

Section 5

ECONOMIC STRATEGIES OF JAPAN AND JAPANESE COMPANIES TOWARD SOUTHEAST ASIA

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1. Supply Chains and the ASEAN under the U.S.-China Conflict

How have geopolitical tensions, particularly the U.S.-China conflict, affected supply chains in East Asia, including Northeast and Southeast Asia?

The first major policy tool in the U.S.-China conflict was tariffs: in July 2018, the U.S. Trump administration imposed high tariffs on some Chinese imports, and China retaliated by imposing tariffs on U.S. imports. This was followed by several rounds of mutual tariffs on a wider range of items in the so-called tariff war. Most of these tariffs have remained in place since the Biden administration took office.

Many researchers have conducted empirical studies on the effects of the tariff wars on supply chains. What has been confirmed is that the economic effects are the same as if the two countries had concluded a “negative free trade agreement.” In other words, trade between the U.S. and China has decreased significantly due to the “negative trade creation effect,” and the world economy has also been negatively affected. However, since countries other than the U.S. and China could continue to trade with both countries, some countries enjoyed a “positive trade diversion effect.” What we want to know here is what happened to exports to the U.S. by East Asian countries other than China. According to Hayakawa (2024), exports to the U.S. from Japan and Korea did not increase, while those from Taiwan and the Association of Southeast Asian Nations (ASEAN) increased significantly. Likely, the main actors behind the increase in exports to the United States from ASEAN countries were not Japanese companies, but rather Korean, Taiwanese, and Chinese companies¹⁾. While overtly diverted exports from China to the U.S. via ASEAN may not be that large, the pattern of importing intermediate goods from China, processing them, and then exporting them to the U.S. is thought to have reached a considerable scale.

1) In the case of Japanese companies, under the China Plus One strategy, the proportion of using China as a platform for exports to the U.S. is low, and most sales to the U.S. are conducted by Japanese subsidiaries in the U.S., so the impact of the U.S.-China tariff war is thought to have been small.

Tariffs are typical policies restricting international trade, distorting the market mechanism, and creating inefficiencies. They are, however, the most transparent of trade-restrictive policies and their economic effects are predictable, enabling private companies to respond appropriately in a sense.

On the other hand, it is difficult to see the policy effects of high-tech export controls, which have been in full swing since 2020 and played a leading role in the second act of the U.S.-China conflict. To what extent have export controls by the U.S. and Japan, which followed suit, reduced trade? The actual number of transactions for which exports have been suspended has not been disclosed for security reasons, and thus the impact on trade has not been empirically measured. The authors attempted to quantitatively understand the impact of tighter export controls on trade using detailed monthly international trade data by product category²⁾. We found that the impact of tighter export controls on trade is not large enough to be detected at the macro-industry level, and is limited to impacts on a more granular level than the most detailed commodity categories. While controls on exports to China may indeed be tightening, trade in adjacent items is decreasing in some cases and increasing in others. The blocking of U.S. technology outflows may in fact be accelerating new investment in China, and this may be increasing Chinese imports, reflecting a rush demand in anticipation of further expansion of export controls. In addition, few exports from ASEAN to China are currently considered to be subject to control, even though U.S. export controls also apply to exports from outside the U.S. (a kind of extra-territorial application).

It is important to note here that the impact of stricter export controls may be more serious than the direct effect of the policy itself, as it may cause a contraction in economic activity due to uncertainty about the current and future expansion of the restrictions. China's inward FDI fell 81.7% year on year to \$33 billion in 2023, shocking many pundits³⁾. Although this figure should be interpreted with caution because it is a preliminary figure based on the balance of international payments statistics, it is at least possible that the capital flow of new FDI to China has slackened to a considerable degree. FDI, rather than trade, may have reacted earlier as a response to uncertainty about the future.

2) See Ando, Hayakawa, and Kimura (2024a, 2024b) and Hayakawa, Kimura, and Yamanouchi (2024). These papers analyze the impact on trade (especially exports to China) of the U.S. tightening controls on exports to Huawei in August 2020, the U.S. tightening controls on exports of advanced semiconductors and supercomputer-related products in October 2022, and Japanese tightening of controls on exports of semiconductor manufacturing equipment in July 2023, respectively.

3) By JETRO (2024a).

