

A world map with a blue background and white grid lines. The Southeast Asian region, including countries like Thailand, Vietnam, Laos, Cambodia, and Indonesia, is highlighted in a bright red color. The rest of the world is shown in a light blue/white color.

Trade and Development Amidst Disruptions: Implications for ASEAN

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September 6, 2019

Outline

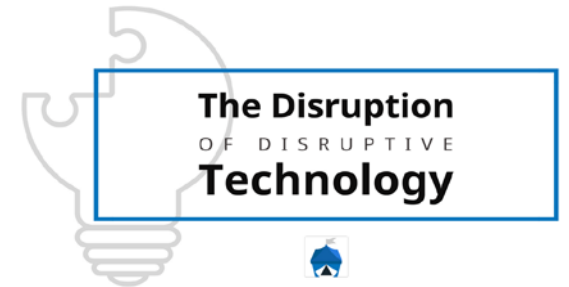
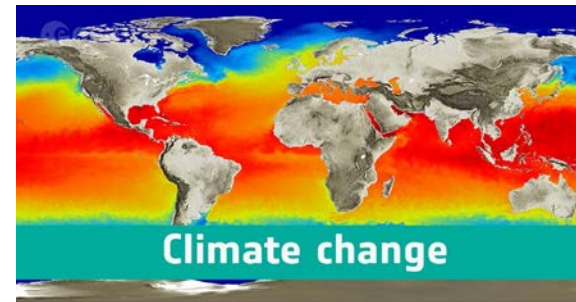
1. The New Normal
2. Impact on ASEAN so far
3. What needs to be done: Responses and Strategies

Drivers of Growth and Stable World Economy pre GFC

1

1. **Conducive world economy:** Trade growth & economic development, poverty alleviation, increased economic integration (trade, investment), East Asia: market driven integration (unilateral liberalization and WTO), FTAs more recently
2. US, EU and **advanced country leadership** on openness (**tailwind**), rules based multilateral trading system (MTS), use of dispute settlement for trade conflicts
3. **Bold unilateral liberalisation** and reforms **underpinned by international and regional commitments** (WTO, APEC, ASEAN -> ASEAN+1 -> RCEP): export-led development strategy, competitive liberalization, reforms post crises,
4. Accession of China to WTO: China and India growth fuelled commodity demand
5. Evolution of **production networks and GVC**
6. **Technology** (transport and telecommunications) -> boosted trade, allowed for second unbundling

