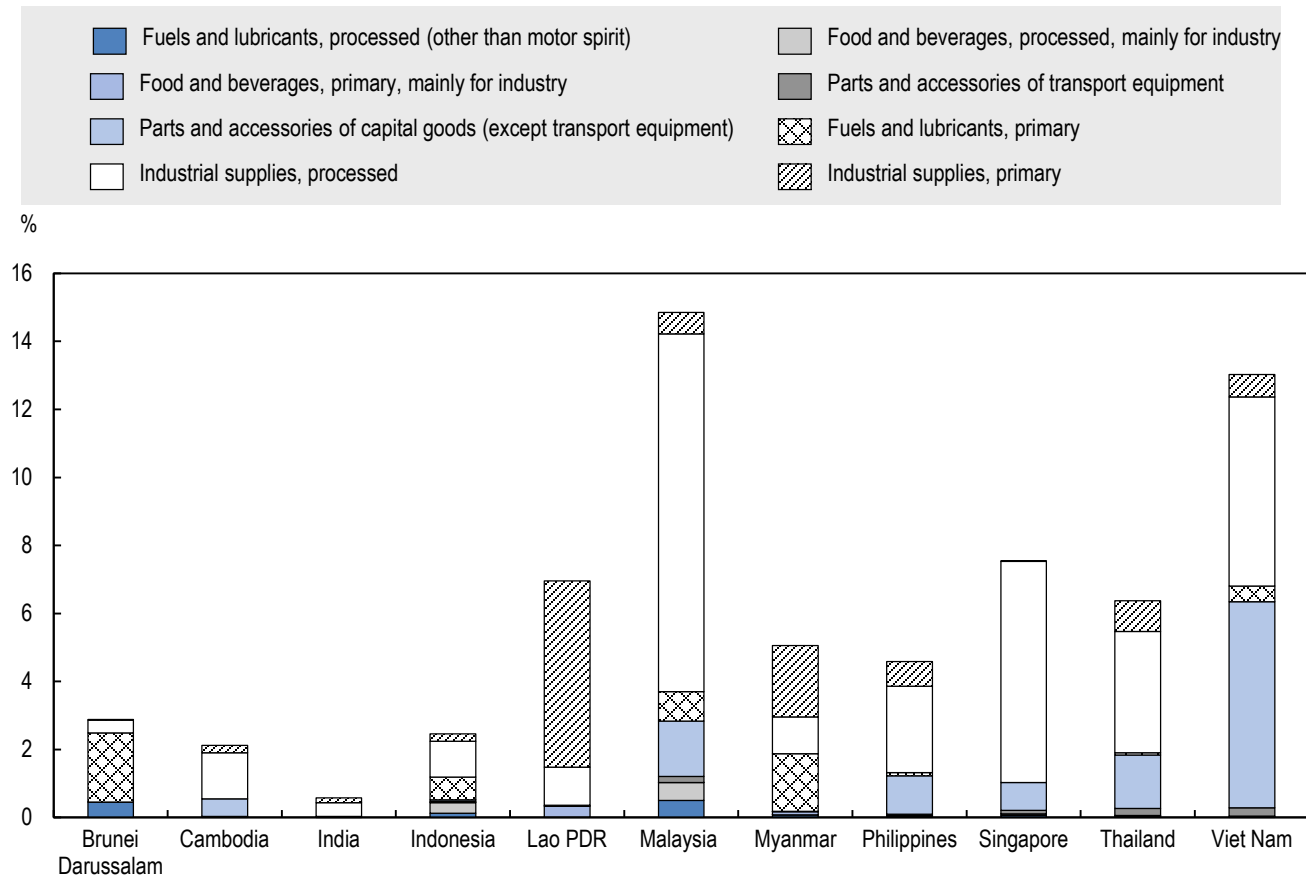


Source: Cali (2018)

- Greatest replacement potential (relative to their GDP) will be perceived by Vietnam, Philippines, and Cambodia, due to their export similarity to US with Chinese exports that are subjects to US tariff
- But will depend on capacity to respond (excess capacity without new investment) and potential new investments

However, GVC linkage to China put more downward risks on some ASEAN countries

Intermediate goods exports to China as percentage of GDP, 2017



Source: OECD (2019)

- While countries such as Malaysia, Viet Nam may benefit from trade reallocation, they may also lose due to slower Chinese exports and link to GVC