The policy implications of this are significant. Appropriate policies for security are necessary under the current geopolitical tensions. However, if we believe that the decoupling of the Chinese economy will ultimately be only partial, it is also important to avoid unnecessary contraction of economic activity due to current and future policy uncertainty. As it is not easy to push back the logic of security with the logic of economies, both the U.S. and China, or the East and West, need to make efforts to minimize the uncertainties that the private sector faces by setting as clearly as possible a “fence” between the part of the economy that is subject to regulation and the rest that is left free⁴⁾.

In addition, we should not forget that, as the power relationship between the U.S. and China changes, emerging and developing countries that do not align themselves with either side and remain neutral comprise the majority of the world. ASEAN countries are a typical example. Japan and Japanese companies are being asked what kind of strategies they should adopt in dealing with such countries and regions.

2. ASEAN Economic Growth and China's Presence

(1) Asia Showing Steady Growth

The following is an overview of the current state of the Asian economy, with particular attention to ASEAN.

In 2023, developed countries were forced to put out the fire of high inflation after the new Corona, but supported by the strong U.S. economy, the economic growth rate was only 1.6%, a smaller decline than initially expected. Meanwhile, emerging and developing countries achieved 4.3% growth (according to IMF (2024)). Asian countries also continued to show solid growth, with East Asia growing at 4.7%, Southeast Asia at 4.1%, and South Asia at 6.4% in 2023 (see Table 1-5-1).

China's domestic economic malaise has been widely reported, including the real estate bubble bursting, but statistics still indicate that the country achieved 5.2% growth in 2023. The Asian Development Bank (ADB) expects growth to remain in the low 4 percent range in 2024 and 2025, which is perhaps a bit more optimistic than most forecasts, but generally solid. The forecasts for 2024 are 6.0% for the Philippines and Vietnam, 5.8% for Cambodia, 5.0% for Indonesia, and

4) The word “fence” was used by Jake Sullivan, National Security Advisor to the President, in a speech on April 27, 2023. There, he said that export controls on China are intended to be “with a small yard and a high fence.” He expressed his desire to achieve a political balance between those who value security and the logic of economies, but unfortunately, he has yet to clarify the position of the “fence” for the future.

Table 1-5-1

Economic growth rates of developing Asian regional economies:
Actual and forecast (%)

	2022	2023	2024 (f)	2025 (f)
East Asia Total	2.9	4.7	4.5	4.2
China	3.0	5.2	4.8	4.5
Korea	2.6	1.4	2.2	2.3
Taiwan	2.6	1.3	3.0	2.7
Southeast Asia Total	5.7	4.1	4.6	4.7
Brunei	-1.6	1.4	3.7	2.8
Cambodia	5.2	5.0	5.8	6.0
Indonesia	5.3	5.0	5.0	5.0
Laos	2.5	3.7	4.0	4.0
Malaysia	8.7	3.7	4.5	4.6
Myanmar	2.4	0.8	1.2	2.2
Philippines	7.6	5.6	6.0	6.2
Singapore	3.8	1.1	2.4	2.6
Thailand	2.5	1.9	3.4	4.1
Vietnam	8.0	5.0	6.0	6.2
South Asia Total	6.6	6.4	6.3	6.6
Bangladesh	7.1	5.8	6.1	6.6
India	7.0	7.6	7.0	7.2

Note: East Asia total, Southeast Asia total, and South Asia total include countries other than those listed separately.

Source: ADB (2024)

4.5% for Malaysia. South Asia is expected to show further growth potential, with India and Bangladesh respectively projected to account for 7.0% and 6.1% of the total in 2024.

While the global economy is subject to geopolitical tensions and other hardships, Asia is expected to grow steadily.

(2) ASEAN Trade and Its Partners

At the core of ASEAN's strong economic growth are international production networks (IPNs), and ASEAN is the region with the highest level of involvement in IPNs, or the international division of labor in terms of production processes or tasks, in the world, especially in the machinery industry⁵⁾. Trade and investment are more important in ASEAN than in any other developing region.

Figure 1-5-1 shows ASEAN's imports and exports in 2019-22, broken down

5) Ando, Kimura, and Yamanouchi (2022) fit a gravity model to a trade matrix for machinery and quantified the high involvement of ASEAN in IPNs by comparing actual machinery trade values with theoretically expected values.