THE WORLD HAS CHANGED DRAMATICALLY: THE NEW NORMAL



**RESPONSE AND STRATEGIES
CAN NO LONGER BE
BUSINESS AS USUAL**

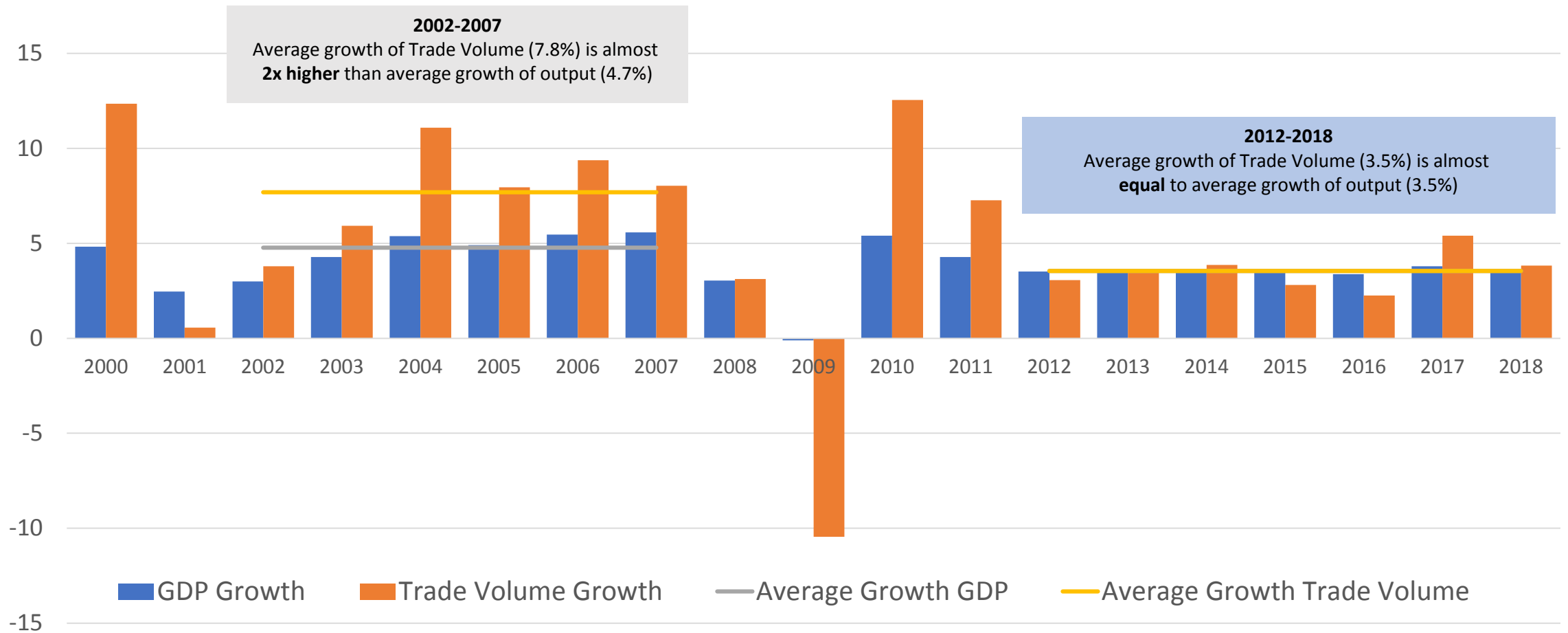


The Context

- ASEAN countries: different levels of development and demographic composition (Thailand aging, Indonesia demographic dividends), potential for growth and increase in middle class, 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:
 - **Slowdown global economy and trade (structural or cyclical)**
 - **Trade tensions**
 - Geopolitical hotspots
 - Technological disruptions and competition: future of jobs, jobs of the future
 - Sustainable development & climate change

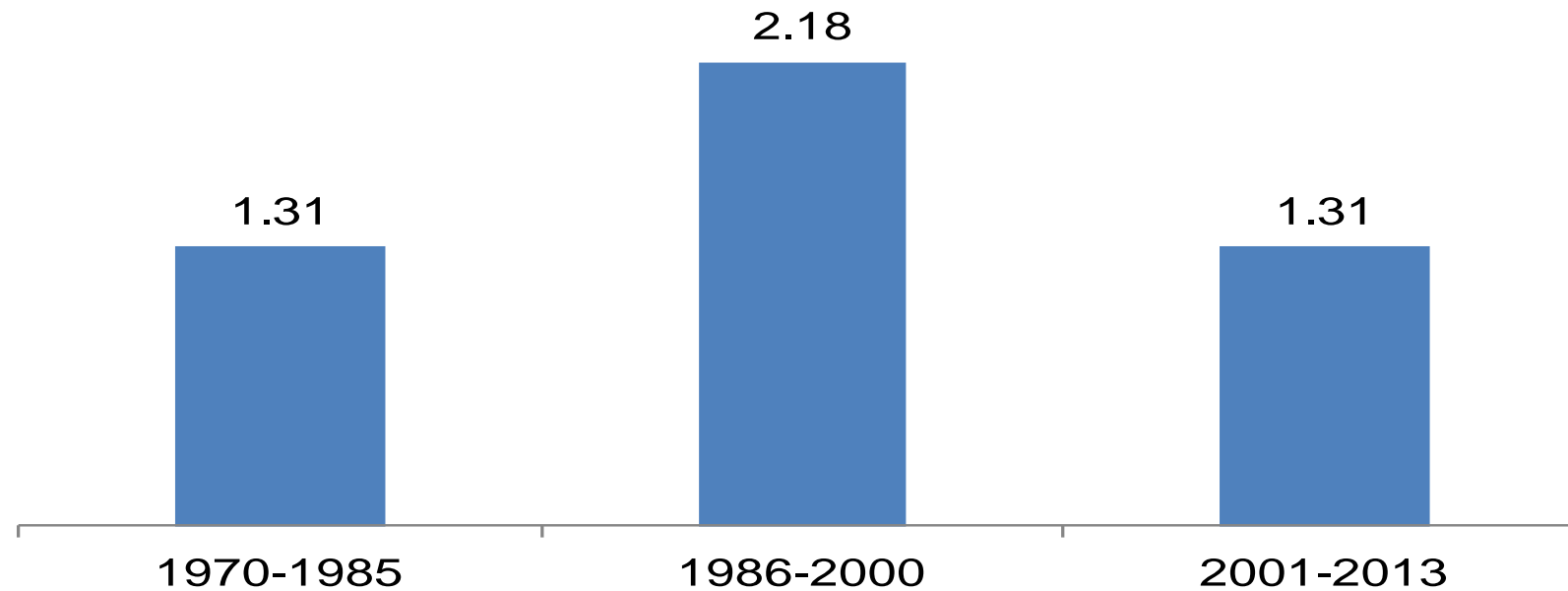
Recent Development: Slowing Down after GFC

The New Normal: Lower GDP growth and Delinking of World Trade and Global Output Growth



