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Does Derisking or Decoupling Signal the Death Knell for the Export-led Model in Southeast Asia?

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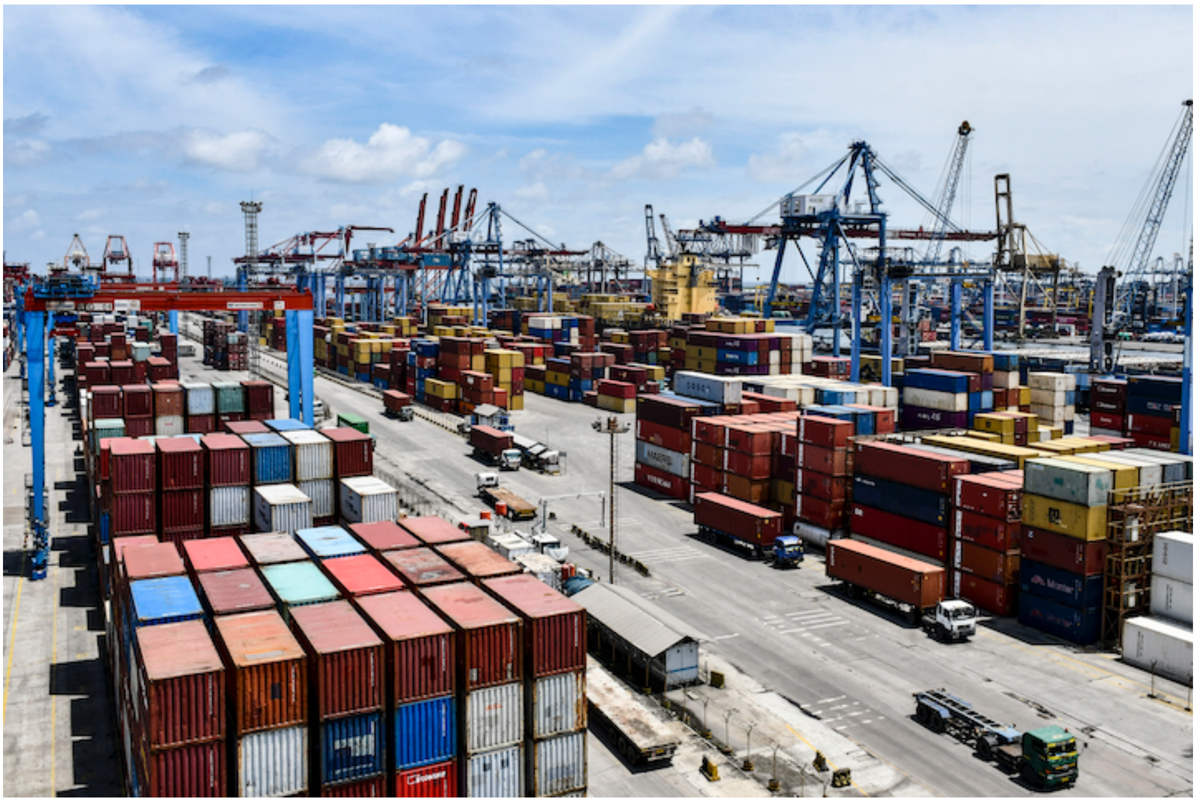

Trucks passing by during the loading and unloading of containers at Tanjung Priuk Port in Jakarta, Indonesia, on 12 February 2024. Photo by Darryl Ramadhan/NurPhoto/NurPhoto via AFP.

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EXECUTIVE SUMMARY

- The death of the export-led model has been predicted many times. Most recently, it has come from the rise in anti-globalisation-driven protectionism and calls for derisking or decoupling, but again the rumours of its demise may be greatly exaggerated.

- If the export-led model of old is dead or dying, then it is being superseded by one in which the composition and the pattern of trade may change, but not at the cost of its importance. The composition is shifting from goods to services while the pattern of trade is being driven more by geopolitics than by efficiency.

- Trade statistics may have underestimated the true significance of digital trade and exaggerated the trade slowdown, given the measurement problems involved. Digital goods and services are likely to make up most of future trade growth, with digitalisation facilitating future services trade growth.

- The export-led model is likely to survive. Southeast Asia's long-standing commitment to free and open trade has facilitated massive economic transformation and brought much social progress. Furthermore, the growth and spread of supply chains in the region have underpinned its economic success, and this is largely irreversible.

