



Background Memo

For Inclusive and Efficient Networking in Asia

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Since 2020, unilateral interventionism in the global economy has increased. Various countries have adopted generally protectionist policies in the financial, trade, and investment systems that depart from the liberalized economic governance mechanisms in operation since the Second World War—and those policies have rattled and divided the global economic order. Although some piecemeal multilateral resolutions were reached at the World Trade Organization’s ministerial conference in 2022, multilateralism is still declining. At the same time, intra- and trans-regional alliances, which are intricately linked to globalization, are accelerating, and discrimination against those outside the alliances is increasing.

In the past, global markets shaped supply chains. Regional supply-chain networks had strong support from various local elements (e.g., labor, land, raw materials, etc.). However, recently, the alliance-based efforts to reshape supply chains through strong centralized interventions rely on more complex means, including subsidies, tariff reductions, and investments, most of which are discriminatory. This is not a supply-chain diversification strategy in the name of resilience, but a politicized attempt to foreclose parts of a regional market.

The Inclusivity of Asian Supply Chains and Economic Integration

Due to the efficiencies of specialized divisions of labor and the flexibility of large-scale collaboration, Asian supply chains are more inclusive and cooperative, and the economic links between countries are more intricate than in other regions. North American and European supply chains do not have the characteristics of this cooperative network. Until recently, the just-in-time model was still successful in Asia. Well-integrated supply chains, abundant and cheap shipping, and data on customer behavior made the model work for companies in Asia, especially in capital-intensive industries such as semiconductor manufacturing. Those factors have allowed the region to develop special advantages and still have even more potential.

In line with the needs of Asian supply-chain networks, regional economic integration has also accelerated over the past decade. The Regional Comprehensive Economic Partnership (RCEP) is undoubtedly a leap forward. It is the largest free trade agreement to date, and its inclusive rules of origin and facilitation regulations accommodate standardized, modular production. RCEP has demonstrated its resilience, even with pandemic disruptions, and its benefits improve regional integration.

Distorting This Model Will Be Costly

The gap between economic development levels and vertical specialization within the region helps guide the still-expanding and deepening Asian supply chains. RCEP's biggest successes are the creation of a general certificate of origin and the establishment of intra-regional accumulation rules, which will directly promote the regional trade of intermediate products, significantly improving the utilization of the preferential tax rates in the agreement. It will also allow multinational companies to implement flexible business plans, which will facilitate intra-regional investment and supply-chain transfers.

The "China plus one" strategy, where companies diversify their investments in China and another country, started around 2010. Companies usually choose to invest in ASEAN countries, which has produced a decade of manufacturing-driven prosperity in Laos, Malaysia, Myanmar, Thailand, Vietnam, and elsewhere. Such intra-regional transfers are dominated by labor-intensive products but will gradually expand to capital-intensive products, a trend that RCEP will reinforce.

However, some new initiatives by small-scale alliances—for example, in semiconductor production—enhance fragmentation and set up discriminatory rules that harm regional integration. In this new round of interventionism driven by the pandemic, the supply chains have become the main target of intervention, and the direct effect could be to decouple and relocate critical regional product supply chains. This intervention has disrupted the original supply chains, greatly distorted the flow of trade and investment, and will heighten uncertainty in the post-pandemic global economic recovery.

Be Inclusive, Not Discriminatory

Asian supply chains can be fortified by promoting the expansion of their production networks, allowing more Asian countries to participate in future development, rather than excluding other countries through small-scale alliances solely based on decisions by some major countries. The just-in-time model's inadequacies and risks, which the trade wars and COVID-19 pandemic underscored, can be lessened in two ways. First, companies should expand the scope of suppliers in the region. Second, they should facilitate the digital integration of regional supply chains. Increasing and deepening the cooperation between Asian supply chains is imperative, taking advantage of network efficiencies, developing intermediate product trade and investment in the region, and simultaneously promoting the next round of RCEP negotiations.