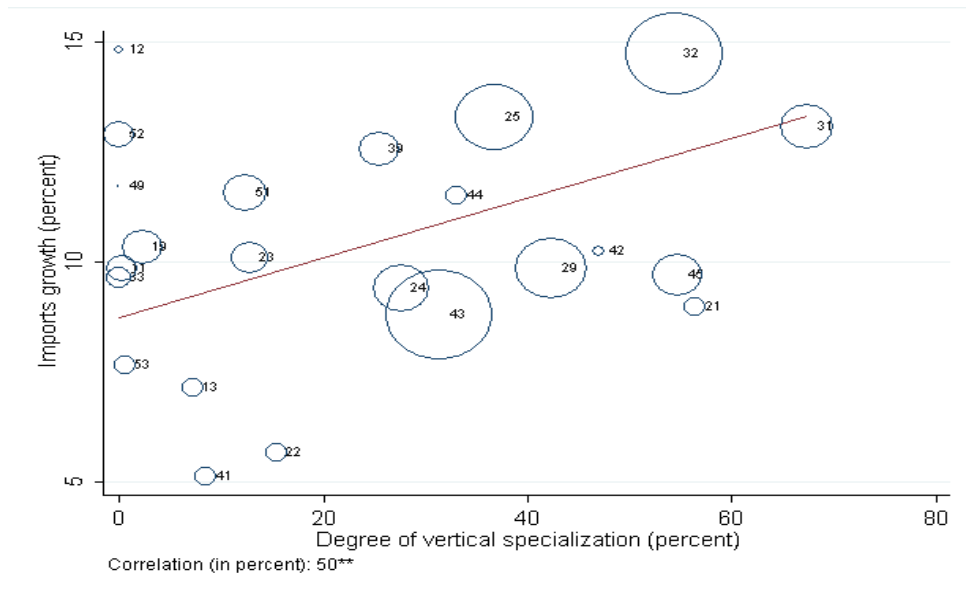
Source: IMF, WEO Database, April 2019

Changing relationship between trade and income (decline in Long Run Elasticity Trade to GDP i.e. 1% of growth lead to 1.3% trade growth)

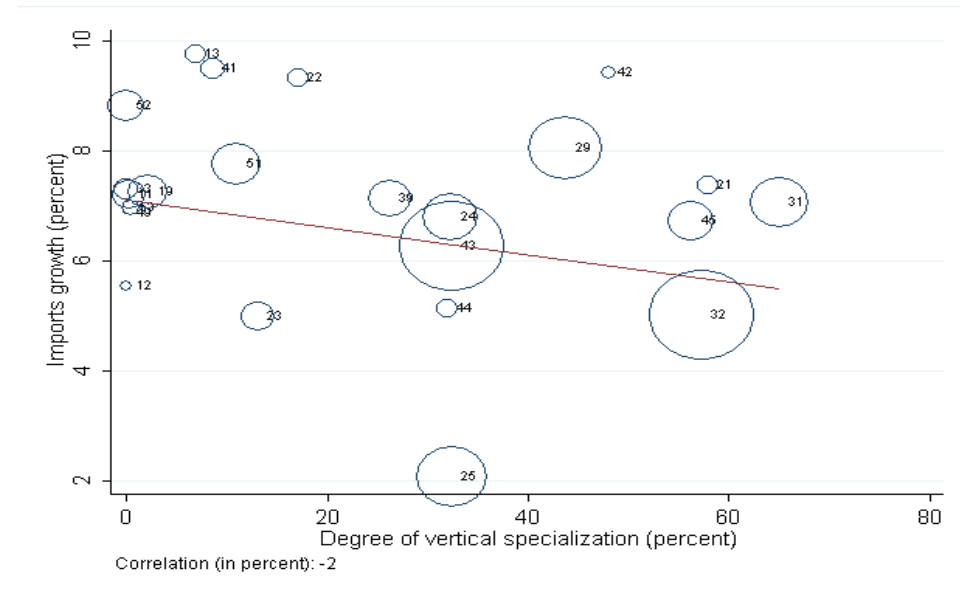


Source: IMF World Economic Outlook and authors' calculations (Constantinescu, Mattoo and Ruta (2015))

Within manufacturing, trade growth declined more in subsectors with greater vertical specialization

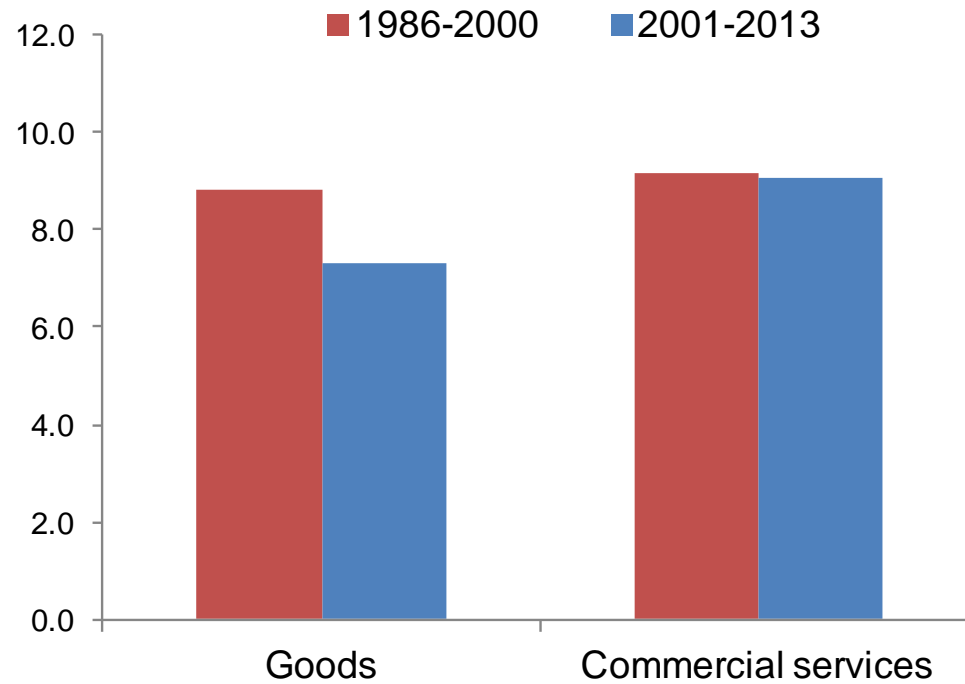


In the long 1990s, trade in the most vertically specialized sub-sectors saw much faster rates of growth than sub-sectors where GVCs were less developed