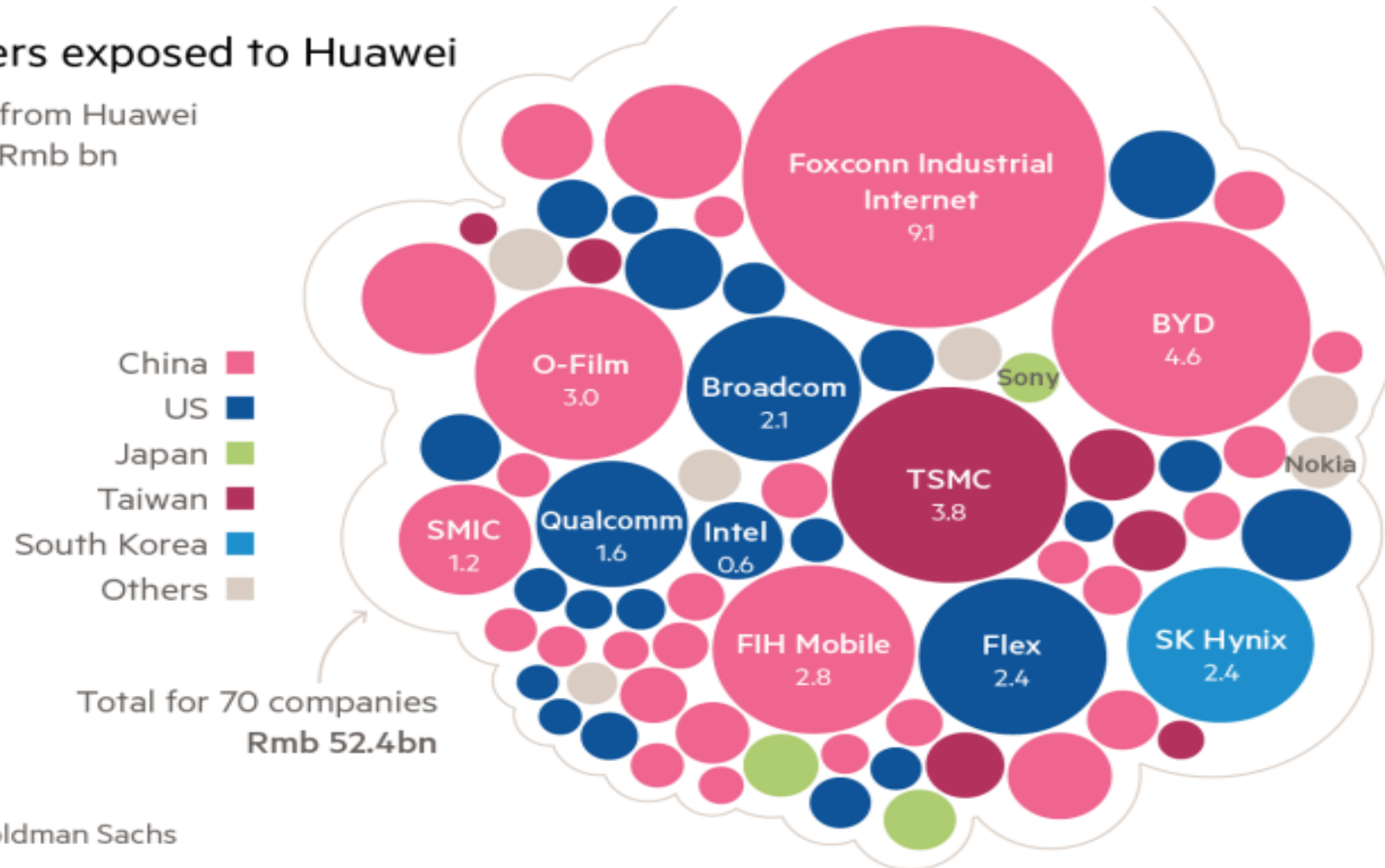
Importance of open trade and investment for global and regional value chains

