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The East Asian Production Networks under the US-China Confrontation and Trump 2.0

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1. The current situation

- Policy debates in Tokyo and Washington, DC were predominated by national security arguments until 2024.

- Trump 2.0 will bring in
  - The usage of trade policy for protectionism and as a tool for “deals,” and
  - (probably) further escalation of the US-China confrontation.
- Economists must go back to constructive policy making.

- Vigorous economy in third countries such as ASEAN will be the key for setting up a strategy/tactics for Japan and Korea.

2. Taxonomy of supply chain-related policies

- Major policy measures on the US side in 2018-2024
  - 2018-: Tariff war
  - 2020-: Tightening of high-tech export control
  - 2022-: Import ban on forced labor products
  - Sept. 27, 2024-: Raising tariffs on imports from China (EVs, semiconductors, medical products, iron and steel) to protect domestic industries.
  - A series of industrial policy.
- Countermeasures on the Chinese side

- Logic behind for supply chain-related policy was confusing, often simply summarized as “national security reasons.”
  - Need to conduct “economic” analyses and check the conformance with trade rules.
    - Three elements: offensive measures, defensive measures, industrial policy.

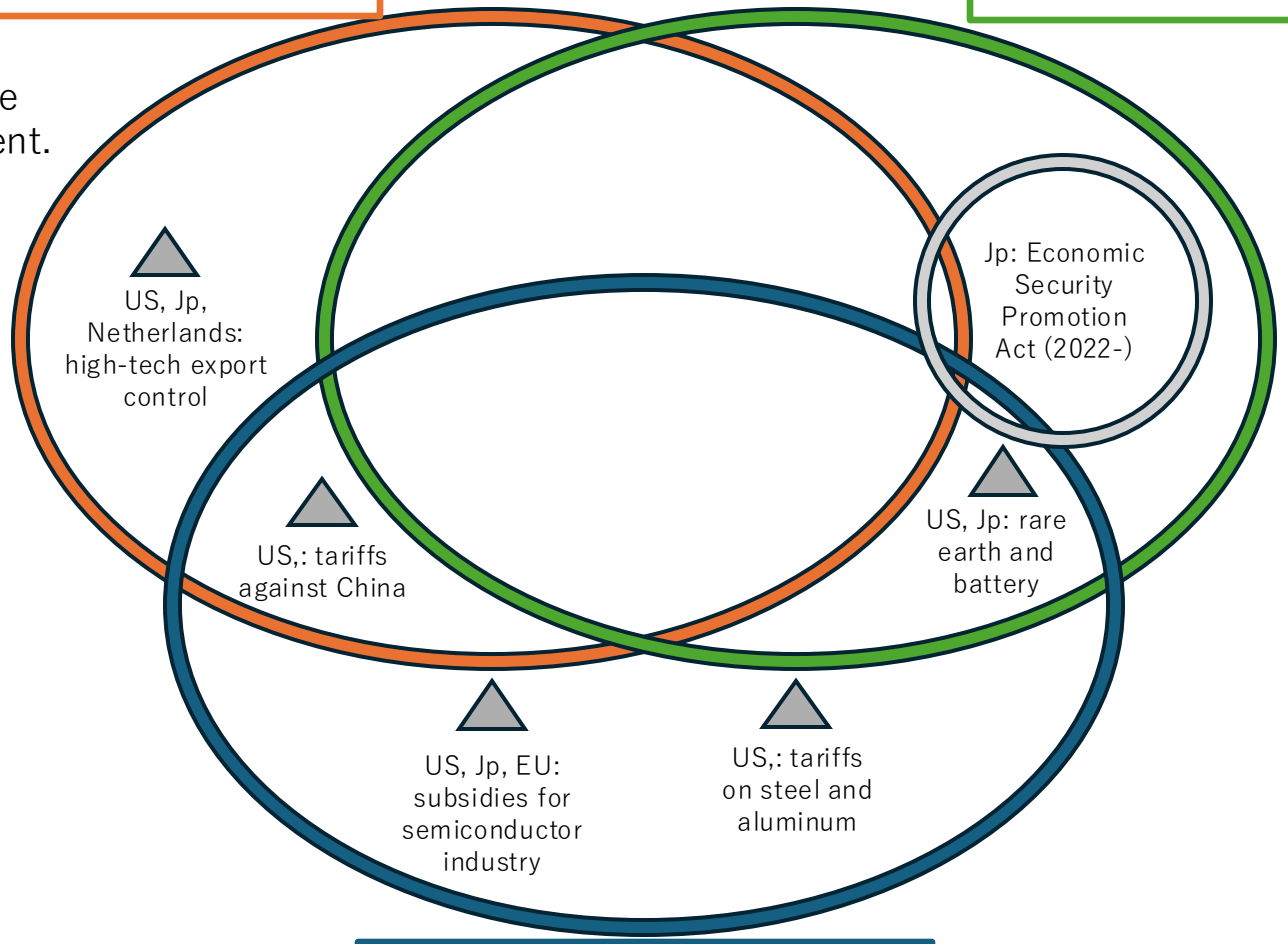
Three elements in supply chain-related policies: 2017-2024

Offensive measures

To strengthen or exercise dominance against the opponent. To strengthen or exercise “strategic indispensability.”

Defensive measures

To prepare for sudden disruption of the supply of “important” items. To strengthen “strategic autonomy.”



Protectionism, industrial policy

To safeguard or strengthen domestic industries

- In Trump 2.0, tariffs are so far at the central stage.
- Tariffs for what?
  - Protection of domestic industry? Policies to reduce trade deficit? “Reciprocal tariffs”?
  - Industrial policy? Technological competition?
  - Tariffs for “deal”?
  - Some domestic resistance in the US exists against tariffs this time.

- Does the US-China confrontation continue?
  - Probably yes, with some room for “deals.”
  - Unstable chemistry in Washington, DC.