In the 2000s, while trade growth fell across the board, the largest declines were in the sub-sectors with higher degrees of vertical specialization

1990s growth driven by goods (manufacturing, machinery and transport), changing to services and commodities



Possible explanations for the structural slowdown in world trade

Global supply chain expansion explained “the long 1990s” when trade growth was double that of income growth: fragmented production networks and supply chain based on trade in parts and components (vertical specialization). China as hub and such trade grew faster.

Global supply chain or GVC contraction now also play a role in trade slowdown as supply chains “mature” and more local procurement. And changing nature of GVCs

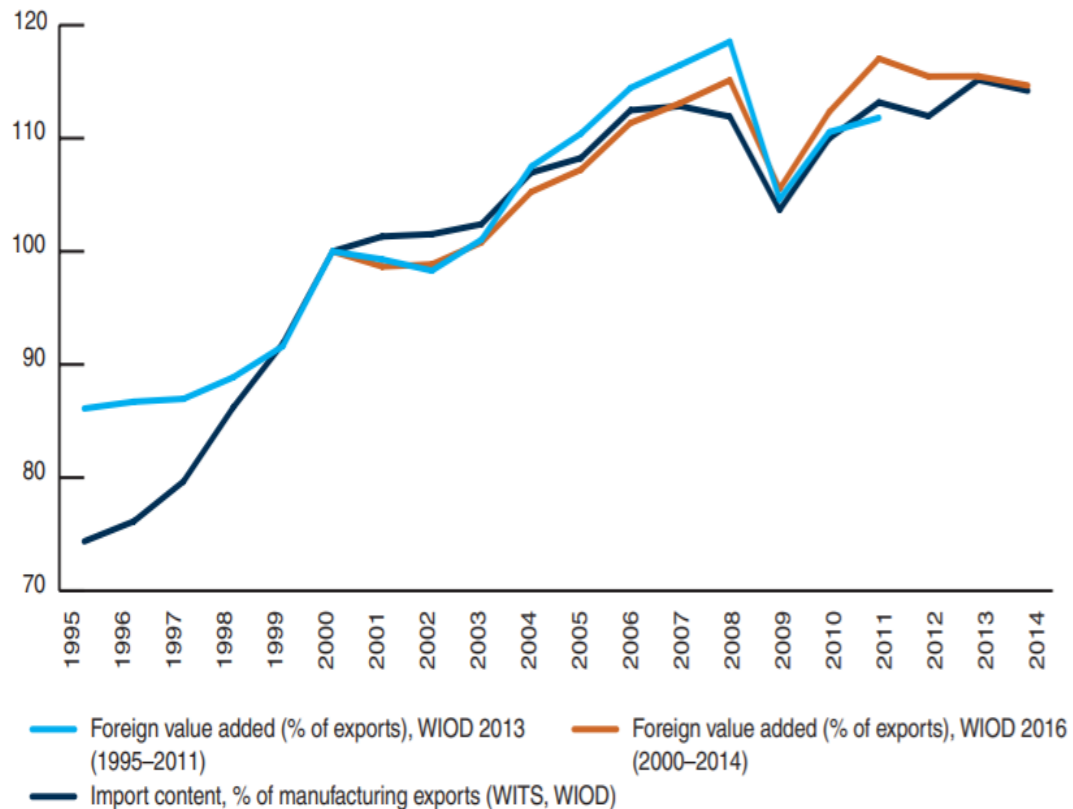
Does slower trade mean reduced scope of increased productivity through specialization and diffusion of technology through trade and investment channel i.e. slower GVC expansion? Export orientation? Potential in services trade, and the evolution of GVCs in future?

Ref: Prospects for Global Trade, World Bank and IMF, May 2015 (see interalia: Constantinescu, Cristina, Aaditya Mattoo and Michele Ruta, 2015, [“The Global Trade Slowdown: Cyclical or Structural?”](#) IMF Working Paper No. 15/6.