- Global and Regional Value Chains of which Japanese companies are an integral part
 - Fragmentation of production and sourcing in most efficient and effective way based on **free flow of goods, services, investment and people**
 - **Unimpeded flow of goods:** importance of low (or at least certainty) with regard to tariffs, non tariff measures, customs (trade facilitation), standards
 - **Unimpeded flow of services and investment:** transport, reliability of logistics links, financial services and payments, services inputs and related people flows
 - **Regional value chains:** production tends to be regionally focused because of geographical proximity, but link to global markets whereby WTO-MFN matters (certainty of markets and fair treatment)
 - **And Increasingly Free Flow of Data** with new business models: digital and data flows, networked economies which are global
 - Digital economy: E-commerce, data flows and data-related businesses
 - Issues are beyond free flow but how to ensure trust and privacy issues
 - In need global governance

Any disruption will affect suppliers in the GVC: if Huawei faces restrictions due to technology and security reasons, not only Chinese companies but also US and Japanese companies will be affected

Suppliers exposed to Huawei

Revenue from Huawei
Q3 2018, Rmb bn



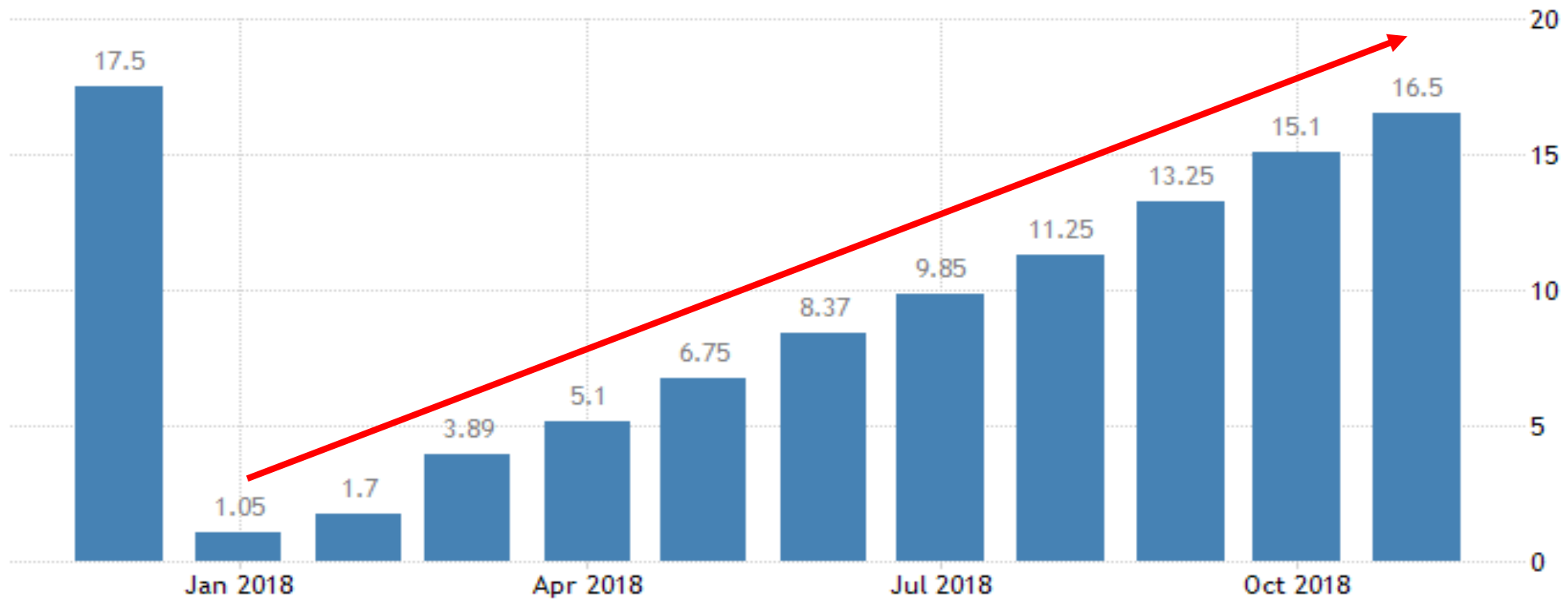
Southeast Asia is considered as top destination

COMPANY	SECTOR	NOTE
Harley Davidson Inc.	Motorcycles	Shifted part of its processes to Thailand
Panasonic Corp.	Electronics	Closed its U.S. plant in early 2017 and switched to consignment production and exports from Malaysia
Steven Madden Ltd.	Shoes and accessories	Announced that it has been shifting production of handbags to Cambodia from China
Kayamatics	Internet of Things devices	Has two Chinese factories but plans to set up production lines in Kuala Lumpur and Penang in Malaysia
Delta Electronics Inc.	Supplies power components to Apple Inc.	Offered \$2.1 billion in July to purchase a Thai affiliate to expand production
Merry Electronics Co.	Makes headphones for firms like Bose Corp.	Intends to move some of its production to Thailand from southern China