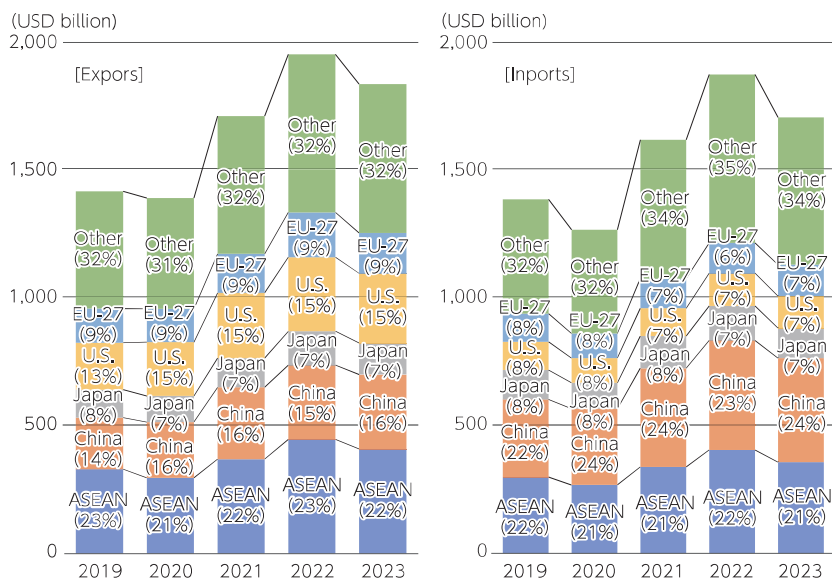


Figure 1-5-1

Exports and imports of ASEAN countries by partner country/region

Source: ASEAN Secretariat HP, JETRO (2024b)

by partner country share. First, it is important to note that the drop in trade due to the new Corona virus was small: the decline from 2019 to 2020 was only -1.9% for exports and -8.6% for imports. This was much smaller than the overall decline in global trade. The new Corona brought negative supply and demand shocks to the world, but ASEAN was able to enjoy not only these negative shocks but also special demand for nesting, a positive demand shock, together with Northeast Asia. This was partly a reason for the respective growth of exports and imports in 2020-21 and 2021-22 at 23.1% and 14.1%, and at 27.8% and 15.8%. However, in 2023, the positive demand shock lost momentum, and exports and imports grew negatively by -5.9% and -9.0%, respectively, due to the slowdown of the world economy as a whole (the above figures are in nominal prices).

The import/export ratio of ASEAN as a whole by a trading partner has not changed significantly over this period, with intra-ASEAN imports and exports hovering between 21 and 23%, indicating that the IPNs are not complete within ASEAN alone, but are integrated with Northeast Asia to form “Factory Asia.” In addition, the competitiveness of exports to the U.S. and EU markets can be seen, especially when looking at exports outside of Asia.

China is still the most prominent trading partner outside of ASEAN. On

the export side, China's share is 14-16%, which is on par with the U.S. share of 13-15%. On the import side, China's share is even higher, at 22-24%. The combined import share of Japan, the U.S., and the EU-27 (27 countries comprising the European Union) appears to be slowly declining from 24 to 21%, and while ASEAN in the aggregate has a trade surplus, it has a trade deficit with China alone. Although the importance of economic relations cannot be measured only by data on trade in goods, China's large presence from the perspective of ASEAN is evident here.

The composition of ASEAN's trading partners clearly shows why ASEAN wishes to maintain good relations with both Western countries and China. It also demonstrates ASEAN's desire to further deepen its economic ties with the West to strike a balance with China, which is gradually increasing its presence in the region.

3. ASEAN Trade Policy and Japan's Economic Diplomacy

ASEAN countries have viewed the U.S.-China conflict as an opportunity to attract trade and investment through a "positive trade diversion effect," and have actively sought to attract investment regardless of the nationalities of companies⁶⁾. However, ASEAN has been able to participate in supply chains by free-riding on the rules-based international trade order. In geopolitical tensions, some developed countries and China are launching a series of industrial policies that deviate significantly from conventional international trade norms, and ASEAN needs to pay attention to the fact that these policies are undermining the global rules-based international trade order.

The weakening of the international trade order is symbolized by the issue of the World Trade Organization's (WTO) Appellate Body, which is the second instance of WTO dispute settlement and is composed of seven Members, three of whom are assigned to hear each case. However, since the U.S. has blocked the appointment and reappointment of Members since the beginning of the Trump administration, all Members were vacant by December 2020, and the Appellate Body has ceased to function. As a result, "appealing into the void" cases have been piling up, in which appeals to the dysfunctional Appellate Body effectively halt proceedings even after a first instance panel has concluded. These include important cases such as India's increase in tariffs on ICT products (DS584) and

6) However, there is a possibility that the U.S. will impose some restrictions on exports to the U.S. by Chinese companies operating in ASEAN. Bloomberg (2024) reports that such a case has emerged with regard to solar panel exports.