Changing Global Trade Environment

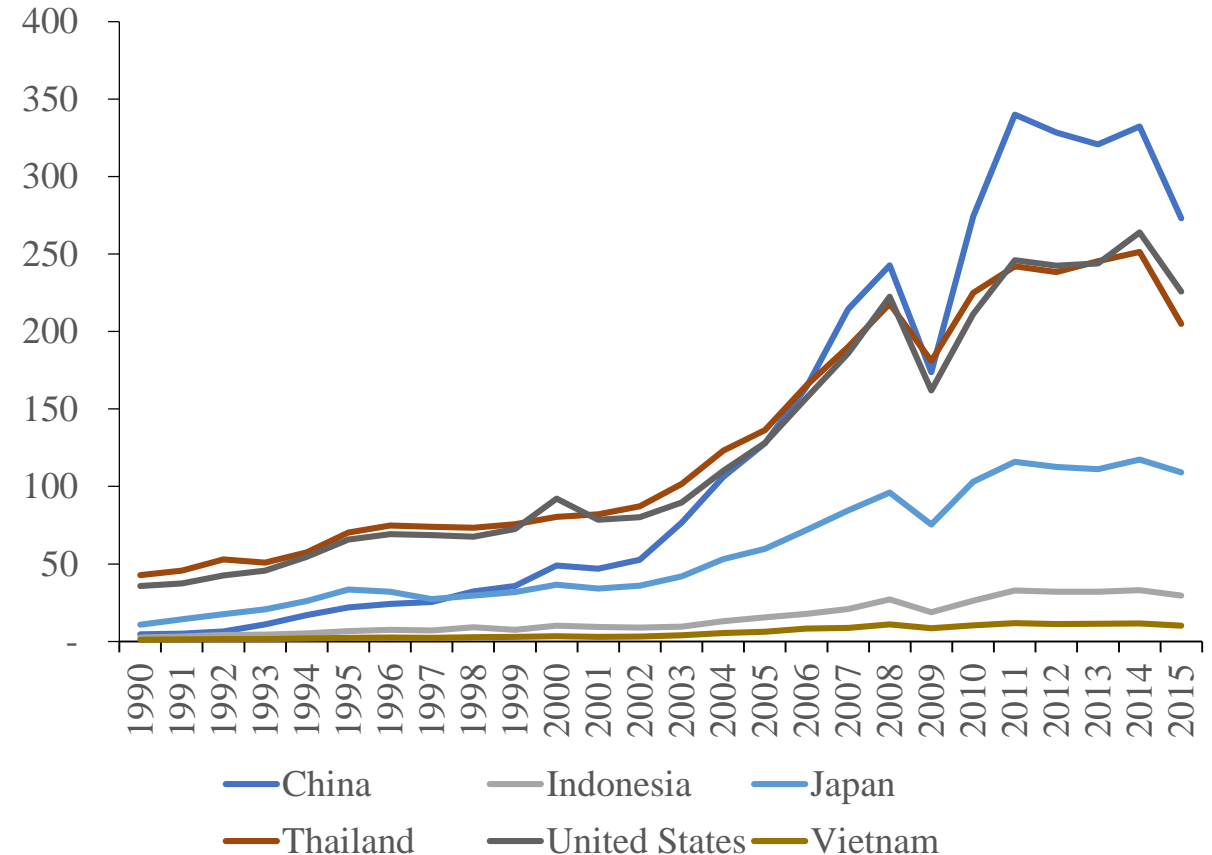
Structural not Cyclical: Maturation of Global Value Chain

World Trade in Value Added stagnated after GFC



Source: WorldBank

Foreign VA in Trade (current USD millions) for selected major economies plateauing and declining



Source: UNCTAD, EORA Database

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 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: something is broken

- 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 (prolonged and uncertain)
 - No longer the internationalist approach, but using tariffs as a tool
 - Its not just a trade war – economic and technology competition mixed up with security
 - **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
 - key role to as Chair of G20