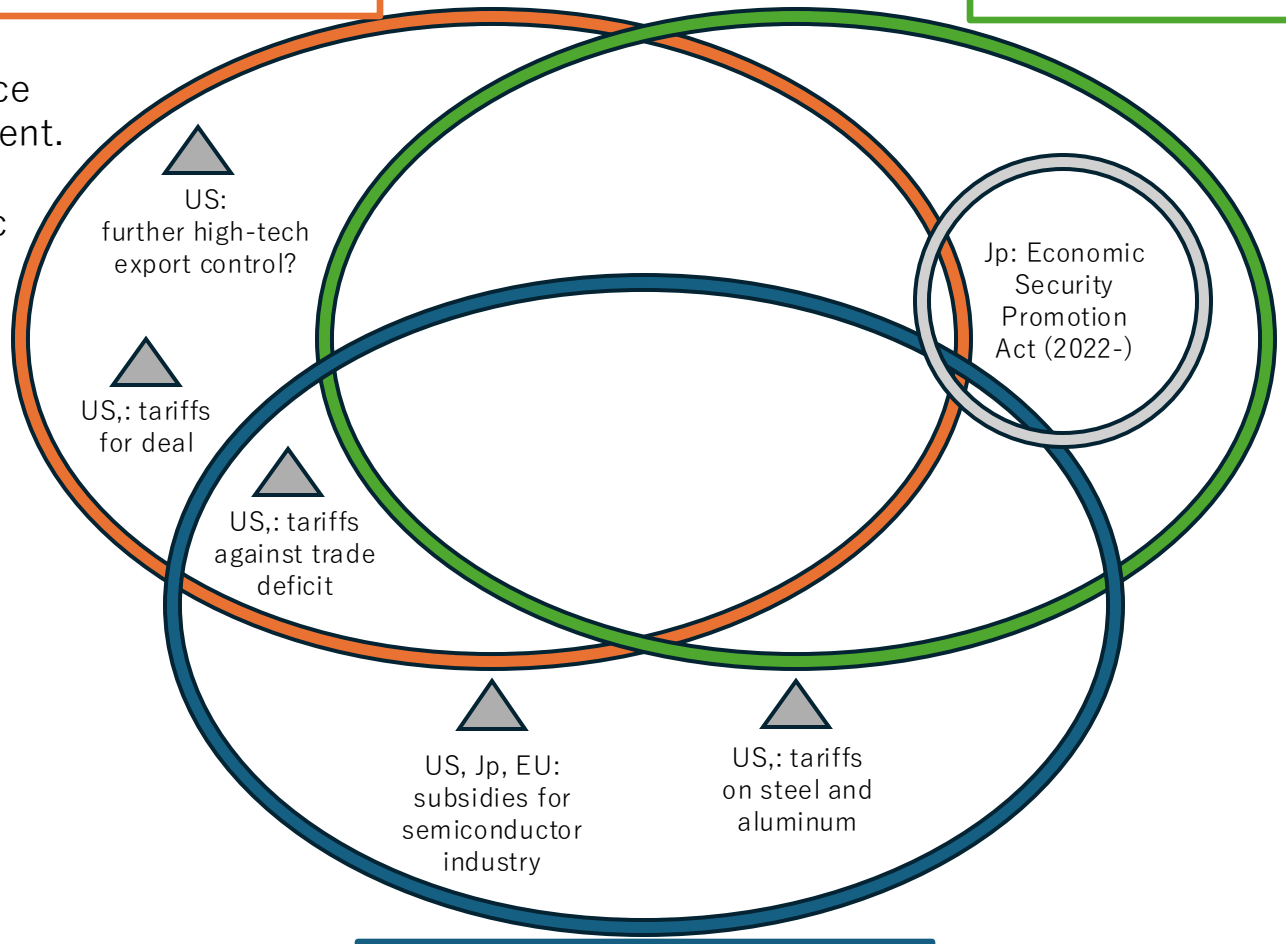
Three elements in supply chain-related policies: under Trump 2.0

Offensive measures

To strengthen or exercise dominance against the opponent. To strengthen or exercise “strategic indispensability.”

Defensive measures

To prepare for sudden disruption of the supply of “important” items. To strengthen “strategic autonomy.”



Protectionism, industrial policy

To safeguard or strengthen domestic industries

3. IPNs and ASEAN

- ASEAN Member States (AMS), particularly the original five plus Vietnam, have been the pioneer of international production networks (IPNs) together with Northeast Asia.
  - Ando and Kimura (2005), Baldwin (2016).
- The level of commitments to machinery IPNs by AMS is high
  - Ando, Kimura, and Yamanouchi (2022).
- AMS have been tightly connected with both China and the Western countries including the US, the EU, Japan, Korea, and Taiwan.
- Machinery IPNs in East Asia have shown their robustness and resilience against temporary shocks including a number of natural disasters and manmade disasters in the past.
  - Obashi (2010), Ando and Kimura (2012), Okubo, Kimura, and Teshima (2014), Ando, Kimura, and Obashi (2021).
  - Supply chain reshuffling means that the private sector perceives “semi-permanent” changes in policy environment.

Gravity equation: actual and predicted machinery trade, 2019

Exporter/Importer	Value (millions US$, %)	China	Japan	Korea	ASEAN	Australia and New Zealand	India	North America	Europe	Rest of the world	Total (World)
China	Actual (A)		75,889	58,515	161,657	7,708	37,831	296,546	249,381	476,571	1,364,100
	Predicted (B)		118,568	65,893	72,285	9,463	50,069	163,984	177,079	295,714	953,054
	(A)/(B) (%)		*64*	*89*	*224*	*81*	*76*	*181*	*141*	*161*	*143*
Japan	Actual (A)	81,031		20,245	59,962	2,582	5,817	126,272	64,669	110,199	470,778
	Predicted (B)	74,293		22,386	21,715	3,928	7,176	64,147	60,411	84,697	338,752
	(A)/(B) (%)	*109*		*90*	*276*	*66*	*81*	*197*	*107*	*130*	*139*
Korea	Actual (A)	84,679	9,161		54,181	744	6,551	66,569	36,682	77,051	335,618
	Predicted (B)	45,860	24,865		8,639	1,307	2,996	21,772	22,348	35,613	163,400
	(A)/(B) (%)	*185*	*37*		*627*	*57*	*219*	*306*	*164*	*216*	*205*
ASEAN	Actual (A)	83,070	39,456	24,559	122,552	4,107	17,733	117,662	83,934	151,101	644,176
	Predicted (B)	39,799	18,528	6,644	45,225	2,846	8,388	34,797	38,940	65,409	260,576
	(A)/(B) (%)	*209*	*213*	*370*	*271*	*144*	*211*	*338*	*216*	*231*	*247*
Australia and New Zealand	Actual (A)	114	57	66	373	11	45	1,215	930	8,395	11,206
	Predicted (B)	2,694	1,766	531	1,521	300	540	7,916	5,269	13,322	33,859
	(A)/(B) (%)	*4*	*3*	*12*	*25*	*4*	*8*	*15*	*18*	*63*	*33*
India	Actual (A)	1,971	792	566	9,107	228		13,273	11,687	27,601	65,224
	Predicted (B)	56,238	12,864	4,836	18,953	2,042		32,905	45,745	87,819	261,402
	(A)/(B) (%)	*4*	*6*	*12*	*48*	*11*		*40*	*26*	*31*	*25*
North America	Actual (A)	63,106	28,621	23,338	43,379	5,678	9,328	617,230	161,678	177,220	1,129,577
	Predicted (B)	105,297	65,732	20,088	42,259	15,982	18,806	591,802	291,501	327,579	1,479,047
	(A)/(B) (%)	*60*	*44*	*116*	*103*	*36*	*50*	*104*	*55*	*54*	*76*
Europe	Actual (A)	144,804	37,144	30,659	64,599	8,846	24,562	286,773	1,517,637	428,107	2,543,132
	Predicted (B)	122,616	66,879	22,266	51,213	11,851	27,976	318,751	1,298,753	542,040	2,462,344
	(A)/(B) (%)	*118*	*56*	*138*	*126*	*75*	*88*	*90*	*117*	*79*	*103*
Rest of the world	Actual (A)	92,501	22,859	16,508	60,029	8,727	21,201	95,207	180,288	192,063	689,382
	Predicted (B)	137,665	59,758	23,082	55,204	17,478	38,627	227,839	380,672	360,433	1,300,757
	(A)/(B) (%)	*67*	*38*	*72*	*109*	*50*	*55*	*42*	*47*	*53*	*53*
Total (World)	Actual (A)	551,277	213,978	174,456	575,838	38,631	123,069	1,620,747	2,306,885	1,648,311	7,253,193
	Predicted (B)	584,462	368,959	165,726	317,013	65,196	154,578	1,463,914	2,320,719	1,812,625	7,253,192
	(A)/(B) (%)	*94*	*58*	*105*	*182*	*59*	*80*	*111*	*99*	*91*	*100*

