On the Way to the (East) Asian Century

The pandemic has given rise to even louder calls demanding a "decoupling" from China. The diversification of global value chains, however, will likely lead to intensified trade in the Asia-Pacific.

By Bertram Lang

When the Chinese government abruptly imposed lockdown measures to contain the further spread of the novel coronavirus in late January, China's critical position in the integrated global economy was dramatically highlighted by major disruptions to global value chains, which are the lifeline of many industries. The Chinese lockdown came as a shock to many multinational corporations, exposing their over-reliance on the industrial supplies and manufacturing capacity of one single country.

As a consequence, pre-existing debates in the United States and Europe over the desirability and feasibility of "decoupling" from China in a new era of geopolitical rivalry have been exacerbated. In this context, much more attention should be paid to the ramifications of the pandemic and its economic aftermath in the region most directly impacted by China's trajectory: East and Southeast Asia.

As Europe and the United States are being submerged by the second wave of the virus and a proliferation of new lockdowns, the first thing worth stressing is how well most East Asian countries have navigated the COVID-19 pandemic in comparative terms. Having drawn their lessons from the first SARS outbreak in 2003, most governments were much more alert to and better prepared and consequently performed much better at controlling the virus. Precisely because of their strong economic interdependency with and geographic proximity to China, Taiwan and South Korea, which have become global models in COVID-19 prevention and containment, were rightly concerned about the Chinese Communist Party (CCP) leadership's honesty and the World Health Organization's independence from Beijing at a time when US President Donald Trump was still cozying up to Chinese President Xi Jinping; he also might not have ever heard of the acronym "WHO" at that point.

Conversely, Taiwan, which remains excluded from the WHO, started systematically monitoring incoming passengers from Wuhan in December

2019 and activated its Central Epidemic Command Center well before Beijing started to warn the world about a dangerously infectious novel coronavirus. As a result, Taiwan recorded a total of only seven COVID-19-related deaths by October 2020.

Beijing's reactions to the stepped-up US trade war have been ambiguous

ASEAN's Hour

Regional cooperation played an important yet much overlooked role in East Asia's relatively successful pandemic management. While often derided as a toothless tiger in international politics, the Association of South-East Asian Nations (ASEAN)—consisting of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam—demonstrated much better crisis preparedness than all other regional organizations worldwide, including the EU. In early January, the ASEAN Emergency Operations Center Network for Public Health Emergencies (ASEAN EOC Network) was activated and used to share information about a potential health threat and coordinate prevention strategies among ASEAN members. In the following months, while EU member states had no better strategy than to sew chaos by indiscriminately closing down national borders, the EOC Network and the ASEAN Plus Three Field Epidemiology Training Network (ASEAN+3 FETN)—another regional governance mechanism set up in response to the lessons from the SARS and H1N1 epidemics—served as important channels for pragmatically coordinating policy responses, sharing medical and epidemiological information, and coordinating humanitarian assistance among ASEAN, South Korea, Japan, and China.

Nonetheless, the economic fallout in the first half of 2020 has been dramatic, especially in developing and emerging ASEAN economies where growth is heavily reliant on foreign direct investment flows. According to the UNCTAD's World Investment Report 2020, published in June, FDI inflows to Southeast Asia are projected to shrink by a stunning 45 percent this year, more than the worldwide average of -40 percent. Countries like Malaysia, Indonesia, and the Philippines are even harder hit by the sudden absense of overseas remittances from migrant workers to their families at home, since precarious migrant workers have been the first to be laid off and sent home as the region's richest economies encountered economic turbulence.

Looking beyond the current economic shock, the crucial question in East Asia as elsewhere is what will happen to trade and international cooperation networks once the immediate health crisis has somewhat abated. From a purely logistic point of view, many global value chains could be reinstated relatively quickly once the coronavirus is under control in the world's major economies. So, the question regarding the pandemic's longer-term implications will be determined primarily by its geopolitical ramifications.