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INTRODUCTION

While the rise in anti-globalisation sentiments can be traced back to at least the 2008 Global Financial Crisis (GFC), the COVID-19 pandemic reinforced it, leading to an increase in protectionism throughout East Asia and around the world. Many of the barriers to labour mobility introduced during the pandemic have been slow to come down and, in some countries, these have still not been completely reversed. Meanwhile, industrial policy has enjoyed a major return to popularity, especially in the United States (US).

These developments have been facilitated by, and ironically contributed to, an increasingly ineffectual World Trade Organisation (WTO). To some, the rules-based multilateral trading system is under threat, and may even signal the end of the export-led model in spearheading growth in the region.

In essence, the export-led model involves a country pursuing economic growth and development mainly by opening itself up to international trade, where most of the increase in employment and per capita incomes derives from the successful export of goods and services. This is in contrast to the import substitution model where countries strive to become self-sufficient by developing their own industries under protectionist and industrial policies.

The objective of this article is to examine whether the increasing moves to derisk or decouple signifies the death knell for the export-led model, particularly for the Southeast Asian region. In other words, will the region's long-standing commitment to openness be able to withstand the rise in anti-globalisation sentiments and the return to popularity of industrial policy? If the export-led model is indeed dead or dying, what will replace it and in what form? Or is the export-led model evolving rather than dying, and what shape is it likely to take, going forward? These are the questions that we will try to answer.

To set the stage, we begin by examining the trend in the reemergence of industry policy and protectionism, focussing on the US, before asking if the recent distinction being drawn between derisking and decoupling is real or rhetorical. We then consider the key question of whether the export-led model is dead, dying, or evolving.

THE US EMBRACE OF INDUSTRIAL POLICY AND SECURITY-DRIVEN TRADE POLICY

Industrial policy, in one form or the other, is not new to the US. More recently, it started gathering momentum with the Export Control Reform Act of 2018, which preceded the *Inflation Reduction Act* (IRA) and the *CHIPS and Science Act* in August 2022. The return of industrial policy is driven by a combination of the need to address climate change challenges through clean energy transitions as well as geostrategic concerns that focus on reducing dependence on China. In less than a year, the 2022 IRA and CHIPS Acts have already had significant direct and indirect effects on the East Asian region, especially on China and Southeast Asia. The subsidies linked to domestic content requirements in these statutes have shifted sourcing patterns, while restrictions on the exports of advanced microchips to Chinese firms have directly affected trade. World Bank (2023) shows how these laws have reduced exports to the US from China by about 10 percent since they came into effect and by almost 5 percent for ASEAN countries, while imports from the United States-–Mexico–Canada Agreement (USMCA) countries have increased. With the nexus between trade and investment, global FDI flows have also slowed since the GFC to a decade-low just before the pandemic hit (United Nations 2017), making them fall even further.

These are worrying trends, but it is important to look beyond the numbers to determine whether or not rumours of the death of the export-led model are exaggerated. Underlying drivers of the current trend favouring industrial policy and other forms of protectionism may represent either transitory forces or a more permanent shift in direction. And there are questions about how accurately the statistics capture the rapidly changing nature of globalisation and the associated changes in international production, trade and investment flows.

The direct impact of US industrial policy extends beyond its borders through the provision of preferential treatment to FTA partners and thereby discrimination against others. It may also have spill-over effects by contributing to an already growing appetite for similar policies in the East Asian region and around the world, especially Europe. This tit-for-tat policy game is not confined to tariffs but also applies to subsidies and other instruments of protection as countries try to compensate for and compete on a playing field that is growing increasingly uneven.

Since it is having both direct and indirect effects on trade in the region, as well as on policy setting, it is important to look more closely at what is driving the interest in industrial policy in the US. For decades, US trade policy was run by the US Trade Representative's (USTR) office. The USTR negotiated all key trade agreements and was strongly pro-trade and pro-liberalisation. Under the Biden administration, the power on setting the trade agenda appears to have shifted to the Commerce Department. This shift in power has already had a profound influence on US trade policy.

Unlike the USTR, whose mission is to promote trade and investment through advancing liberalisation and maintaining a rules-based order, the Commerce Department is focussed on the defence and promotion of US companies and the protection of US technologies. Although the zeal with which the USTR has been pursuing its mission has weakened under the Biden administration, it is the shift in power to the Commerce Department that has markedly changed the nature and direction of US trade policy. This shift favouring the Commerce Department itself reflects the underlying 'securitisation' of US trade policy and the rise in US nationalism in technology and other associated forms.