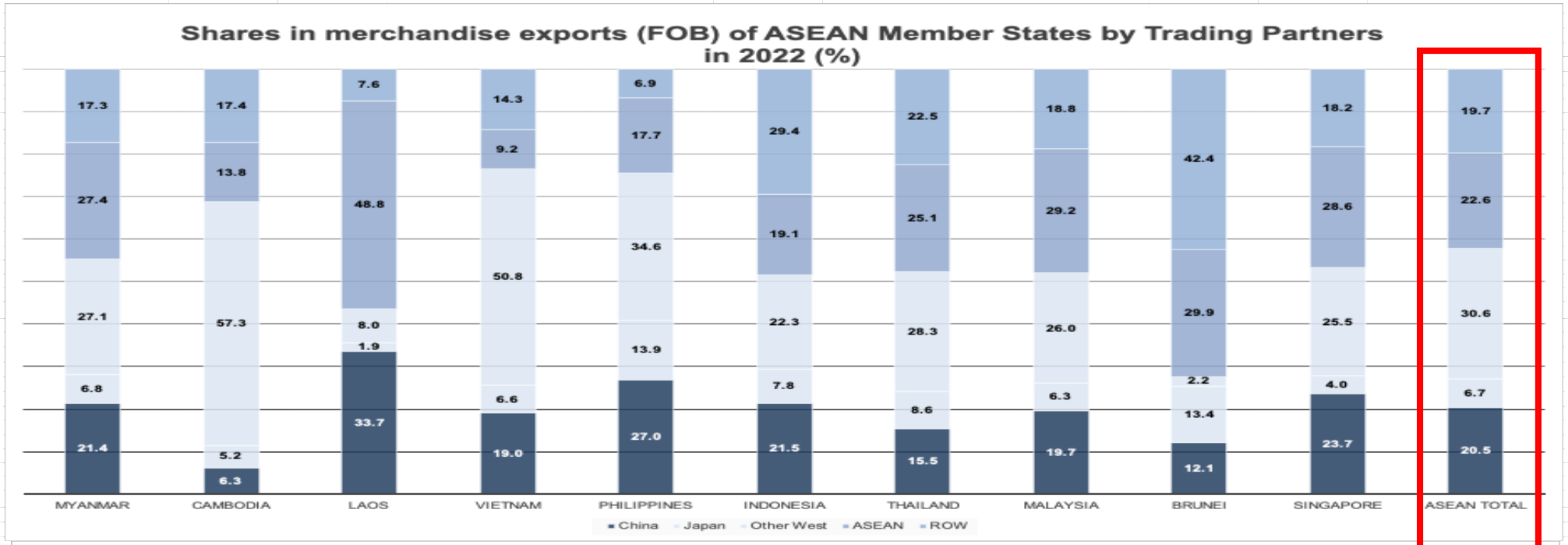
Notes: 'Actual (A)' denotes the actual values of specific country/region pairs, 'Predicted (B)' denotes the corresponding predicted values, and '(A)/(B) (%)' denotes the ratio of actual to predicted values in percentage. North America refers to Canada, Mexico, and the United States; Europe refers to the 27 European Union member countries and the United Kingdom; and 'Rest of the world' refers to 128 countries and regions, including Hong Kong, Macao, and Taiwan. The predicted values for regions are calculated by totalling the member countries' predicted values.

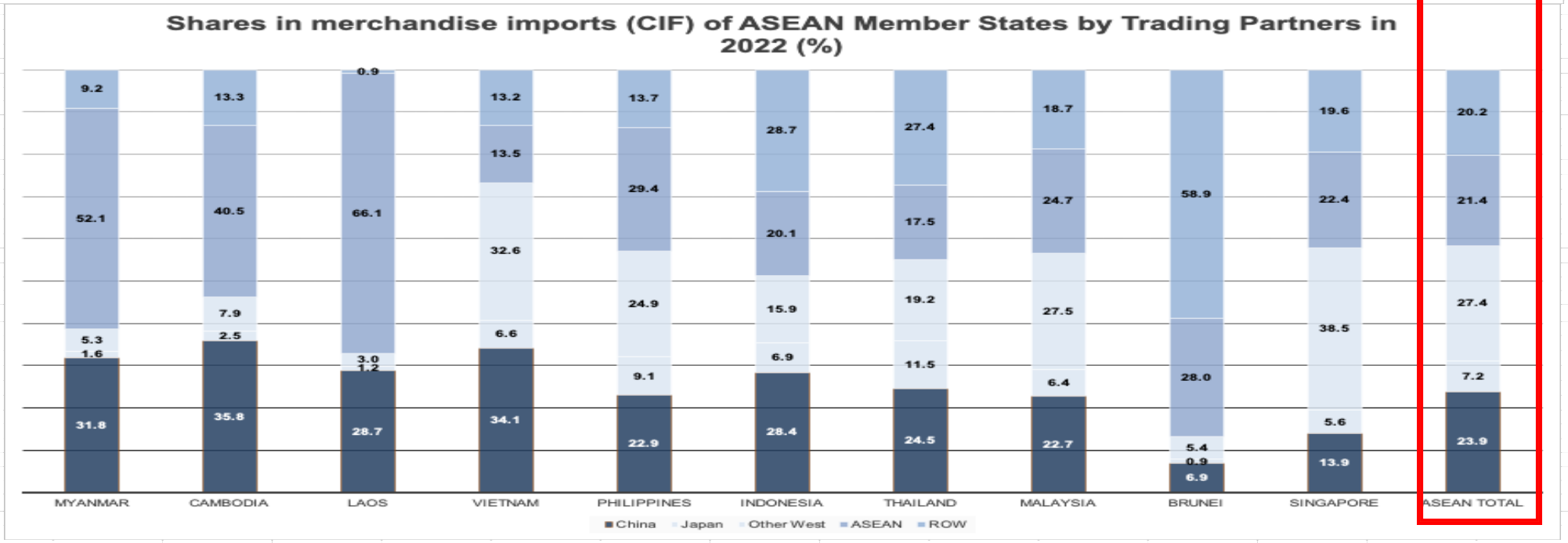
Source: Ando, Kimura, and Yamanouchi (2022).

Gravity equation: actual and predicted machinery trade for ASEAN Member States, 2019