Against the background of an emerging new US foreign policy consensus which claims that engagement with China has

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failed and that the era of systemic competition has arrived, there's been much talk in Europe and America about the "end of globalization." Since the third wave of globalization was characterized by radical offshoring, often at the expense of working classes in industrialized countries, "reshoring" of value chains has been alternately observed as the new trend or even proposed as the solution in the era of "de-globalization."

The escalation of the US-China trade conflict has been the most visible political consequence of the COVID-19 pandemic. US sanctions on Chinese multinational companies have the potential to disrupt global value chains far beyond the bilateral relationship, and far beyond the Internet and communications technology (ICT) and the defense sectors that are currently on the frontline of the Trump administration's boycott measures.

Reactions from Beijing have been ambiguous. As a result of the intensified trade conflict with the US, China is accelerating its self-sufficiency policy, which is geared toward onshoring full supply chains in critical industries. The "Made in China 2025" master plan, aimed at import substitution and technological leapfrogging in strategic industries, had already been quietly shelved by Beijing after creating big waves of anxiety and pushback in Europe and the US. Now it is experiencing something of a renaissance. Visa policies have been further restricted and digital party-state surveillance, including of foreign citizens and organizations, has been massively stepped up. (As for other new restrictive political measures in China, no one knows how many will be overturned or eased after the pandemic.)

At the same time, the Chinese government has zealously continued its overtures to "Belt and Road" partner countries despite many projects running into financial distress against the backdrop of a global recession and lingering public debt crises in the Global South. The announcement of a detailed "master plan" for a new Free Trade Port in Hainan, including a relaxation of import duties, tax rate caps, and relaxed visa requirements, also signals Beijing's continued efforts to attract new foreign investment and talent in a tense international environment. Besides, China's policy agenda remains primarily focused on supporting its domestic economy in times of a severe (albeit mostly hidden) job crisis and on propping up local governments with new finance instruments.

Near-Shoring, Not Reshoring

While everybody concerned with European China policy is fixated on Washington's next move, it has been barely noted that Japan, South Korea, and Taiwan all had some sort of "reshoring policy" away from China in place well before the COVID-19 pandemic hit. But the US-China trade war and the immediate disruptions caused by China's manufacturing shutdown in early 2020 have increased the sense of urgency in East Asia's advanced economies, albeit with different degrees of public emphasis.

South Korea's Moon Jae-In sailed to a landslide election victory in April mainly on a convincing pandemic containment platform, without even trying to play an anti-China card. Meanwhile, Japan's departing prime minister, Shinzo Abe, was the only one to put economic decoupling from China center stage in early 2020. With much international fanfare, Tokyo in April announced a $2.2 billion government fund explicitly designed to subsidize Japanese manufacturers' reshoring or relocating production away from China. The government in Seoul also presented its own "Reshoring Initiative" when the

China's manufacturing shutdown has increased the sense of urgency in East Asia's economies: the Kwai Tsing Container Terminal in Hong Kong

South Korean economy's over-reliance on a booming Chinese market and manufacturing sector was painfully highlighted in February: A preferential lending program worth €3.3 billion is meant to focus on Korean small and medium enterprises and help them diversify their supply chains. But even as Samsung has become a major beneficiary of Washington's global crusade against Huawei, the South Korean government has strongly rejected US pressure to follow suit and ban Huawei from its own networks, repeatedly emphasizing the wisdom of "strategic openness."

The Taiwanese government, meanwhile, had already established an ambitious reshoring plan for the period 2018-20 to avoid the repercussions of the US-China trade war and position itself as a viable alternative for high-end production. Domestic political incentives include privileged land use offers and loans. But throughout 2019, US punitive tariffs and threats of sanctions against China had a much stronger push effect on many Taiwanese manufacturers (especially of IT hardware) producing there to devise plans for reshoring parts of their supply chains and invest domestically. UNCTAD even declared Taiwan the main beneficiary of "China diversion effects" in 2019.