Source: Bloomberg, *Southeast Asia Has an Investment Boom, Thanks to the Trade War*

Examples of winner? Vietnam medium term investment

FDI into Vietnam has recorded a time high reaching 17.5 USD Billion in December 2017 and projected to reach 19 USD Billion in 2018. FDI pledges is largest for manufacturing (46.2% of total pledges)



SOURCE: TRADINGECONOMICS.COM | MINISTRY OF PLANNING AND INVESTMENT, VIETNAM

Responses: seize the opportunities

- Seeing the immediate opportunities for export diversification and investment relocation, overcoming barriers and impediments, and pro active inviting investment
- Understanding the regulations in the US and Chinese markets
- Issues: labor policies, trade facilitation, investment climate, availability of supporting industries and local inputs/raw materials
- Two elephants fighting: how to balance the two major powers, need to be agile (not allies to either side)
 - Don't want to be squeezed in the middle or have to take sides

But beware double edged sword

- Increasing exports to the US – put you on the radar screen, e.g. Vietnam got a special mention by President Trump at G20:
- EO on Trade Deficit, March 31, 2017, Omnibus Report on Significant Trade Deficits: assess causes whether trading partner “directly or indirectly imposing unequal burdens on or unfairly discriminating commerce of US, assess effects on manufacturing and defense industrial bases, employment and wage growth and identify import and trade practices that impair national security
 - 8 countries in Asia have deficit with the US. Indonesia is no. 15 with trade deficit of \$13 billion or 1.79% with growth of 5.5% (compared to total \$735 billion, China \$345 billion and Japan, Germany and Mexico in the \$60 billion range)
 - US refusal to look at trade deficit to include services
 - April 2017 – Steel (national security)
 - Section 301 (IPR) – China, Indonesia still on Priority Watch List
 - GSP withdrawal (\$1.9 billion, 10% export kita ke US)

US Trade deficit with its partners: 8 from Asia

		Trade Deficit, in Billion US\$				Share		% Change (15-16)
Rank	Country	2014	2015	2016	2014	2015	2016	
	World	-735.2	-745.7	-735.5	100.0	100.0	100.0	-1.4
1	China	-344.9	-367.2	-345.0	46.9	49.2	46.9	-6.0
2	Japan	-67.6	-68.9	-68.9	9.2	9.2	9.4	0.0
3	Germany	-74.8	-74.8	-64.9	10.2	10.0	8.8	-13.3
4	Mexico	-55.4	-60.7	-63.2	7.5	8.1	8.6	4.2
5	Ireland	-26.2	-30.4	-35.9	3.5	4.1	4.9	18.2
6	Vietnam	-24.9	-30.4	-32.0	3.4	4.2	4.4	3.3
7	Italy	-25.5	-28.0	-28.5	3.5	3.8	3.9	1.8
8	Korea, South	-25.1	-28.3	-27.7	3.4	3.8	3.8	-2.3
9	Malaysia	-17.5	-21.7	-24.8	2.4	2.9	3.4	14.4
10	India	-23.9	-23.3	-24.3	3.2	3.1	3.3	4.2
11	Thailand	-15.4	-17.4	-18.9	2.1	2.2	2.6	8.7
12	France	-15.8	-17.7	-15.8	2.2	2.4	2.2	-10.7
13	Switzerland	-9.2	-9.2	-13.7	1.3	1.2	1.9	48.4
14	Taiwan	-14.2	-15.0	-13.3	1.9	2.0	1.8	-11.8
15	Indonesia	-11.1	-12.5	-13.2	1.5	1.7	1.8	5.5
16	Canada	-36.5	-15.5	-12.1	5.0	2.1	1.7	-22.1