Exporter/Importer	Value (millions US$, %)	Singapore	Brunei	Malaysia	Thailand	Indonesia	Philippines	Vietnam	Laos	Cambodia	Myanmar	ASEAN	China, Japan, and Korea	Total (World)
Singapore	Actual (A)		393	13,234	3,955	5,543	4,543	3,470	30	338	815	32,321	34,364	156,011
	Predicted (B)		128	5,444	678	1,469	274	210	34	59	150	8,446	6,468	34,514
	(A)/(B) (%)		*309*	*243*	*583*	*377*	*1,657*	*1,653*	*88*	*572*	*543*	*383*	*531*	*452*
Brunei	Actual (A)	90		55	4	2	0	4	0	0	0	155	42	250
	Predicted (B)	74		70	25	38	19	10	1	2	6	245	327	1,416
	(A)/(B) (%)	*122*		*79*	*15*	*5*	*1*	*38*	*2*	*0*	*0*	*63*	*13*	*18*
Malaysia	Actual (A)	19,879	110		6,593	1,785	1,609	2,958	8	97	86	33,125	27,355	147,174
	Predicted (B)	8,476	188		1,486	2,124	269	214	36	62	161	13,015	6,308	38,377
	(A)/(B) (%)	*235*	*59*		*444*	*84*	*598*	*1,384*	*22*	*156*	*54*	*255*	*434*	*383*
Thailand	Actual (A)	3,786	49	4,377		3,574	3,860	4,798	915	1,581	827	23,768	22,145	113,417
	Predicted (B)	1,310	82	1,844		1,114	435	513	231	283	538	6,348	11,006	44,997
	(A)/(B) (%)	*289*	*59*	*237*		*321*	*888*	*935*	*397*	*559*	*154*	*374*	*201*	*252*
Indonesia	Actual (A)	3,471	40	1,210	2,311		3,226	1,851	21	91	147	12,367	4,551	30,530
	Predicted (B)	3,323	150	3,087	1,305		691	455	71	109	171	9,361	16,248	70,177
	(A)/(B) (%)	*104*	*26*	*39*	*177*		*467*	*407*	*30*	*83*	*86*	*132*	*28*	*44*
Philippines	Actual (A)	5,852	2	1,497	2,189	473		1,061	0	10	6	11,090	17,663	62,111
	Predicted (B)	608	74	383	499	678		239	32	44	65	2,623	9,235	27,307
	(A)/(B) (%)	*962*	*3*	*391*	*438*	*70*		*445*	*0*	*23*	*9*	*423*	*191*	*227*
Vietnam	Actual (A)	1,718	20	1,493	2,535	1,122	1,073		105	295	244	8,606	40,332	131,657
	Predicted (B)	492	40	322	623	472	252		225	162	85	2,674	11,129	28,431
	(A)/(B) (%)	*349*	*51*	*464*	*407*	*238*	*425*		*47*	*182*	*286*	*322*	*362*	*463*
Laos	Actual (A)	6	0	8	397	4	0	27		1	0	444	82	770
	Predicted (B)	45	3	30	159	42	19	127		17	19	462	814	2,460
	(A)/(B) (%)	*13*	*0*	*28*	*250*	*9*	*0*	*21*		*8*	*1*	*96*	*10*	*31*
Cambodia	Actual (A)	8	0	16	202	1	62	47	1		2	341	346	1,403
	Predicted (B)	91	6	62	225	74	30	107	19		10	624	658	2,906
	(A)/(B) (%)	*9*	*0*	*27*	*90*	*2*	*206*	*44*	*7*		*18*	*55*	*53*	*48*
Myanmar	Actual (A)	133	0	13	113	6	11	60	0	0		336	205	852
	Predicted (B)	304	19	209	564	153	60	74	30	13		1,426	2,777	9,993
	(A)/(B) (%)	*44*	*0*	*6*	*20*	*4*	*19*	*81*	*0*	*1*		*24*	*7*	*9*
ASEAN	Actual (A)	34,944	614	21,904	18,299	12,510	14,385	14,276	1,082	2,412	2,126	122,552	147,085	644,176
	Predicted (B)	14,723	690	11,451	5,563	6,163	2,050	1,948	679	752	1,205	45,225	64,971	260,576
	(A)/(B) (%)	*237*	*89*	*191*	*329*	*203*	*702*	*733*	*159*	*321*	*177*	*271*	*226*	*247*
China, Japan, and Korea	Actual (A)	49,071	427	34,230	41,200	31,174	25,148	86,404	995	2,485	4,664	275,800	329,520	2,170,496
	Predicted (B)	18,495	1,609	11,602	16,517	20,509	11,853	14,692	1,893	1,236	4,234	102,639	351,865	1,455,207
	(A)/(B) (%)	*265*	*27*	*295*	*249*	*152*	*212*	*588*	*53*	*201*	*110*	*269*	*94*	*149*
Total (World)	Actual (A)	154,458	1,729	86,621	81,632	58,174	57,501	119,042	2,257	6,313	8,112	575,838	939,711	7,253,192
	Predicted (B)	72,025	5,168	47,512	50,633	65,241	27,378	28,933	4,342	4,069	11,713	317,013	1,119,147	7,253,192
	(A)/(B) (%)	*214*	*33*	*182*	*161*	*89*	*210*	*411*	*52*	*155*	*69*	*182*	*84*	*100*

Source: Ando, Kimura, and Yamanouchi (2022).





Notes: China includes Hong Kong and Macao. Other West consists of the US, EU, Korea, and Taiwan.

4. Policy tools #1: tariffs

(1) Economics of tariffs

- Tariffs: powerful policy tool to restrict trade, but the most transparent and clear-cut protection policy if they are used in a normal way (esp. in terms of ROO)

(a) Benchmark model

- Perfect competition, partial equilibrium, small country, perfect substitutes

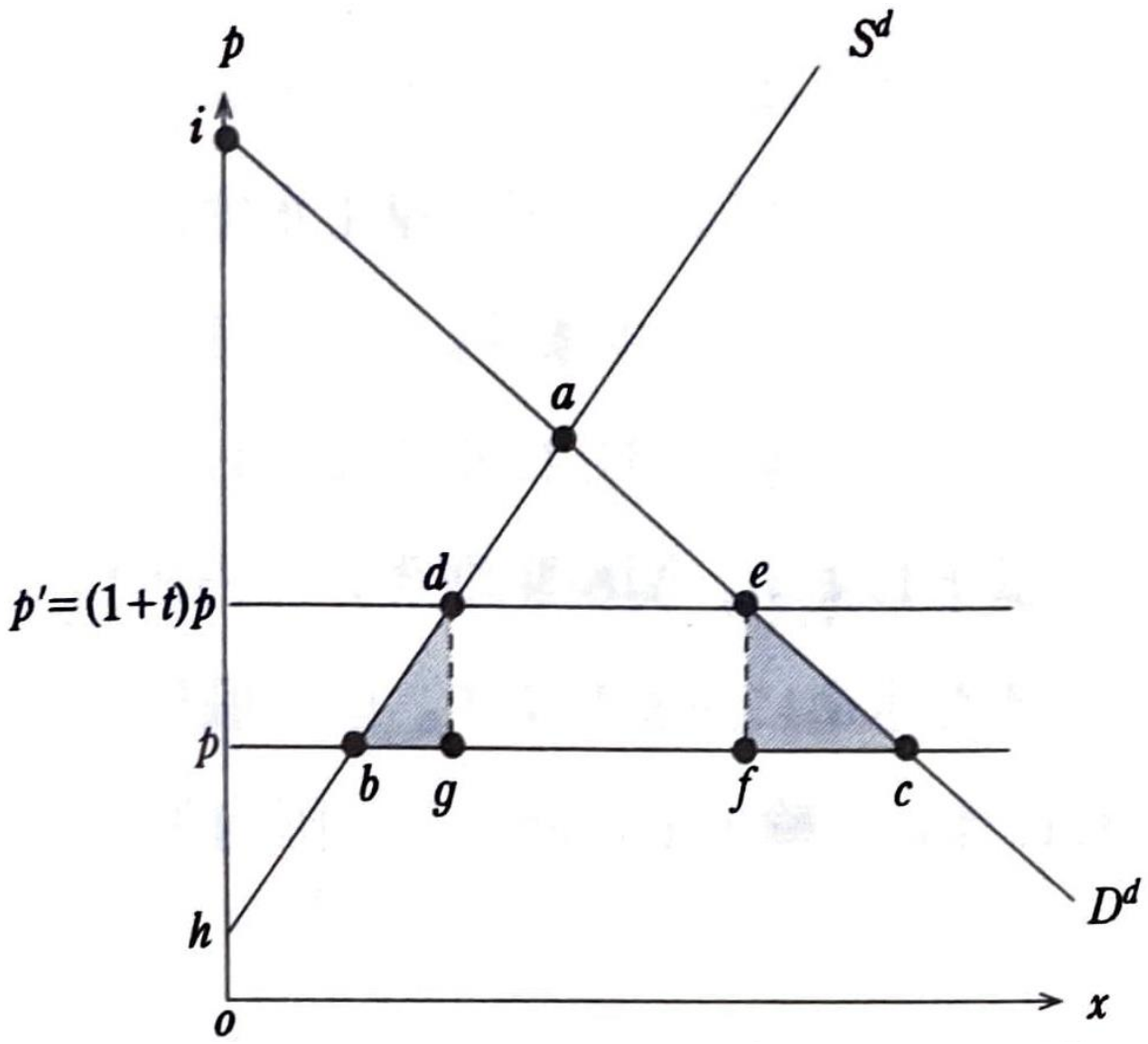
(b) Discriminatory tariffs: FTA/CU model for a bilateral tariff war