The coronavirus crisis has only reinforced this trend, with many Taiwanese companies now investing onshore rather than in China, which apart from Taipei's impressive virus containment is another reason why Taiwan's economy has navigated the crisis so well. But whereas Taiwan is also most critically at risk from the growing geopolitical tensions between China and the US, Southeast Asia stands out as the region that is poised to reap the most benefits from industrial countries' China containment and diversification strategies.

It is indeed remarkable how leaders from China as well as the whole industrialized world are now courting ASEAN countries, angling for the conclusion of preferential trade agreements (the EU just concluded such an agreement with Vietnam) or investment accords. In the longer run, ASEAN middle-income countries may become double beneficiaries of the current crisis, as they remain in a good position to attract FDI from both China and Western countries. Economically, Southeast Asian countries are among the most attractive target countries for relocating manufacturing supply chains away from China. Several ASEAN countries including Vietnam, Malaysia, and Singapore have stepped up policies to attract foreign investors seeking to leave China due to rising labor costs or because of supply chain risk management. In a perfect example of how economic cooperation offers are blended with geostrategic motives from all sides, Japan's new Prime Minister Yoshihide Suga in October reinforced Japan's diplomatic overtures to Southeast Asian countries in an explicit push to counter Beijing's geo-economic advances

Simultaneously, trade ties between China and ASEAN are becoming closer: In the first quarter of 2020, ASEAN surpassed the EU to become China's biggest trading partner. And Beijing also invests a lot in cultivating diplomatic relations, reaching out to Southeast Asian countries with new investment promises, supplies of COVID-19 testing capacity, and health governance support. As opposed to the short-sighted US leadership, Chinese policymakers and business managers are keenly aware of this opportunity to gain both market shares and a reputation as reliable investors at a time when other foreign investors are withdrawing or withholding their money.

ASEAN middle-income countries may become double beneficiaries

Resilient Trade in East Asia

Trade patterns have also shown more resilience in East and Southeast Asia, especially when compared to Europe and the Americas. UNCTAD calculations suggest that East Asia and Southeast Asia taken together was the only world region where intra-regional trade had already recovered by July, contrasting with dramatic two-digit declines everywhere else. What's more, a number of regional trade and investment agreements are awaiting conclusion or ratification in the Asia-Pacific. While the pandemic has slowed down negotiations, most agreements appear on track.

Despite the pandemic-related logistical difficulties, China, Japan,South Korea, New Zealand, Australia and the ten ASEAN governments signed the region's largest free-trade agreement, the Regional Comprehensive Economic Partnership (RCEP), on November 15. RCEP is not only a stark repudiation of protectionist tendencies but also significantly increases pressure on the next US administration to back down from Trump's harmful unilateralism. (Even India's nationalist government, which withdrew from the RCEP negotiations last autumn, is considering a return to the table in an effort to promote post-crisis supply chain integration with Southeast Asia.)

Then there is the CPTPP, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, formerly known as the Trans-Pacific Partnership (TPP). It was negotiated by the Obama administration but immediately dumped by Donald Trump; the 11 remaining members went ahead without the US, and the renamed CPTPP entered into force in December 2018. This summer, Chinese Premier Li Keqiang made a surprise overture for his country to join. For sure, the hurdles for such a move appear insurmountable given the geopolitical situation and the CPTPP's higher standards in terms of labor and competition law or intellectual property rights compared to the RCEP. But Li's statement follows and reflects domestic warnings, most markedly by China's former chief WTO accession negotiator Long Yongtu, that China risks being left out of a reconfigured regional trade order. It thus confirms a widely perceived trend toward more, rather than less, regional trade integration in Asia.