Indonesia's ban on the export of nickel ore and domestic processing requirements (DS592). Another concern is that the number of disputes brought to WTO dispute settlement since 2020 has been declining to single digits each year. Policy discipline through trade rules is becoming increasingly fragile throughout the world⁷⁾.

Among the states known as the Global South, countries with large populations are particularly vulnerable to the temptation to revert to the previous century's infant industry protection and import-substitution industrialization policies because of the large potential market within their borders. Indonesia has also recently launched a series of protectionist policies, such as import restrictions on a wide range of products, export bans on mineral products, and local content requirements for domestic production⁸⁾. However, there are also those within the government who question these policies from a market mechanism-oriented perspective, symbolized by Coordinating Minister Airlangga's aggressive moves to join the Organization for Economic Cooperation and Development (OECD), as well as the new membership in the Comprehensive and Progressive Agreement on Trans-Pacific Partnership (CPTPP)⁹⁾. This can be interpreted as an expression of the desire to become a developed country even if they accept international rules, rather than necessarily agreeing with the maxim of "defiance of the unfair international order established by the developed countries," which is the claim of the countries collectively called the Global South. Many countries in ASEAN are aiming to become well-developed countries by the year 20xx, and Japan should welcome and support such a move.

ASEAN's deep involvement in IPNs is unparalleled in the region, and the importance of the rule-based international trade order should be well understood. ASEAN should actively make efforts to preserve trade rules in cooperation with Japan and other countries.

There are many areas on the economic and diplomatic agendas in which Japan and ASEAN can work together. First is cooperation for the restoration of the WTO. We need to align ourselves with many countries so that the Appellate

7) See Trade Policy Bureau, Ministry of Economy, Trade and Industry (2024) pp. 104-106, 161-162, 483, 486-491.

8) See Trade Policy Bureau, Ministry of Economy, Trade and Industry (2024), pp. 101-117.

9) The OECD Ordinary Council had decided to start Indonesia's accession talks in February 2024, and on May 2, the OECD Ministerial Council adopted the "OECD Accession Roadmap," which lays out a path to accession (JETRO 2024c). In addition, Minister Airlangga participated in the 29th Nikkei Forum "Future of Asia" in May of the same year, and declared his positive attitude toward Indonesia's accession to the CPTPP (Nihon Keizai Shimbun 2024), which was followed by the formal submission of application to CPTPP in September 2024.

Body can be reinstated. If the revival is not forthcoming, it is also important to encourage ASEAN countries to join the Multi-Party Interim Appeal Arbitration Arrangement (MPIA), which was initiated by Europe. MPIA has 26 member states/regions worldwide (53 if EU member states are included), with East Asia including Japan (from March 2023), China, Hong Kong, Macau, the Philippines (from May 2024), Singapore, Australia and New Zealand¹⁰⁾. MPIA can take the place of the Appellate Body in a manner consistent with the WTO Agreement, provided that both parties to a dispute are its members. In addition, ASEAN countries is also expected to actively cooperate in the Joint Statement Initiative (JSI) that is underway to strengthen international rule-making in the WTO, especially in initiatives on e-commerce¹¹⁾.

Second, mega-FTAs can also be leveraged to contribute to the maintenance of the rule-based international trade order. The Regional Comprehensive Economic Partnership (RCEP) agreement, of which China is a member, could be used proactively to take advantage of opportunities such as the annual ministerial meetings and the joint committee meetings under them to help prevent arbitrary operation of trade policies and to deal with negotiations. It remains to be seen how attractive the still partially negotiated Indo-Pacific Economic Framework (IPEF) will be to ASEAN countries, but at least the Pillar II goal of addressing supply chain disruptions could function to stabilize the international trade order. The CPTPP is symbolic of the rule-based international trade order in which neither the U.S. nor China participates. It needs to be made more effective concerning the e-commerce chapter and other issues and nurtured as a forum for free trade and investment-oriented countries to gather.

Japan should not be so preoccupied with security issues, but should also pay sufficient attention to the vibrant economy that exists outside of them, and develop economic diplomacy from multifaceted perspectives.

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10) See Trade Policy Bureau, Ministry of Economy, Trade and Industry (2024) pp. 489-490.

11) See Trade Policy Bureau, Ministry of Economy, Trade and Industry (2024), pp. 506-508.

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