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Maintaining ASEAN's Leverage in a Volatile Trade Policy Landscape

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The US-China trade spat has seen ASEAN emerging as an alternative to China as a manufacturing hub, especially for technology-related goods. In this picture taken on 29 August 2023, an employee working at Heesung Electronics Vietnam factory in Hai Phong. (Photo by Nhac NGUYEN AFP).

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EXECUTIVE SUMMARY

- Geopolitical tensions between the US and China have been rising, with international trade facing more frequent challenges in what has become a tit-for-tat retaliatory landscape. Moreover, economic security initiatives have become more strategic and sophisticated, and more players now find themselves caught in the crosswinds of the strategic battleground.
- The US-China trade spat has seen ASEAN emerging as a viable alternative to China as a manufacturing hub, especially for technology-related goods. ASEAN economies collectively account for around 30% of US Electrical and Electronics (E&E) imports, notably on par with China, in 2022.
- Major economies have stepped up their engagement with ASEAN economies this year through the G2G channel and at a business level through the relocation of operations out of China into Thailand and Vietnam as part of a China+1 diversification strategy. China's strict zero-COVID policies may have also catalysed the search for viable alternative production bases.
- ASEAN economies should proactively maintain their favourable position amid the global supply chain recalibration. Possible strategies could include: 1) Active engagement with key trade partners, 2) Domestic policies that provide a stable and predictable business environment, 3) Productive capacity upgrading policies, 4) Leveraging on multilateralism and 5) Strengthening the public-private-academic nexus.

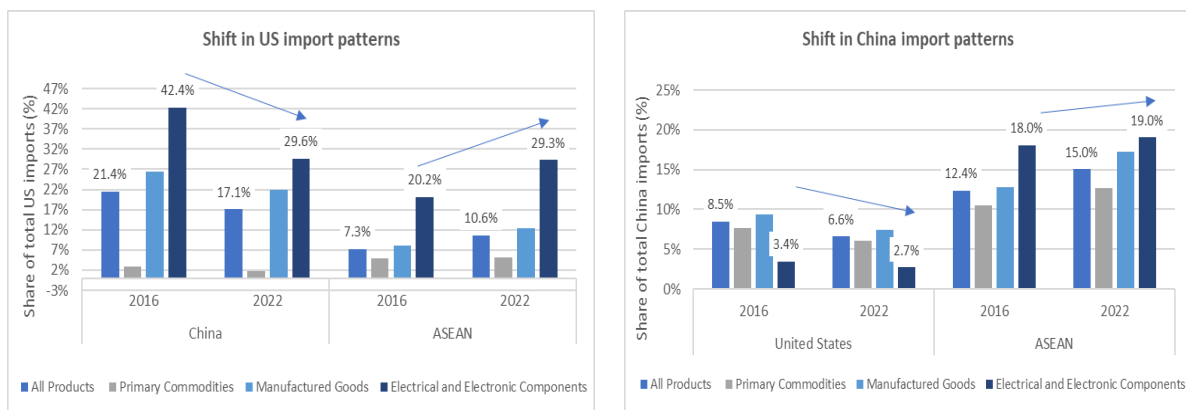
A MORE SOPHISTICATED GEOPOLITICAL BATTLEFIELD

As geopolitical tensions between the US and China continue to rise, middle powers and small countries alike remain inadvertently caught in the crosswinds and become part of the strategic battleground. Whilst the Trump presidency (2017-21) was dominated by a barrage of retaliatory tariff increases between the two economic majors, the approach to international trade policy has since become more sophisticated, taking on elements of investment policy. One such approach has countries building up capacity onshore and attracting new investments in key strategic areas in the technology supply chain, exemplified by the US CHIPS Act of 2022¹ and the European Chips Act² enacted in September 2023. Some non-tariff barrier approaches are more direct and are laced with a security angle, such as China’s export restrictions on key rare metals (gallium and germanium, and related compounds)³ (effective 1 August 2023), the US’ export caps on Chinese technology giant, Huawei⁴ and more recently, the Netherlands’ additional restrictions on the export of ASML Holding’s chipmaking machinery to China.⁵ This back and forth is set to continue with new measures and announcements of counter-policy measures making the headlines more frequently as it becomes increasingly a race for technological dominance as much as to address economic security concerns. That said, official dialogue between the US and China on trade and investment matters, including the establishment of a working group, convey some positive signals that having a ceiling to, if not a de-escalation in, trade tensions would be the preference of both sides.⁶

ASEAN RESILIENCY AMID GEOPOLITICAL UNCERTAINTIES

Although small in its constituent parts, the ASEAN region has grown in importance as an integral node in global value chains, as both a manufacturing hub and a significant player in the technology supply chain network. The region has effectively emerged as a viable alternative to well-established supply chains, diverting some of the global manufacturing concentration away from China. To assess the extent of the trade pattern shifts catalysed by the onset of the Trump, tariff-driven trade war, and ASEAN’s standing in the global ecosystem, we take into consideration trade data from the 2016-2022 period, covering the period before the Trump trade war, through the pandemic and into the present day.