US-Indonesia

- October 2015, Indonesia indicates “intention” to join TPP, but after US Withdrawal – stopped discussions.
- No 15 Trade Deficit; submission of report and investigation; and also requested exemption from tariffs on steel and aluminium.
- Bilateral talks reveal similar patterns (threat of tariff imposition, GSP withdrawal and provision of exemption) in return for desired unilateral asks for “fair trade” and “level playing field” for US interests. Making “deals” vs upholding the principles of fair trade
 - Linked to localization of server, national payment gateway and foreign investment restrictions
 - Indonesian strategy of making a “deal” – voluntary imports (soybean, Boeing, textiles and garments), Indonesian investments in the US

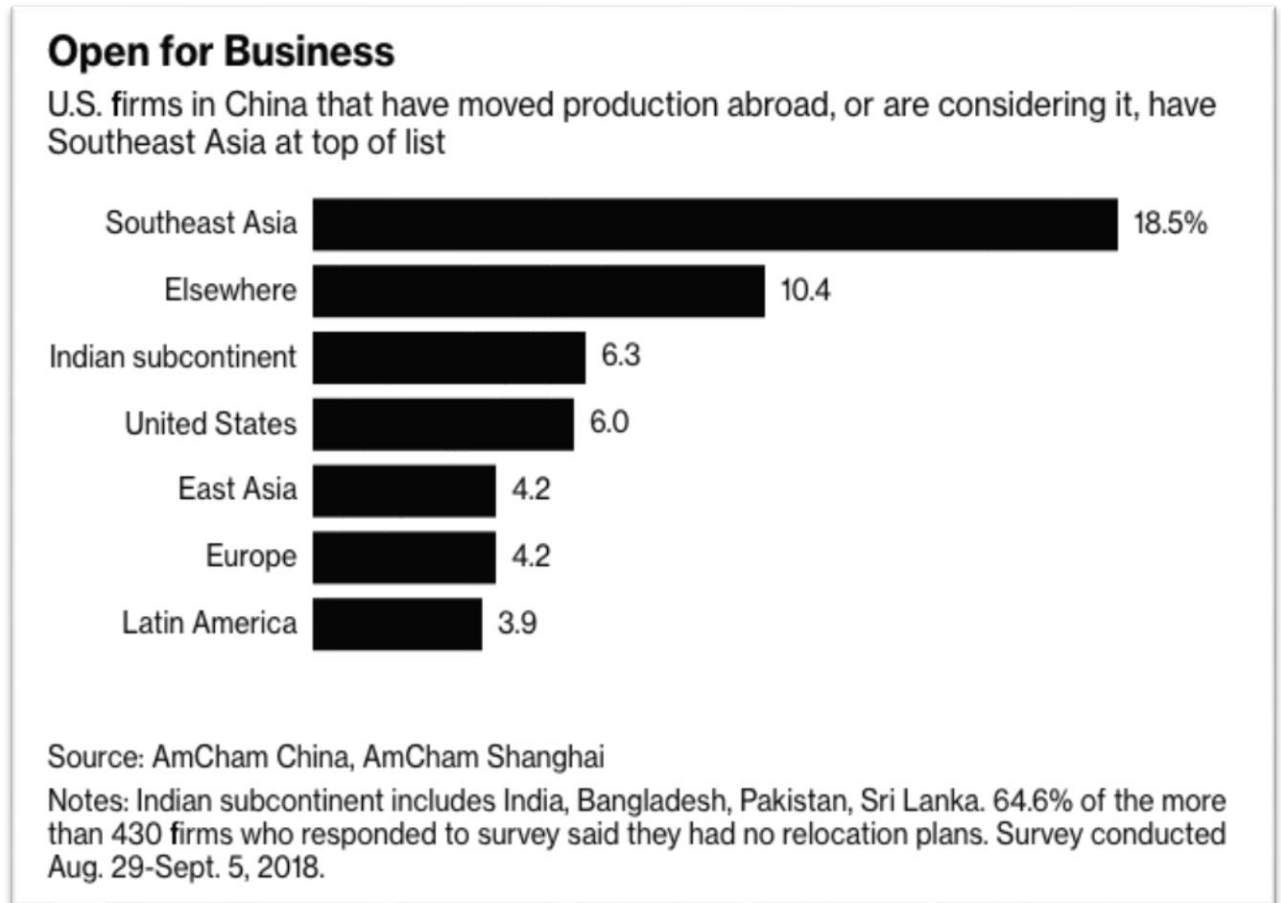
What needs to be done?