(c) Tariff-jumping/quid-pro-quo FDI model

(a) **Benchmark model**

assuming

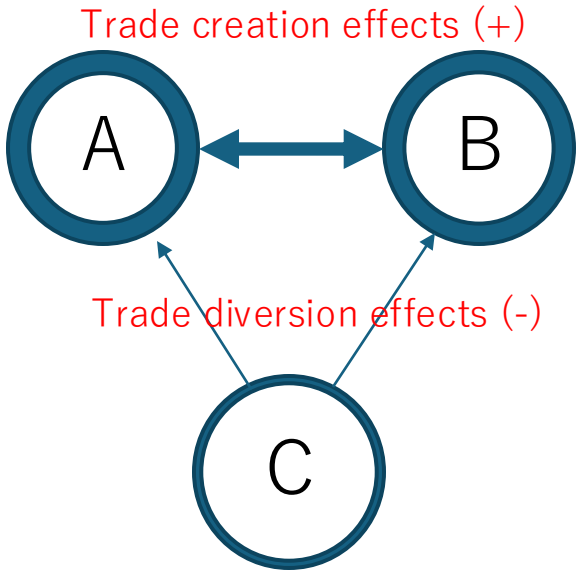
- Perfect competition
- Partial equilibrium
- Small country
- Perfect substitutes between domestically produced goods and imported goods



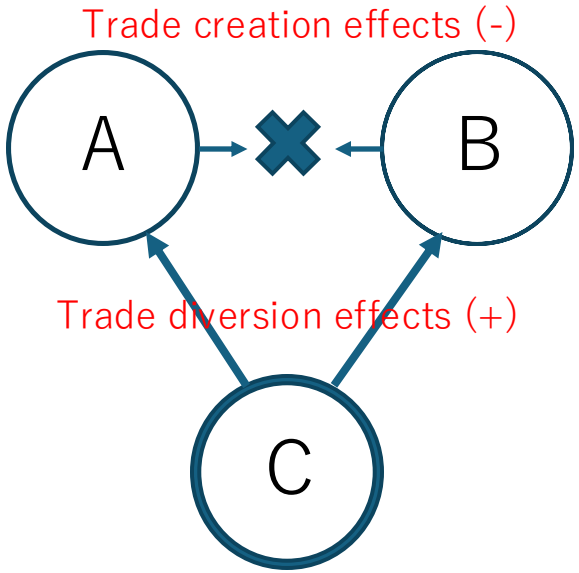
Cf. Amiti, Redding, and Weinstein (2020): tariff passthrough = 100% in Trump 1.0

(b) FTA/CU model and a tariff war: economic effects on the third country

(a) Free trade agreement

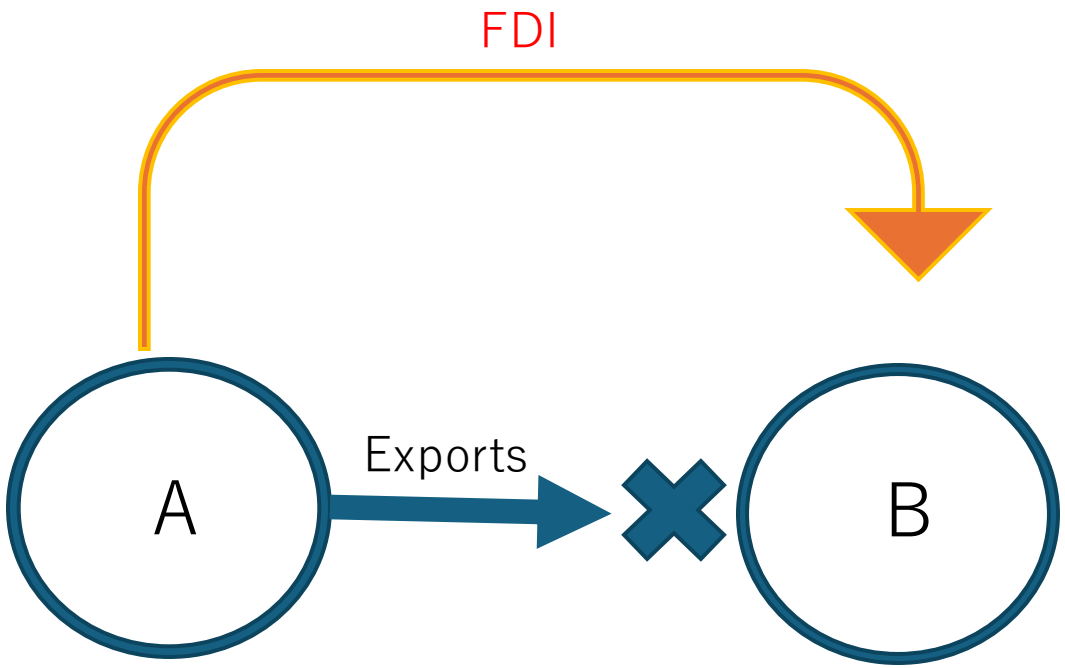


(b) Bilateral tariff war



- Economic effects of tariff war is equivalent to those of a “negative” free trade agreement (FTA).
  - Trade creation effects: big negative between country A and country B, some negative spillovers to country C.
  - Trade diversion effects: possibly positive for country C
- With foreign direct investment (FDI), “investment diversion” would also occur.

(c) Tariff-jumping/quid-pro-quo FDI model



(2) Empirical studies on Trump 1.0 tariffs

- Tariff pass-through on the US side is high (Amiti, Redding, and Weinstein 2020); tariffs are borne by the US consumers (Mr. Trump: “I’m a tariff man!”).
  - However, due to the large domestic economy and some trade diversion, the US consumers do not feel the cost much…(see Costinot and Rodriguez-Clare 2018).
- A series of empirical studies present that positive trade diversion effects benefit some third countries including Taiwan, Mexico, the EU, and Vietnam, by increasing exports to the US.
  - e.g., Nicita (2019), Fajgelbaum et al. (2024), Hayakawa, Pyun, Yamashita, and Yang (2024); Taiwan: Yang and Hayakawa (2023); Mexico: Ando, Kimura, and Yamanouchi (2024), Utar, Zurita, and Ruiz (2023)
  - Depending on location advantages (including political stance) and the position in GSCs
- Kumagai, et al. (2023) conduct a simulation analysis with the Geographical Simulation Model and show that the East-West sharp decoupling may still generate positive trade diversion effects on some neutral countries such as ASEAN Member States (AMS).
  - Assuming that neutral countries can continue normal businesses.

(3) What would happen with Trump 2.0 tariffs?

- Three points that we expect on the US tariff policy
  - Tariffs are heavily used as a tool for deal; the third countries may also suffer from the US tariffs.
  - However, tariff differentials between China and other countries are likely to stay.
  - Due to domestic resistance in the US, the US tariffs may become country-specific and sector-specific rather than uniform/MFN tariffs.
- Likely strategies of ASEAN (and other third countries)

  *(a) Responding to tariff differentials, AMS would continue to exploit "positive trade diversion effects." [dominant strategy so far]