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It is the Commerce Department that has been overseeing the rollout of the massive subsidies being offered to re-shore, near-shore or friend-shore semiconductor manufacturing, restricting sales of advanced US technologies to various Chinese companies and other protectionist policies. This led some commentators like Alden (2023) to conclude that the US shift to a more nationalist trade policy, driven by domestic industrial interests and national security concerns, will be durable.

The question we need to ask is whether this shift will also permanently change Asia's commitment to open and free trade and investment.

DECOUPLING AND DERISKING: REAL OR RHETORICAL?

At the G7 Summit in Tokyo in May 2023, US President Joe Biden tried to clarify that the objective of US economic relations with China was not to decouple[1] from it but to derisk and diversify. Biden has repeated the 'derisk, not decouple' mantra several times since, most recently at the United Nations General Assembly in September 2023.

These statements should be welcomed by East Asian countries whose manufacturing supply chains are intricately linked to China. Given the highly interdependent nature of production through supply chain networks, policies that directly impact China will reverberate throughout the region. But this rhetorical shift may not translate directly into substantive change. The United States may stall punitive measures initially, to be followed by a reversal or reduction. On the other hand, Biden's statements may turn out to be simply a play on words. If it is mostly a rhetorical rather than substantive change, as many fear, then the real risk of further escalation in tensions, and increased supply chain disruption, will remain.

Elon Musk recently described the economic relationship between China and the global economy as akin to conjoined twins,[2] implying that the two were inseparable. This expressed position also reflects the growing chasm between private sector interests and government policy, even when the latter claims to reflect and serve the former. If Musk is correct about China and the global economy, then the interdependence between China and ASEAN is greater still. ASEAN's supply chains remain China-centred and the idea that they can decouple from China is both impractical and imprudent.[3] There may be room, however, for diversification. Over-reliance on one or a few countries, or indeed firms, carries obvious risks.[4] ASEAN's economic prospects are heavily dependent not just on China, but also the US. Reducing dependence on both countries through diversification would also reduce risk.

While diversifying trade patterns will increase the resilience of trade flows, and thereby the sustainability of the export-led model, will it be sufficient to counter the long-term trend decline in trade growth? Trade growth has been slowing in East Asia for some decades. While it averaged over 8 per cent in the years leading up to the 2008 GFC, it slowed to around 5.2 per

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cent after 2010 and is expected to fall to 4.4 per cent in the post-pandemic years (Pacific Economic Cooperation Council 2023). When normalised by GDP, the slowdown is less pronounced but it still remains significant.

The slowdown in trade growth has led some to suggest yet again that the export-led model is dead. Similar predictions were made soon after the 2008 GFC when current account imbalances came to dominate the global economy. The focus then was to rebalance sources of economic growth by shifting them from the external sector to domestic demand. Though much attention had focused on China, other Asian countries with sizeable current account surpluses also proposed rebalancing. The International Monetary Fund (IMF) was prominent in calling for China to rebalance in the early 2010s (Singh 2011; Arora and Carderelli 2011). The fact that it is still calling for it in 2023 suggests that the expected rebalancing has not happened (Bloomberg 2023).

The two-decade steady decline in the region's trade growth rate is a cause for concern but a lot will depend on what is driving it. While supply chains are shortening (Antras 2020), and some policy-induced reshoring has taken place (Nguyen 2024), the slowdown has mainly affected goods rather than services trade (McKinsey 2016). The potential for growth in trade in services, especially intermediate services, is huge, and technological change related to digitalisation will further reduce barriers to trade in services (Baldwin 2022).

EVOLVING, NOT DYING

This has led some commentators like Baldwin (2023) to assert that globalisation is not dead but is simply transforming. Similarly, if the export-led model of old is dead or dying, then it may be superseded by one in which the composition and the pattern of trade change, without affecting its role or importance. The composition will shift away from goods towards services while the pattern of trade will be determined less by efficiency and more by geopolitical factors.

Recent research by the World Bank (2021) and the IMF (2018) warn that the trend of premature deindustrialisation and the spread of automation and digital technologies has made the traditional development model of export-led manufacturing seen in East Asia less viable for developing countries to replicate in the future. The World Bank study goes so far as to suggest that a services-led export model is the only alternative for developing countries. While debate continues (see Hauge 2018) on the respective roles that services and manufacturing play in different developing economies, there is growing agreement that diversification must increase within, not just between, these sectors.

Rapid growth in digital trade is related to this compositional shift towards services. Digital trade did not exist when the trade slowdown started two decades ago. In fact, trade has now rapidly evolved to include trade in digital goods and services, digitally ordered goods and

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services and digitally delivered services. Digitalisation increases the scale, scope and speed[5] of trade. And this will affect assessment of the viability of the export-led model in at least three ways.