"China + 1 Strategies"

"Decoupling" from China and reshoring supply chains is easier said than done. So far, US policymakers have understandably focused their sharpest measures on sectors where geopolitical and security interests trump their own national economic considerations and where key Chinese players can be sanctioned in a highly visible way. But in the US as well as in Western Europe, Japan, or South Korea, many industries are simply too reliant on China-originated parts and raw materials to follow through with major systematic relocations. Companies and whole industries which rely on China as a prime consumer market will avoid and even actively oppose an "out-of-China" strategy as the potential economic costs of disintegration would be far too high. Thus, for most industries, what can be expected rather than a major disruption is an accelerated trend towards gradual diversification of manufacturing chains by companies with heavy supply-side reliance on China, often referred to as a "China + 1 strategy."

But even selective and gradual American "decoupling"—invariably followed by diplomatic pressure on Washington's allies to do the same—will fundamentally transform economic networks across East

Even a gradual "decoupling" by the US will transform networks

and Southeast Asia. This is most obvious in the ICT sector, which so far has been a huge crisis beneficiary due to the sudden forced large-scale digitalization of business operations as well as administrative activities across the globe. Here again, the crisis has laid bare a significant strategic advantage of East Asian economies that are years if not decades ahead of major European countries (notably Germany) in terms of e-government and digital infrastructure.

At the same time, the ICT sector is also rapidly emerging as the focal point of a veritable "technology war" between Washington and Beijing. China has been the only country in the world to successfully develop an entire parallel digital ecosystem rivalling that of the US technology giants Google, Apple, Microsoft, and Amazon. With the advent of 5G networks, the control over digital ecosystems is emerging as the core question not only of global economic power but also with significant security, intelligence, and cultural soft power ramifications. How many businesses and ordinary people in third countries will buy goods on Taobao, Jingdong, or Amazon, search the web with Google or Baidu, communicate via Whatsapp or WeChat, and pay their bills with Paypal or Alipay is a decisive question for the 21st-century international order.

Europe and Southeast Asia are the most interesting "playing fields" (rather than players) in this new era of great power competition. Whereas Europe for now remains firmly in the grip of Google & Co., Southeast Asia's booming e-commerce and e-government markets are being rapidly populated by the globalizing Chinese tech giants. And while European and "Five Eyes" allies have mostly surrendered to the Trump administration's "America First" agenda, which only enforces decoupling from China where it benefits US corporate interests, governments in Southeast Asia are wisely hedging their bets and remain unwilling to pick sides.

Re-Globalization Underway

Rather than foreshadowing an end of globalization and a return of nationalism, the external COVID-19 shock will likely strengthen regional integration within Asia in the longer run. The pandemic has accelerated existing trends toward reshoring and supply chain diversification, but the current economic crisis has also reined in some nationalist tendencies and could eventually benefit regional trade negotiations.

Politically, the coronavirus pandemic has vividly demonstrated the benefits of closer regional coordination, including on a technical level within the ASEAN+3 format despite high-level geopolitical tensions. Economically, the disruption of global value chains and the perspective of continuing in-and-out-of-lockdown phases in other parts of the world are accelerating the trend toward "Asia-for-Asia" supply chains. Rapidly rising consumption levels and improved domestic as well as regional supply chains make Southeast Asian countries interesting as consumer markets for their neighbors. Much points to an accentuated (sub-)regionalization of value chains, rather than what some have started to term "de-globalization."

Thus, despite the severe current economic repercussions, odds are that in retrospect, 2020 will be remembered as a watershed year for the dawn of an (East) Asian century. Democratic as well as authoritarian East Asian governments' effective management of this major public health crisis compares dramatically to the epic failures of liberal democracies from the US to Brazil and from the United Kingdom to Spain. And unless the two great powers that are mainly responsible for the growing geopolitical disorder and insecurity in the region actually approach the abyss of a military confrontation, East and Southeast Asia's middle powers and emerging economies stand to gain economically and politically from the geostrategic convolutions induced by the COVID-19 pandemic. IP