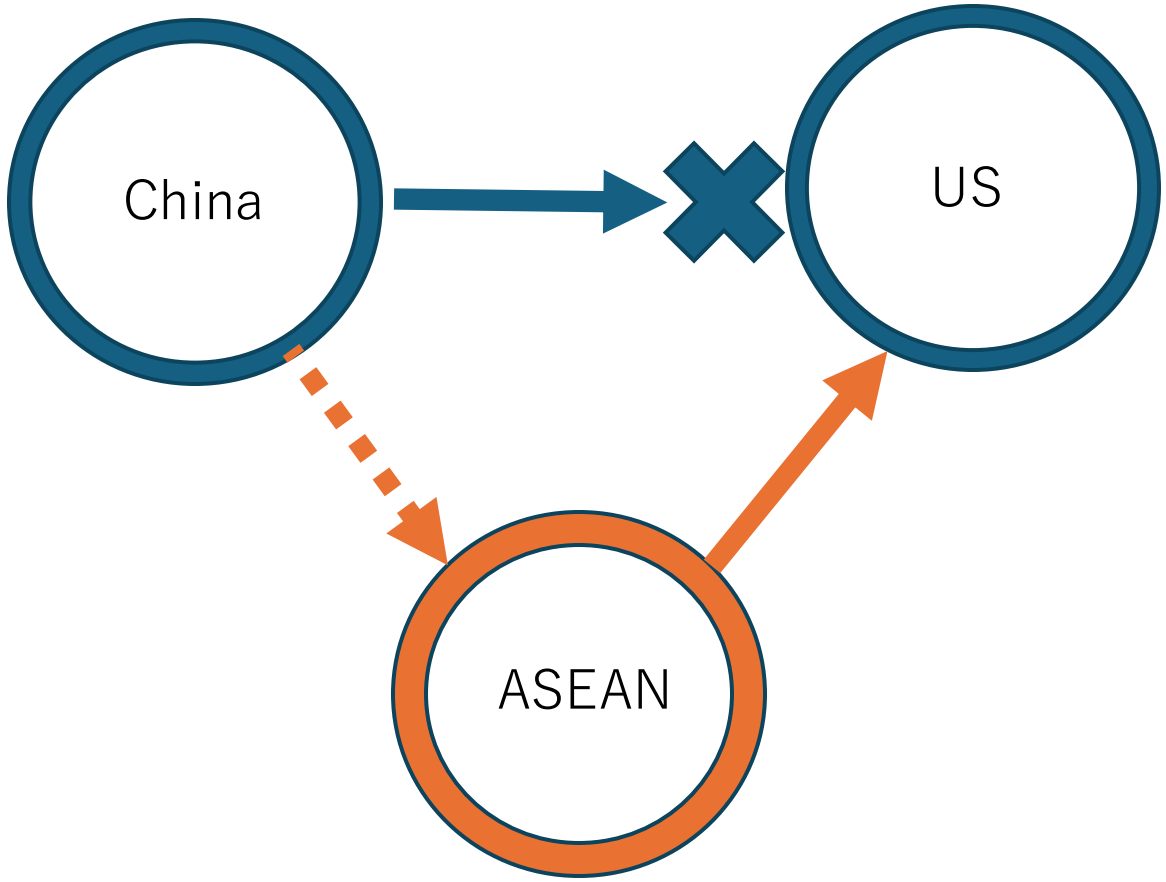
  (b) Anticipating possible tariff imposition by the US, AMS would seek the possibility of "diversification of export destination."

  (c) Preparing possible flooding-in imports for electric vehicles and others due to other countries' protectionism, some of the AMS would consider "the introduction of safeguards."

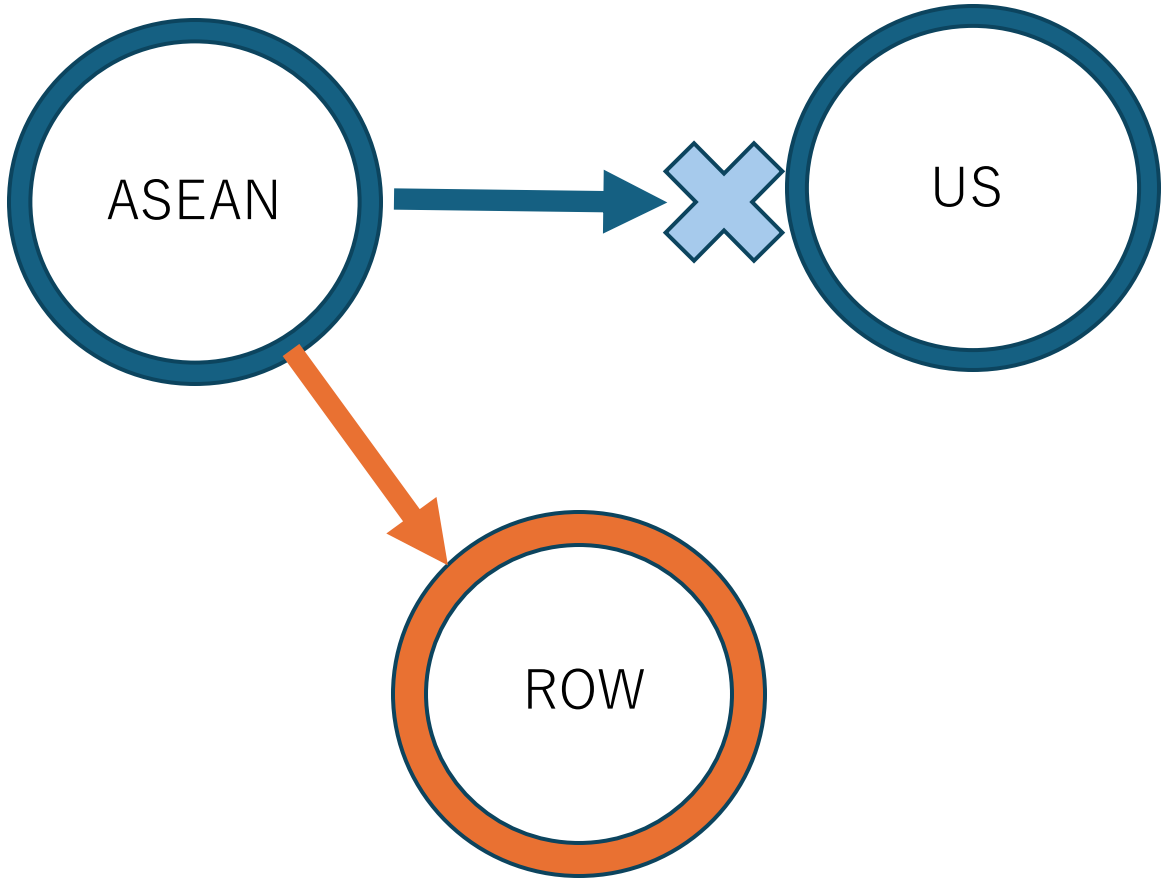
  (d) Some AMS would explore the US market by strengthening exports and FDI (particularly by multinationals located in ASEAN).

Possible responses by the third countries (ASEAN) to Trump 2.0

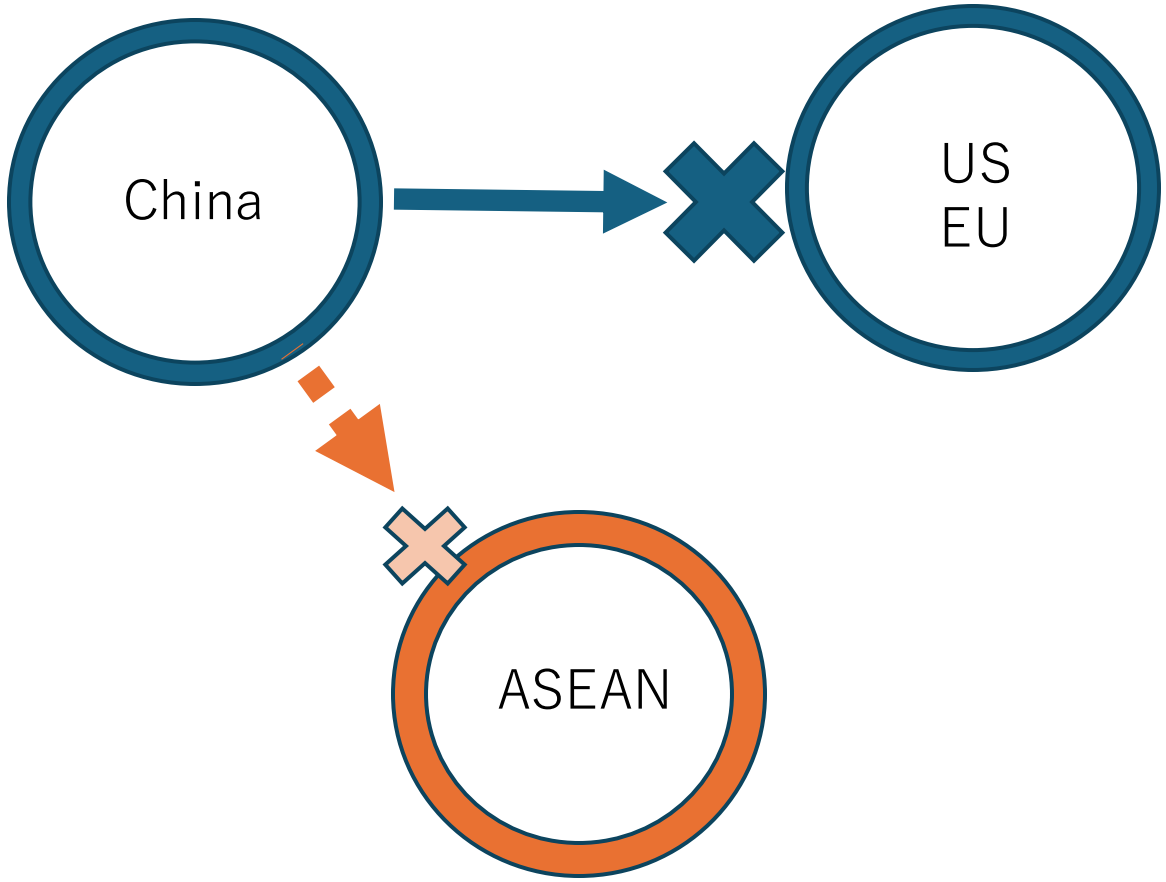
(a) To exploit “positive trade diversion effects”