Trade Tensions: not likely resolved soon

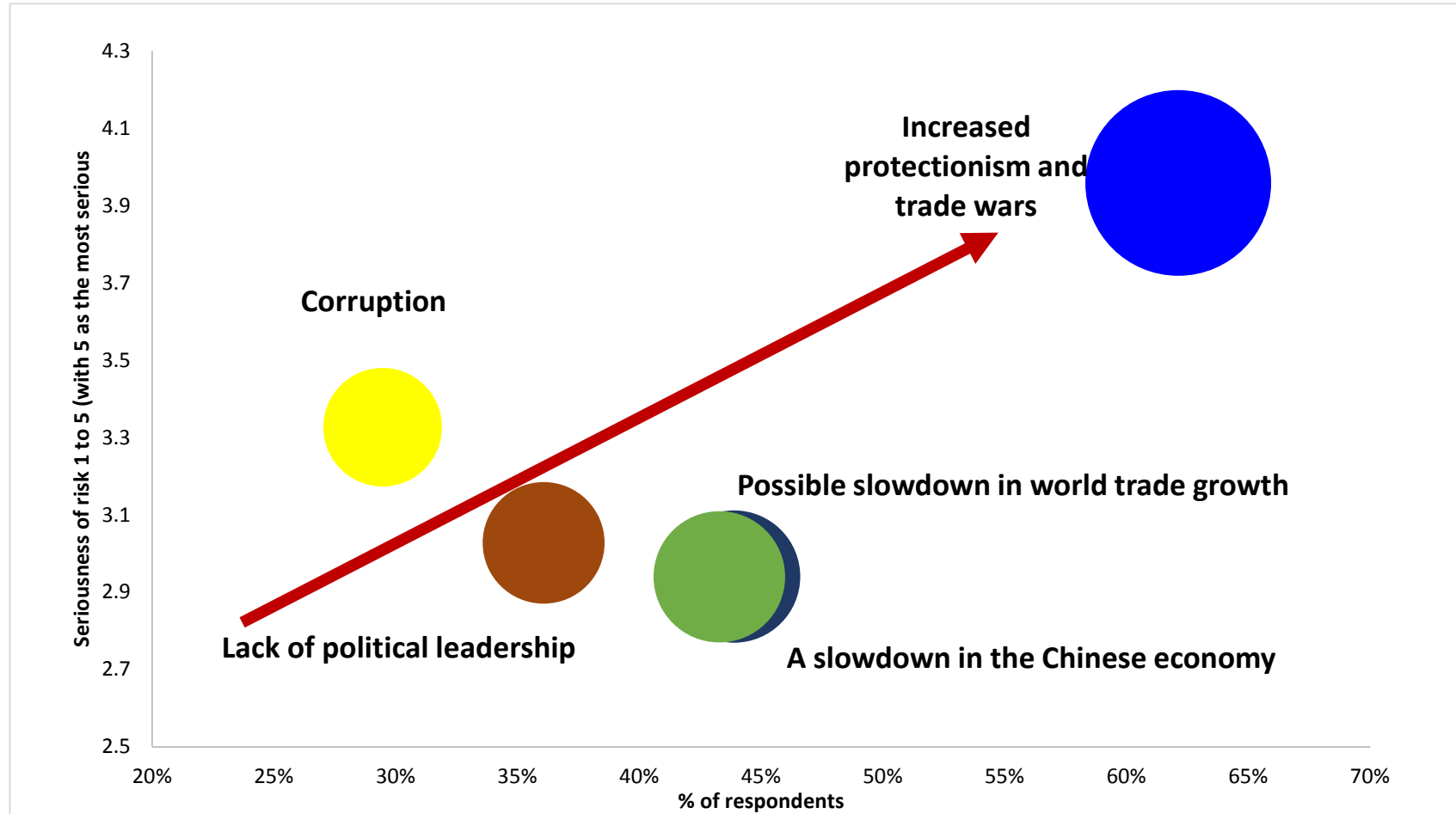
- US-China
 - US: Trump and 2020, anti China and trade bipartisan
 - **Emergence of China** (economy grew 6x (2001-2017) and trade 10x to \$1.7 Trillion (1992-2017))
 - China: nationalists vs reformists
- It is here for the long term and complex:
 - **Unfair Trade:** trade deficit in goods and currency 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

2. TRADE TENSIONS IS CREATING GREAT UNCERTAINTY

**External uncertainties: growth, trade and China slowdown
affected growth and trade outlook of ASEAN**

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

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



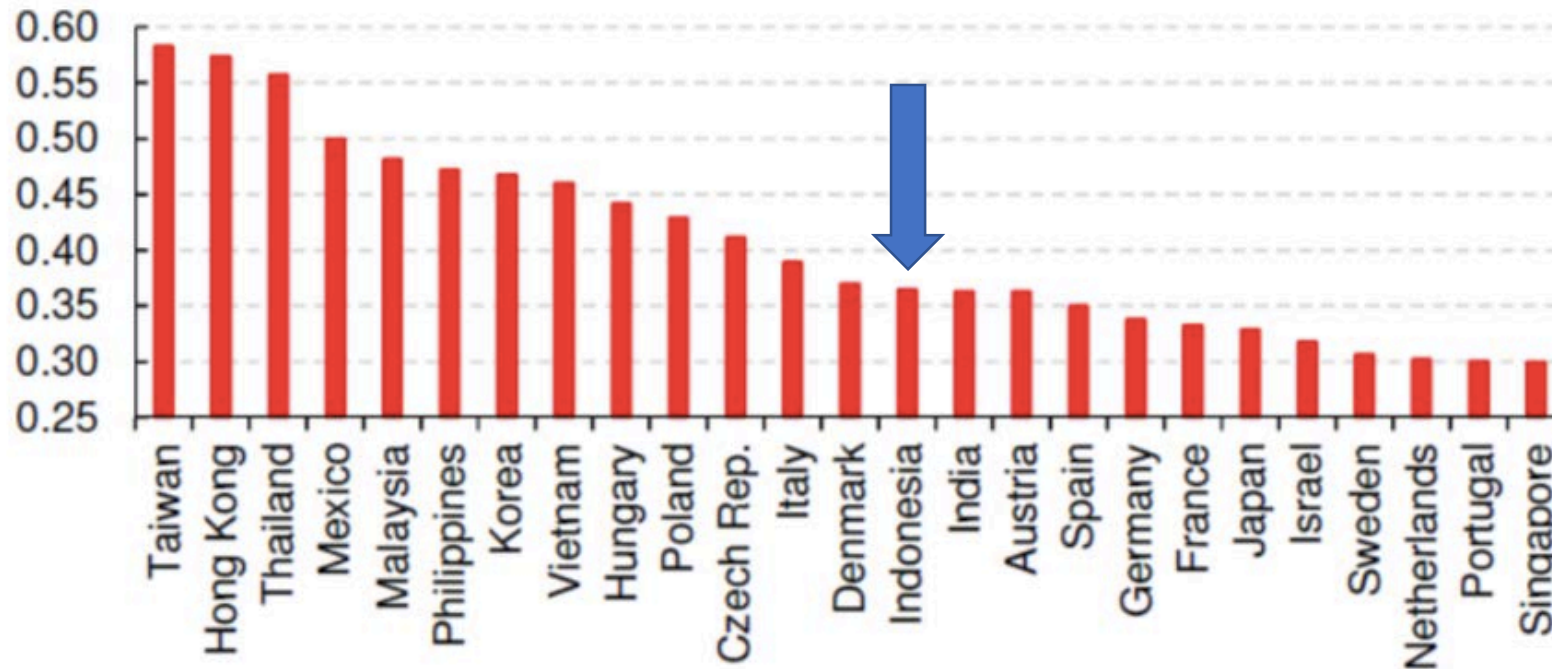
How do you expect your company's globalization strategy to change over the next three years?