Figure 1. Import pattern shifts for the US and China (2016-2022)



Source: UNCTAD and author’s analysis

From the initial analysis of both the US' and China's import patterns for this period, we observe a notable shift in imports away from one another and subsequent positive spillovers to the ASEAN region, as shown in Figure 1. For the US, the share of overall imports from China fell to 17% in 2022 from 21% in 2016, while the share of China's imports from the US fell more marginally to 7% in 2022 from 9% in 2016. ASEAN's share of imports correspondingly grew to 11% for the US (2016: 7%) and 15% for China (2016: 12%). Notably, there are significant dynamics exhibited by the changing patterns in the Electrical and Electronics components (E&E) imports. For the US, the significant shift away from China as a key backward linkage in this sector has resulted in import shares falling to 30% in 2022 (2016: 42%), while the shift to ASEAN in tandem has resulted in import shares totaling 29% in 2022 (2016: 20%). For context, ASEAN-sourced imports for E&E products make up almost a third of US imports of these components compared to a fifth before the Trump trade tensions started. This puts ASEAN on par with China in terms of import shares for the US in this respect. That said, some of this change could have also resulted from Chinese MNCs adding capacity to ASEAN locations for their own de-risking strategies on account of rising tariff rates imposed by the US.

Comparatively, China's import share trends over this period are more stable, with shifts in imports from ASEAN for the main categories observed more muted in comparison. Import shares for overall products stood at 15% (2016: 12.4%) and 19% for E&E components as at 2022 (2016: 18%), reinforcing the central importance of ASEAN in the trade landscape. Amid the ongoing US-China trade rivalry, ASEAN's relationship with China has remained intact, while its relationship with the US has strengthened. However, it should be noted that despite the growing ties with the US, ASEAN's overall trade with China stood at USD 730.1 billion in 2022, 1.7 times that with the US which had a corresponding value of USD 422.5 billion. Moreover, China constitutes 19.1% of ASEAN's total trade, whilst the US makes up only 11.0%.

A BROAD ROLE FOR ASEAN IN INTERNATIONAL TRADE

ASEAN's changing trade patterns with major economies reflects its growing importance, as seen in Table 1. Although European economies did not see substantial changes to imports from ASEAN over the period, Japan experienced an increase in ASEAN import share, especially for that of E&E products to 16.9% in 2022 from 13.7% in 2016. This too can be a shift away from reliance on China; Japan's import shares from there fell from a significant 52.3% in 2016 to 42.2% in 2022 in E&E components. Not only has ASEAN grown in importance as an upstream producer for major economies, it has also markedly grown as an export destination for economies such as China and Japan (Table 1). All in all, the ASEAN region is greatly intertwined in the global supply chain, with its importance growing as both a viable backward and forward linkage. That said, it illustrates the importance and provides growing impetus for all stakeholders in the global value chain to prioritise the relationships between developed economies and China with ASEAN, and vice versa.

Table 1. Major economies and their trade dynamics with ASEAN

	United States		China		Europe		Japan	
	2016	2022	2016	2022	2016	2022	2016	2022
ASEAN imports to total imports (% share)								
All products	7.3%	10.6%	12.4%	15.0%	3.1%	3.1%	15.2%	15.0%
Primary Commodities	4.9%	5.2%	10.6%	12.7%	1.9%	1.7%	14.1%	12.1%
Electrical and Electronic Components	20.2%	29.3%	18.0%	19.0%	11.6%	11.2%	13.7%	16.9%
Exports to ASEAN to total exports (% share)								
All products	5.1%	5.4%	12.2%	15.8%	1.9%	1.6%	14.8%	15.8%
Primary Commodities	5.9%	5.8%	24.1%	25.7%	1.7%	1.1%	20.5%	23.0%
Electrical and Electronic Components	12.3%	10.5%	9.2%	15.1%	3.4%	3.7%	19.1%	22.6%