First, digital goods and services are likely to make up most future trade growth, while digitalisation will facilitate future services trade growth.

Second, reported statistics on trade may underestimate the true volume of digital trade, given a host of measurement difficulties (see, for instance, IMF 2023). As the most rapidly growing component of trade, some of which is in place of conventional trade flows, the underestimation of digital trade volume may have significantly exaggerated the extent of the trade growth slowdown.

Third, many of the barriers that inhibit goods trade in developed countries do not apply to services trade (Baldwin 2022), accounting for its rapid growth, while the increasing use of the digital medium enhances the ability of traders to circumvent existing barriers, reducing the effectiveness of protectionist policies. New technologies and business models are challenging the way that international trade and investment policy is made. As far as the performance of the export-led model is concerned, the above factors suggest that trade may be growing a lot faster than statistics suggest, and further, that this trend is only likely to increase.

There are several reasons why the export-led model is unlikely to die anytime soon. Though the shift towards embracing industrial policy may represent more than a transitory phenomenon in the US, the fact that its security-driven trade policy has favoured friend-shoring and near-shoring more than reshoring implies a change in the pattern rather than the volume of trade. Such policies have so far favoured countries which have FTAs with the US, especially USMCA countries and trusted allies like India and Viet Nam, at the expense of China and ASEAN. This could change if members of the Indo-Pacific Economic Framework for Prosperity succeed with efforts to improve market access provisions, which seems increasingly unlikely (see Menon 2023a), or if attempts by ASEAN countries like Indonesia[6] and the Philippines to sign limited FTAs for critical minerals materialise (see Moriyasu 2023).

Japan's recent foray into industrial policy is also aimed at reducing reliance on imports from China, by offering incentives to its firms to relocate their imports to ASEAN countries though with relatively limited impact so far. Again, this will mainly change the pattern rather than the significance of trade. Similarly, the rapid growth in digital trade is altering the product composition of trade, as new digital goods and services are traded and as modes of delivery change. To the extent that these changes affect volumes of trade, the trade statistics probably underestimate its true significance given that measurement difficulties lead to under-reporting (Menon 2023b).

CONCLUSION

The recent rise in protectionism and the return to popularity of industrial policy around the world have led some to conclude that the export-led model is dead, yet again. Similar predictions were made soon after the 2008 GFC but these were proven to be wrong then, as they might be again. The main reason why the export-led model is likely to survive this time, in one form or the other, is the region's long-standing commitment to free and open trade, which has facilitated massive economic transformation and social progress. This experience cannot be denied, overlooked, or forgotten. The growth and spread of supply chains in the region have underpinned its economic success and is largely irreversible.

There is evidence that this commitment is still present. Recently, Malaysia decided to remove price controls and subsidies [7] on sensitive agricultural products, while reiterating its commitment to openness. The country also questioned the need to return to pre-pandemic levels of dependence on foreign workers deemed critical to retaining the competitiveness of its tradable goods sector. But pragmatism has trumped nationalism and the policy of openness to such flows has been reinstated. The Philippines has removed [8] the long-standing and controversial foreign equity limitation on public services, allowing 100 per cent foreign ownership in all public service sectors outside of public utilities, but including railways and airports.

These are indicators of the region's commitment to openness, reaffirming its liberalisation credentials even during uncertain times when the temptation to turn inward is at its highest. The ASEAN-led Regional Comprehensive Economic Partnership initiative with its open rules of origin at a time of global pressures against liberalisation is an example, as is the recent launch of negotiations for the ASEAN Digital Economy Framework Agreement.

If there is a risk to the export-led model, then it is likely to come from outside rather than from within the region. But whether the region's long-standing commitment to openness will be sufficient to withstand the disruption from a sharp escalation in geopolitical tensions that leads to more fragmentation remains the primary concern.

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ENDNOTES

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[2] https://www.washingtonpost.com/world/2023/06/01/elon-musk-tesla-twitter-china/
[3] Before the pandemic hit, ASEAN's total merchandise trade with China consisting mostly of supply chain-related parts and components was approaching $600 billion or a fifth of total trade, which was the impetus for upgrading the ASEAN-China FTA (Menon and Melendez 2019).
[4] The concentration and dependence on a small number of firms is particularly the case with critical minerals; see Gill (2022) and Pangestu (2023).
[5] https://www.oecd.org/trade/topics/digital-trade/
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