n = 770



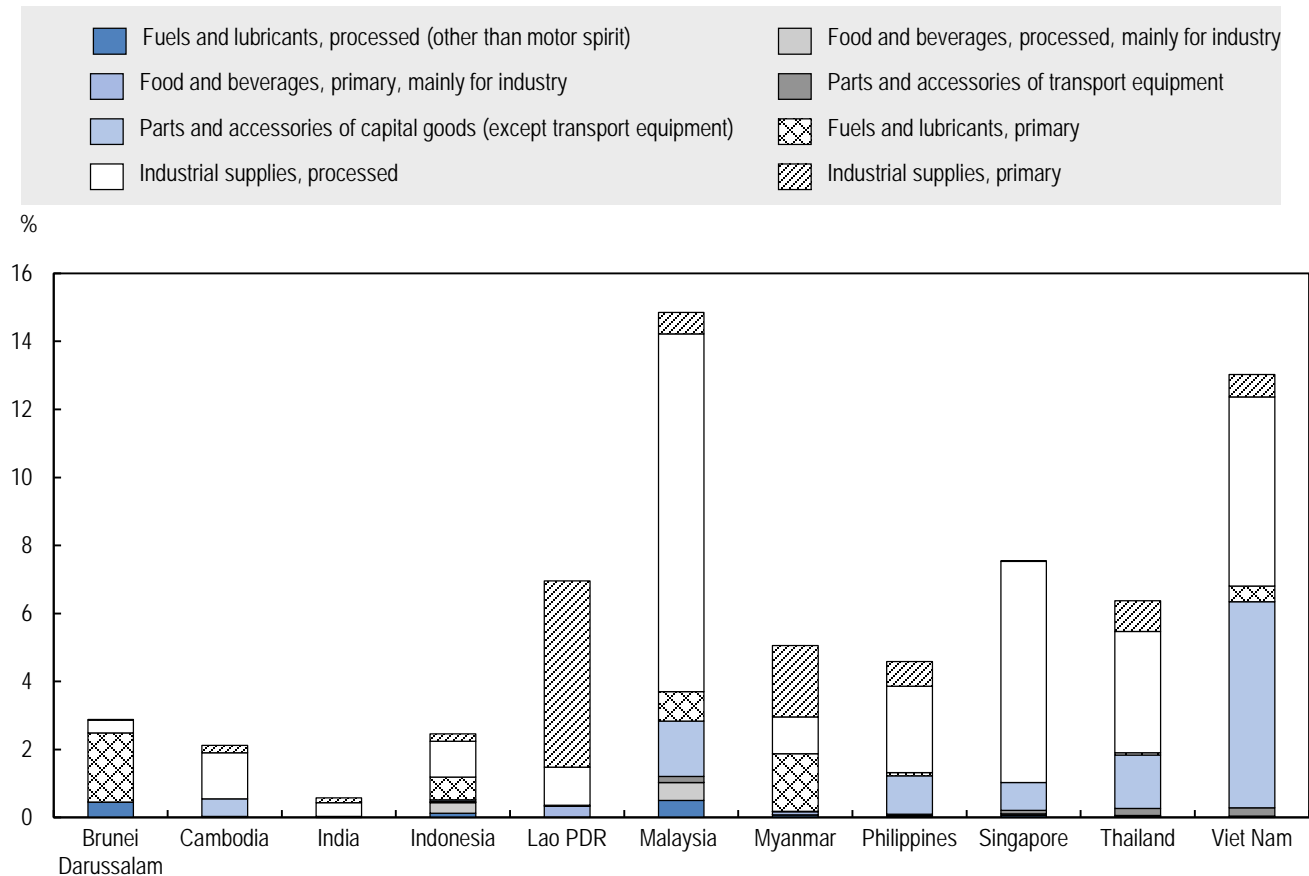
Thailand, Malaysia, Philippines and Vietnam will be the most potential alternative exporters from ASEAN to replace goods from China in US market, based on the similarity of the export basket. Indonesia less so.