Source: UNCTAD and author's analysis

ASEAN'S COMPETITIVENESS IN KEY AREAS OF MERCHANDISE TRADE

As Table 2 on Revealed Comparative Advantage (RCAs)⁷ shows, ASEAN is an evident choice for supply chain recalibration to 'de-risk and diversify'. Illustrated by the RCA values of more than 1, Malaysia, the Philippines, Singapore, and Thailand have maintained their productive competitiveness in semiconductors and related electronics over this period, while Vietnam has established its standing in this regard driven by the additional capacity built up in this sector since the onset of the trade spat. Given the high level of sophistication and specialisation along the technology value chain, most of the trade diversification trends at the start of the US-China trade tensions could have initially been centred around labour-intensive and lower-tech activities.⁸ However, the tide could be shifting as even very niche producers such as TSMC, a global leader in semiconductor foundries, is seeing the need to diversify from its home base of Taiwan. This may provide more high-tech opportunities for those ASEAN countries that have capabilities to move up the value chain, such as Singapore.⁹ Apart from these products, resource-endowed ASEAN countries such as Indonesia and Malaysia also find themselves competitive in the supply of integral energy-related exports such as natural gas.

Table 2. Revealed Comparative Advantage (RCAs) of ASEAN countries in selected products

Products/Years	Brunei		Cambodia		Indonesia		Lao PDR		Malaysia		Myanmar		Philippines		Singapore		Thailand		Vietnam	
	2016	2022	2016	2022	2016	2022	2016	2022	2016	2022	2016	2022	2016	2022	2016	2022	2016	2022	2016	2022
Petroleum oils, oils from bitumin materials, crude	9.2	2.6	0.0	0.0	0.9	0.2	0.0	0.0	0.7	0.5	0.1	n/a	0.1	0.1	0.0	0.0	0.1	0.1	0.3	0.2
Natural gas, whether or not liquefied	55.3	8.9	0.0	0.0	5.4	4.1	0.0	0.0	4.6	3.9	30.4	8.4	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Copper	0.0	0.0	0.0	0.2	1.5	1.1	15.2	2.8	1.4	1.2	3.6	0.1	1.6	3.7	0.4	0.2	0.7	1.2	0.4	0.7
Cathode valves & tubes	0.0	0.0	0.0	0.6	0.1	0.1	0.0	0.0	4.6	7.2	0.0	0.0	7.6	13.7	5.7	8.3	1.1	1.5	1.0	2.1

Source: UNCTAD (SITC Product code classifications); Note: SITC Product code of 776: Cathode valves and tubes include that of semiconductors and integrated circuits.

THE ASEAN REGION IN FOCUS FOR MAJOR TRADE PARTNERS

The region holds strategic importance with respect to backward and forward linkages and has become increasingly significant in the technology value chain, especially as a China+1 diversification strategy. As a positive spillover, the added focus on the ASEAN region as a major global trade player has spurred greater industrial capacity building in select sectors; this has led to sectoral specialisation and enhanced economic development through human capital and technological upgrading. Thus, from the perspective of ASEAN and its trade partners, it is of mutual benefit to continue active engagement and remain open to trade growth. This stance has already taken root as perceptions of ASEAN as a leader in championing global free trade amongst respondents surveyed in the *ISEAS State of Southeast Asia 2023* has risen from 15.5% in 2022 to 23.5% in 2023.

To ensure economic security, major powers that are wary of China have stepped up their engagement with ASEAN, for example through a slew of face-to-face high-profile roadshows this year. One notable example is US Secretary of the Treasury Janet Yellen's trip to Vietnam in July, after earlier trips to China and India. Objectives of the trip included enhancing cooperation between the countries in manufacturing, and promoting the G7's Just Energy Transition Partnership (JETP) funding for renewable energy adoption, of which USD 15.5 billion were allocated to Vietnam. In the same trip, Treasury Secretary Yellen also promoted the USD 500 million available funding for international semiconductor factories under the CHIPS Act, to build up capabilities along the global technology supply chain. All these activities laid the groundwork for the official upgrade of US-Vietnam relations to a Comprehensive Strategic Partnership in September,¹⁰ along with a spate of business deals and partnerships quickly revealed thereafter involving the participation of technology heavyweights such as Nvidia and Microsoft.¹¹

MULTINATIONALS HAVE ALSO TAKEN INTEREST IN ASEAN

There have also been moves by multinational businesses, especially those in the E&E sector, to do more in ASEAN countries as part of their own strategies for self-preservation. Several major computer hardware manufacturers have announced concrete plans to diversify away from their reliance on China. In January, Dell announced its intention to completely shift away from "Made in China" chips by the end of 2024 and target at least 20% of its laptop production in Vietnam this year.¹² Subsequently, HP announced in July that they are working with suppliers to shift more production of consumer and commercial laptops to Thailand and Mexico this year, with preliminary intentions to move some of this capacity to Vietnam next year as well.¹³ Apple has also diversified some of its MacBook production to Vietnam this year, marking the first time its laptops have been produced outside China.¹⁴ Malaysia has also gained some sizeable wins with Infineon Technologies announcing that it will build the world's largest 200-millimeter Silicon Carbide (SiC) power fab there,¹⁵ as well as Tesla making known its intentions to set up a headquarters there later this year.