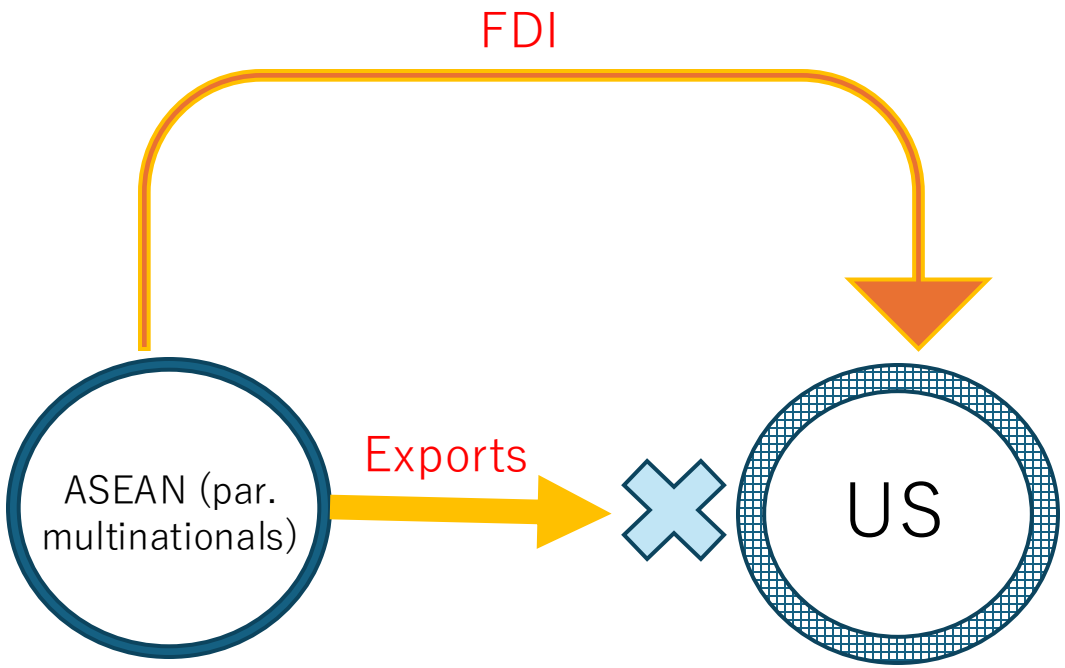
(b) Diversification of export destination



(c) Safeguards against flooding-in imports (e.g., EVs)



(d) Strengthening exports and FDI to capture the US market



5. Policy tools #2: high-tech export control

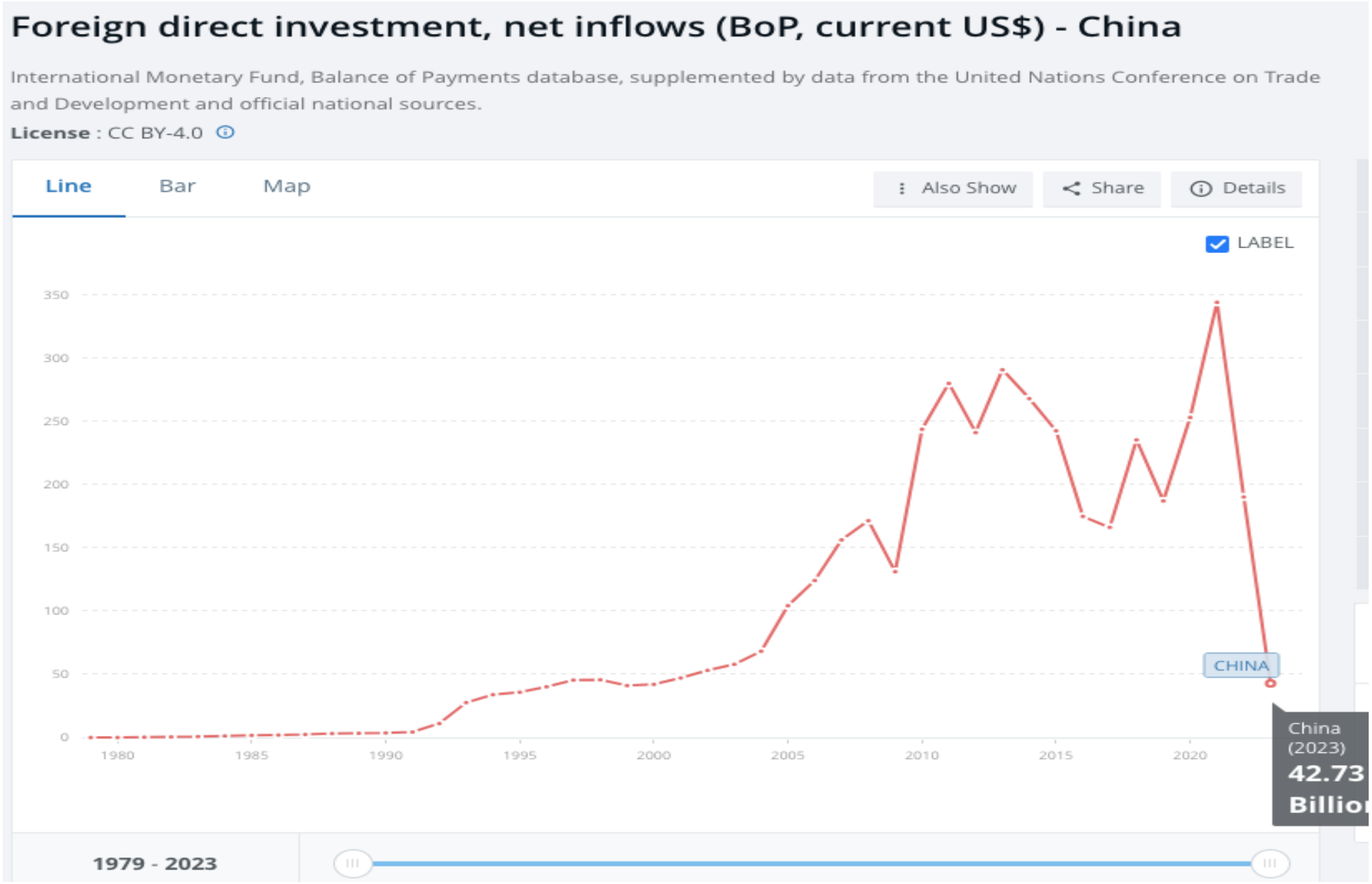
(1) What happens so far?