Export Similarity With China In The US Export Market



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

Responses: seize the opportunities

- Seeing the immediate opportunities for **export diversification and investment relocation**, overcoming barriers and impediments, and pro active inviting investment
 - Displacing US in China market: Malaysia waste & scrap alloy, natural gas, benzole
- **Domestic Reform agenda key**: labor policies, trade facilitation, investment climate, availability of supporting industries and local inputs/raw materials
- **BUT: 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

Beware of the double edged sword

- Increasing exports to the US: Vietnam got a special mention by President Trump at G20 (41% increase in its imports into the US vs -13% for China)
- 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”
 - 4 countries in ASEAN 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 (Indonesia \$1.9 billion, 10% exports to the US)

US Trade deficit with its partners: 4 from ASEAN

		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

- 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

3. What needs to be done? Responses and Strategies

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

- Global and Regional Value Chains
 - 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

A Three-Pronged Approach

- **Unilateral reforms – predicated on regional and multilateral commitments**
- **Strengthening and building on Regional Economic Integration: Collective leadership – ASEAN, Japan, Aust-NZ – RCEP, potential for expanding CPTPP, as well as APEC.**
- **Collective ASEAN centrality in upholding the Multilateral Trading System** under the WTO: maintain the current rules based regime and pro active in renewing the WTO rule book.

Unilateral Reforms

- Attract current relocation strategically: reforms (e.g. Indonesia: labor); access to international inputs and services, talent; and investment climate: ease of doing business; parts of GVC. US+1 and China+1
- Short and medium term:
- comprehensive and holistic strategy for competitiveness: beyond labor cost, not just manufacturing but also services, efficient services important for competitiveness (trade negotiations within this – bilateral and ASEAN centrality)
- job creation: skill, upskilling, talent,
- Sustainable development: traceability and emerging standards
- technology and innovation and development: fourth industrial revolution is not just in industry but across the board (digital, data analytics, machine learning and AI), IPR, ecosystem (including education), openness to talent
 - New issues – freedom of data flows vs data localization, source code, privacy, taxation, data governance, security

Regional

- **Regional agreements are still important. Ensures stability and predictability of trade policies in countries involved, continued market expansion and openness (signal)**
 - **Collective leadership: ASEAN and middle powers (Japan), Australia-NZ?**
- Improving relations with RoW – balancing act (e.g. Japan-China warming up, what about with India?)
- Regional agreements (catalyst) can also address issues that are not yet addressed in the WTO
 - Eg. E-commerce in RCEP, and CPTPP

Regional

- **Different pathways to broadening and deepening regional integration, and with major trading partners outside of region with ASEAN Centrality**
- Deepening and broadening of ASEAN Economic Community (AEC): ASEAN Centrality
- **Complete East Asia Regional Comprehensive Economic Partnership (RCEP) this year: 10 ASEAN + China, Japan, Korea, Aust, NZ and India by this year**
- Japan's leadership - CPTPP (includes North America and Latin America) Asia Pacific base, implementation is key (several ASEAN members)
 - Expanding members? As rest of ASEAN?
 - Potential "Benchmark" for other regional agreements and MTS in terms of ambition and for new issues

Regional

- China-Japan-Korea: uncertain?
- What about APEC, G20, Belt and Road Initiative and Indo Pacific (EAS base)? Can play an important role in setting of Principles and Norms, priorities, signaling of political will
 - **Malaysia is the Chair of APEC in 2020 (Putra Jaya Vision for APEC beyond 2020), NZ on Implementation 2021 and Thailand on Action in 2022.**
 - **Indonesia Chair of G20 2023**
- Bilaterals with major trading partners e.g. EU and eventually EU-ASEAN:
 - Japan-EU, Vietnam EU
 - In negotiations Indonesia-EU

The importance of safeguarding the MTS

- US-China trade tensions can bring benefit in terms of trade diversion and investment relocation, the short term benefit is greatly outweighed by the uncertainties of the MTS
- **The uncertainties created by the serious threat to the MTS:**
 - ASEAN, NZ, Aust, Japan etc have a great deal at stake with 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 distorting policies

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 WTO-1?
- 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, that will need **strategic and political direction which can come from the G20 Leaders.**
- The direction for reform and prioritizing of issue chosen as ones that will help alleviate current trade tensions internationally, better to deal with them multilaterally rather than bilateral/unilateral
 - in fact some are already included in regional and bilateral agreements (precedence)
- And the new issues which are not in the WTO yet
- There is a clear opportunity for G20, APEC and other fora (Pacific Alliance) to realistically set the direction and principles for these reforms in **good faith and build trust, and** agreement among its members, which will in turn help to bring on board the broader WTO membership through a transparent and inclusive process

Strengthening the WTO: the issues

- Includes those issues that are part of the trade tension internationally (red), completing issues on the table and new issues to keep WTO Relevant (blue). This is a medium and long term agenda, which will be in need of political will and direction through G20 process:
 - Distortions in trading system:
 - Such as **Subsidies**: agriculture (on going), and **industrial (new)**
 - **IPR (strengthening IPR)**
 - Investment issues: investment facilitation (on the table) **and related to technology transfer and more broadly such as localization (new)**
 - **Competition policy and level playing field**, including with regard to **SOEs**
 - **Data Flows and E-Commerce** (77 countries Joint Statement, PM Abe Davos statement on Osaka Track for Data Governance under WTO roof) and data free flows with trust (DFFT)
 - Server localization, moratorium on duties, free flow but standards and systems for privacy and security
 - Begin to look at the **development issue**: differentiated levels of responsibilities and commitments related to level of development