A Three-Pronged Approach

- **Unilateral reforms**
- Strengthening and building on **Regional Economic Integration**
- UPHOLD the **Multilateral Trading System** under the WTO: maintain the current rules based regime and pro active in renewing the WTO rule book.
- (Cognizant of importance to address shared prosperity from openness)

1. Unilateral Reforms

- Part of strategy for continued development and increased competitiveness: attract relocation of investment/GVC (Trade war, technology), not because pressured by the US
- Domestic policies regarding infrastructure, human capital, trade and investment regime, and fair but flexible labor market regulations
- Identify new sources of growth (services, digital economy, technology and innovation)



Source: Bloomberg, U.S.-China Trade Tussle Is Creating Winners in Southeast Asia

2. Regional

- **Regional agreements are still important. Ensures stability and predictability of trade policies in countries involved, continued market expansion and openness (signal)**
- Improving relations with RoW (e.g. Japan-China warming up, what about with India?) – balancing
- Asia's past experience with unilateral reforms have been done in the framework of regional and multilateral commitments
- Regional agreements can also address issues that are not yet addressed in the WTO

2. Regional

- Different pathways to broadening and deepening regional integration, and with major trading partners outside of region
- Deepening and broadening of ASEAN Economic Community (AEC): ASEAN Centrality
- Complete East Asia Regional Comprehensive Economic Partnership (RCEP): 10 ASEAN + China, Japan, Korea, Aust, NZ and India by next year RCEP Leaders commit to completion by end of the year
- CPTPP (includes North America and Latin America) Asia pacific base, implementation is key
 - Expanding members?
 - Potential “Benchmark” for other regional agreements and MTS in terms of ambition and for new issues
- China-Japan-Korea?
- What about APEC and Belt and Road Initiative?
- Bilaterals with major trading partners e.g. EU
 - Japan-EU, Vietnam EU
 - In negotiations Indonesia-EU

3. The importance of safeguarding the MTS

- The **uncertainties created by the serious threat to the MTS:**
 - We should be worried about US, China and any other large power's behaviour without the constraints of the multilateral system
- **US-China trade tensions will not go away whatever “deal” is reached**, because many other issues to be settled. **G2 deals harm the system.**
 - There is an inclination for both US and China to do deals that are outside of the system, divert trade, and undermine confidence in WTO.
 - And “we” could be next, with much lower bargaining position
 - Better to deal with the issues under multilateral umbrella: transparency, IPR, industrial subsidies, trade and investment/market distorting policies, data flows and protection, data governance

What are the “Necessary Reforms of the WTO to improve its functioning”

The necessary reforms of the WTO should be about **safeguarding the system, not just improving the system (how can we improve the system if the system implodes?)**

SAFEGUARDING is in the short term and urgent to address to give WTO relevance and momentum:

- Securing the crucial aspects of the system that are under immediate threat,
 - resolving the issue of the **dispute settlement system**
 - need political will/input to address the proposals for reforms, and not just Appellate Body judge nomination, but also more fundamental changes in rules
 - We may also need a back up plan if no agreement by year end
- Build back confidence in the WTO process by making quick progress on less contentious issues (low hanging fruit) and ongoing negotiations, that can make an immediate difference
 - For instance **notification of obligations and transparency, fisheries subsidies**
 - **Capacity building** for Trade Facilitation, **Duty Free and Quota Free** for LDCs

What are the “Necessary Reforms of the WTO to improve its functioning”

IMPROVING, to be relevant for the changing situation

- This is about addressing more contentious issues, **strategic and political direction which can come from the G20 Leaders and other fora.**
- The direction for reform and prioritizing of issues chosen:
 - completing some of the current negotiations on the table (subsidies: agriculture, fisheries);
 - Issues central to trade tensions and already in regional/bilateral agreements: IPR, technology transfers, industrial subsidies, market distorting policies, competition policy, role of SOEs, developing country issue
 - New issues to make WTO relevant: data flows, e-commerce (plurilateral)

A new international economic order?

- How about international economic order and global governance under the WTO
 - Collective leadership role in G20 (Japan, EU and middle powers such as ASEAN, South Korea)
 - Institutional changes in WTO
 - Plurilateral – open and transparent process
 - Early harvest/issue by issue rather than single undertaking
 - Developing country: not self declared, but not also over defining by criteria
 - Capacity building related to commitments (e.g. Trade Facilitation Agreement)