- The US policy related to supply chain decoupling
  - August 2018: strengthened export controls from the perspective of national security.
  - May 2019: added Huawei and its 68 affiliates to the Entity List (EL).
  - May 2020: requested firms (even outside the US [extra-territoriality]) to obtain prior permission of the exports of "direct products (using US-origin tech. or software)" if used in the production or development of chipsets and others designed by Huawei.
  - August 2020: requested prior authorization for exports to be used for the production or development of chipsets purchased or ordered by Huawei or its affiliates; particularly for foreign-produced items that are capable of supporting the development or production of telecom systems, equipment, and devices of the 5G level (including "indirect inputs").
  - December 2020: added Semiconductor Manufacturing International Corporation (SMIC) to the EL.
  - August 2022: CHIPS Act was introduced (in exchange of receiving subsidy, the expansion or renewal of production capacity of high-end semiconductors in China is banned).
  - Oct. 2022: introduced export control in terms of the end-use (including any firm in China) for the development, production, or others of super computers or high-end semiconductors in China.
  - December 2022: added more than 30 Chinese firms to the EL. Further expansion of the EL followed.
  - …
- Japan's export controls
  - March 2023: Japan announced the introduction of export control on semiconductor manufacturing equipment (plan to start in July 2023). Cf. The Netherlands had already introduced export control.
    - To cover items without using the US technologies.

(2) Assessment

- The purpose of the policy is to restrict flows of cutting-edge technologies.
- Extraterritoriality is partially imposed.
- Measures by the US include restrictions on FDI and the movement of people.

- Trade effects of export control are so far limited within the detailed product level (below HS 6 or 9-10 digit level).
  - DID analysis by Ando, Hayakawa, and Kimura (2024a, 2024b) and Hayakawa, Kimura, and Yamanouchi (2024) for (i) an entity list control for Huawei by the US in 2020, (ii) a control for semiconductor manufacturing by the US in 2022, and (iii) a control for semiconductor manufacturing equipment by Japan in 2023, respectively.
- However, chilling effects due to policy uncertainties in the short and middle run may become serious.
  - Inward FDI by the BOP statistics in China dropped in 2023.



Source: World Bank Open Data.

(3) Further export control?

- From the viewpoint of ASEAN, direct effects of the US (and other) export control do not seem to exist so far.
  - Production plants located in AMS are not involved in real high-end semiconductor-related production yet.
  - Cf. A case of Singapore and Malaysia on possible circumventing high-end semiconductor
- Some AMS, notably Malaysia and Vietnam, recently attract new investment in semiconductor industry and try to upgrade their position in global value chains (GVCs).
- FDI in data centers is also active in Singapore, Malaysia, Thailand, and others.
- Once stepping into real high-tech, however, AMS may need to make its political stance clearer.
- To retain a vigorous economy, the “fence” between the restricted economy and the rest of the economy must be shown as clearly as possible to reduce policy uncertainties.

6. How to deal with “the US tariffs for deal”?

- The EU and Canada seem to choose confrontation and impose retaliatory tariffs.
  - Can/Should we (Japan and Korea) follow them?? Is it effective??
- The US prefers bilateral deals.
  - Can we make negotiations collective??

- Voice for retaliation is weak in Japan.

- Do we want the US to stay in international forums such as WTO?
- How far do we value the rules-based trading regime?

- Perhaps, we must prioritize the national security argument.

7. How to defend the rules-based trading regime?

(1)Weakening of the rules-based trading regime

- Some of the recently introduced trade/industrial policies in the G7 (and China) are inconsistent with their WTO commitments or conventional trade norms.
  - These moves are weakening the rules-based trading regime.
- Some countries in the Global South also start introducing policies that seem to violate trade norms.
  - The issue of the WTO Appellate Body (AB) affects the policy discipline.
    - The US blockage of the appointment of AB members stops AB to work.
  - 25 cases have become “appeal into void” by the end of 2024.
    - E.g., India in tariffs on ICT products (DS584), Indonesia in export ban on nickel (DS592)
  - The number of WTO DS cases reduced after 2020.
    - The number of cases per year: 19.1 cases in 2010-2019, 7.6 cases in 2020-2024.
- The rules-based trading regime must be retained at least for the “rest” of the economy.

(2) Supporting the WTO

- Voice to support the WTO is substantially weakened in the US; middle powers including ASEAN must be proactive to reconfirm its value.

- Issue 1: dispute settlement mechanism
  - The Appellate Body issue must be taken care of.
  - The expansion of membership of MPIA (Multi-Party Interim Appeal Arbitration Arrangement) must be promoted in Asia.
    - The current members in extended East Asia: Japan (March 2023-), China, Hong Kong, Macao, Philippines (May 2024-), Singapore, Australia, and New Zealand (https://wtoplurilaterals.info/plural_initiative/the-mpia/)

- Issue 2: WTO as a rule maker
  - Cooperation in JSI (Joint Statement Initiatives) can be enhanced.
    - Particularly, JSI on e-commerce is important.
      - 91 WTO members are participated, 71 members submitted a joint proposal to the General Council of the WTO (including Japan and Korea).

(3) Promote regional initiatives

- The link among AMS can be further strengthened.
- RCEP (Regional Comprehensive Economic Partnership) can be utilized for
  - Supporting the rules-based trading regime
  - Reducing policy uncertainties for the private sector
- The second pillar of IPEF (Indo-Pacific Economic Framework for Prosperity) may reduce policy uncertainties if it survives.
- Any move to promote the rules-based trading regime must be supported.
  - E.g., Indonesia's interest in OECD (Feb. 2024) and CPTPP (Sept. 2024) with its aspiration for 2045
    - CPTPP
      - Pro-trade gathering of middle powers (without the US or China)
      - Costa Rica started accession negotiation in Nov. 2024.
    - OECD
      - Less binding setting but a good basis of overall policy reform toward fully developed economies.
      - Indonesia (Feb. 2024) and Thailand (June 2024) started accession discussions.
        - Recent new members: Latvia (2016), Lithuania (2018), Colombia (2020), Costa Rica (2021)
        - Under negotiation: Argentina, Brazil, Bulgaria, Croatia, Indonesia, Peru, Romania, Thailand
      - OECD Secretary-General: switched from Jose Angel Gurria (Mexico) to Mathias Cormann (Belgium->Australia) in June 2021.
  - Acceleration of FTA negotiations with the EU, Canada, and others by AMS.

(4) New rules needed in the middle and long run?

- At the end, China must get involved with the rules-based trading regime.
- A question is how the current issues could be resolved by the rules.
  - State-owned enterprises
  - Digital governance
  - “National security exceptions” in the context of trade rules
    - Interpretation of GATT XXI: from self-judgment to disciplined borderline
      - Panel decisions on Russia transit transport (DS512, 2019), the US Section 232 (DS544+, 2022).
    - May need to set a borderline of national security exceptions for each individual policy mode.
  - “Subsidy + over-production” vs. “Marshallian externalities +adjustment costs + international income distribution”
    - Current argument on iron and steel, solar panels, EVs, and others.
    - Different economic logic would apply. May need new trade rules.
    - Responses by the US, the EU, and other countries.

8. Way forward

- The third countries including Japan, Korea, and AMS must take advantage of the market mechanism to minimize negative effects of distorted policies.

- Japan and Korea should get together with pro-trade third countries such as AMS to retain the rules-based trading regime as widely as possible.

- Japan and Korea need to show more presence in ASEAN to back up the losing credibility of the US (e.g., Gaza, USAID, …) and keep a good balance between the East and the West.

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