ASEAN HAS WELL-ESTABLISHED TRADE AND INVESTMENT AGREEMENTS

One of ASEAN's strengths is that it already has some robust formal relationships with major economies individually and at bloc level. These established platforms for active engagement

in trade and investment activities are beneficial to facilitate greater collaboration, and perhaps, more importantly, brings ASEAN to the fore with respect to the latest global developments. Some notable Free Trade Agreements include the Regional Comprehensive Economic Partnership (an ASEAN+6 trade deal, that includes China), the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (which includes four ASEAN countries – Brunei, Malaysia, Singapore and Thailand + 8 including Australia and Japan), ASEAN+1 FTAs with China, South Korea and India. Of note, the ASEAN-China FTA is currently undergoing an upgrade and the ASEAN-India Trade in Goods Agreement (AITIGA) is being reviewed. Other major bilateral FTAs include Singapore’s bilateral FTAs with the European Union (EU), United Kingdom (UK), and the United States, Vietnam’s bilateral FTAs with the EU and UK, and Thailand’s bilateral FTAs with China, Australia and Japan, with some notable ongoing negotiations between the EU and US and a number of ASEAN economies. Most recently, the EU announced the start of a scoping exercise to relaunch negotiations for the EU-Philippines FTA when the European Commission’s President Ursula von der Leyen visited the country in late July.¹⁶

STRENGTHENING ECONOMIC LEVERAGE WHILE REMAINING NEUTRAL

In tandem with the more focused interest that major economies’ have taken in ASEAN economies, ASEAN economies should take proactive steps to maintain their favourable position amid the global supply chain recalibration. Some possible policy strategies are:

- 1) Pursuing active engagement with key trade partners – In line with how major economies and companies have been stepping up efforts to engage with ASEAN, it is important for ASEAN economies to show the same level of commitment and, likewise, pursue opportunities and build up relationships with key trade and investment partners. Although, ASEAN is undoubtedly in a favourable position in terms of manufacturing capabilities and competitive aspects such as production costs, ASEAN economies are not the only ones on the radar of major economies. India has frequently emerged as a key market for E&E components relocation. Complementing high-level G2G engagements this year, companies such as Tesla and Apple are seeking to build up a viable technology hub in India. Thus, there is a risk that potential complacency may lead to a loss in some of the strategic leverage ASEAN currently holds. Active engagement will also help ASEAN economies de-risk their own supply chains as well.
- 2) Promoting domestic policies that provide a stable and predictable business environment Amid global risks and uncertainties, companies prefer operating in a business environment characterised by economic policy certainty and political stability. Thus, placing emphasis on this objective will help regional economies rank higher in terms of a relocation preference. In the latest IMD World Competitiveness Ranking 2023, five ASEAN economies feature in its assessment of 64 economies. Singapore ranks highest in terms of government and business efficiency, while the Philippines ranks the lowest. To note, Malaysia’s rankings in both these measures appear to be lower than what would be expected of an upper-middle income economy.

Table 3. IMD World Competitiveness Rankings 2023

	Overall ranking	Economic Performance	Government efficiency pillar	Business efficiency pillar	Infrastructure
Indonesia	34	29	31	20	51
Malaysia	27	7	29	32	35
Philippines	52	40	52	40	58
Singapore	4	3	7	8	9
Thailand	30	16	24	23	43

Source: IMD World Competitiveness Center

- 3) Prioritising productive capacity upgrading policies – Being at the forefront of technological development lends itself well to how the prospects of an economy are perceived. Targeting capital investments in new technologies and having a workforce sufficiently skilled to reap the benefits of these technologies, should be high on the priority list of ASEAN governments. Regional economies must tread carefully so as not to unleash beggar-thy-neighbour policy implications akin to the impacts some developed economies are now facing by virtue of the competitive subsidy regimes they have adopted.¹⁷ Relocation attraction should not be based on costs alone and hence, having a robust foundation of capital and skills can help limit adverse spillover effects, as there is more to the value proposition than attractive subsidies.

- 4) Leveraging on multilateralism – Strengthening respective domestic productive capacities and building up industrial specialisation may be worthwhile objectives for economies to pursue independently, but there are certain benefits to acting together as a bloc, especially in terms of collective interests and for smaller ASEAN member states to benefit in terms of visibility and credibility. Moreover, collaborating as a bloc on aspects such as digital upgrading and harmonisation of standards would also strengthen the region as an attractive business ecosystem. In terms of active participation in high-profile and multilateral FTAs, it would serve to maintain the region’s relevance in the global supply chain and avoid the risk of ‘being left out’ of key global economic developments. Moreover, deep FTAs, such as the ones initiated by the EU and the US, can also set the stage for economic reforms in investment protection and labour rights, which could also make these economies more attractive from an investor perspective, if implemented in a non-distortive way for the host country. In preparation for accession to high-profile FTAs such as RCEP and CPTPP, ASEAN countries involved are required to amend relevant domestic laws in order to comply with the terms of the deal. These FTAs also provide an opportunity for CLMV countries to transition to open regionalism through the multilateralisation of preferential terms of the trade accords they are party to.¹⁸ As a start, the RCEP requires these countries to extend preferential tariffs to all RCEP members, above and beyond ASEAN. In this context, the Margin of

Preference (MOP)¹⁹ would ideally be reduced to zero and hence, again, help to increase the attractiveness of ASEAN as a trading bloc ecosystem. As of 2018, the import-weighted MOP for Cambodia, Laos and Vietnam stood at 10%²⁰ which is more than double that for other ASEAN economies.

- 5) Strengthening the public-private-academic nexus – In any major industrial development, it is vital that a clear and constant line of communication between the business sector and the government exists. The benefits of this are particularly important for new areas of business and innovation. Businesses would gain a better pulse on new technological developments in their industry and perhaps even be market leaders in the area. This would be useful for policy prescriptions, especially to capacity build for the future. Moreover, businesses would also be able to provide relevant and valuable feedback on the right kind of policy mix for their industry to sustainably grow. The further integration of academic output and knowledge-sharing to this nexus, would enhance the innovation capabilities and competitiveness of economies in the region.

ENDNOTES

¹ <https://www.semiconductors.org/chips/>

² <https://digital-strategy.ec.europa.eu/en/policies/european-chips-act>

³ <https://asia.nikkei.com/Business/Tech/Semiconductors/China-s-chip-material-export-curbs-4-things-to-know>

⁴ <https://www.bbc.com/news/business-64461877>

⁵ <https://www.bloomberg.com/news/articles/2023-06-30/dutch-publish-new-limits-on-asml-s-chip-gear-exports-to-china#xj4y7vzkg>

⁶ <https://asia.nikkei.com/Politics/International-relations/US-China-tensions/U.S.-and-China-agree-to-new-dialogue-on-trade-chip-export-curbs>

⁷ Revealed Comparative Advantage (RCA) is a measure of a country's competitiveness in producing and exporting a product compared to other countries. An RCA value of more than 1 would indicate relative competitiveness and vice versa for a value of less than 1.

⁸ https://www.amro-asia.org/wp-content/uploads/2021/04/AMRO-AREO-2021_C2-rev.pdf

⁹ <https://www.forbesindia.com/article/essec-business-school/diversification-away-from-taiwan-chipmakers-is-necessary/71173/1>

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¹³ <https://asia.nikkei.com/Spotlight/Supply-Chain/HP-to-move-production-of-millions-of-PCs-to-Thailand-Mexico>

¹⁴ <https://www.ft.com/content/1a68ef89-92f2-4e35-856a-122d4e461571>

¹⁵ <https://www.marketscreener.com/quote/stock/INFINEON-TECHNOLOGIES-AG-436299/news/Infineon-Technologies-to-build-the-world-s-largest-200-millimeter-SiC-Power-Fab-in-Kulim-Malaysia-44502303/>

¹⁶ https://ec.europa.eu/commission/presscorner/detail/en/IP_23_4024

¹⁷ <https://www.bloomberg.com/news/features/2023-07-25/global-subsidy-wars-force-us-allies-to-pay-up-for-chips-evs#xj4y7vzkg>

¹⁸ <https://fulcrum.sg/the-clmv-countries-and-rcep-will-they-grasp-the-opportunities/>

¹⁹ The Margin of Preference (MOP) refers to the difference between preferential and Most-Favoured-Nation (MFN) rates.

²⁰ https://www.eria.org/uploads/media/Books/2021-Impact-of-the-ATIGA-on-Intra-ASEAN-Trade/09_Ch.5-Analysis-Tariff.pdf

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