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THOUGHT LEADERSHIP BRIEF

How Important Are Global Value Chains for The Indo-Pacific?

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KEY POINTS

- The retrenching activities through global value chains (GVCs) suggest that the economic globalization has recently stagnated, particularly in the Indo-Pacific region.
- As China remains a major player in GVCs globally, the key question is whether the Indo-Pacific economic integration can be developed even if China is not part of this geography.
- The Indo-Pacific region, which includes Australia, India, Japan, the US, and ASEAN member states, has seen varying degrees of participation in GVCs, with ASEAN being the most integrated.
- That said, ASEAN's progress in GVC integration is mainly associated with China, while integration with other Indo-Pacific countries is declining except for India, whose size is hardly relevant compared to China.
- The Indo-Pacific Economic Framework for Prosperity (IPEF) could facilitate greater trade and investment exchanges among Indo-Pacific countries, but given the unbalanced developments in the region bilaterally, and that China remaining in the center stage, it remains to be seen whether it will have a significant impact on the region's supply chain integration.

ISSUE

What was thought of as an unstoppable trend – globalisation – has recently halted, and worse still, it seems to have started reversing. The development of global value chains (GVCs) has been instigated by transnational corporations as a way to reduce their costs of production through efficiency gains. More specifically, GVCs refer to international production sharing, a phenomenon where production is broken into activities and tasks carried out in different countries. The ability of developing economies to tap into their comparative advantages of cheap labour markets through the liberalisation of trade and investment policy – not to mention lax environmental and labour regulations – has allowed them to gain more productive jobs and sticky capital investment, to raise productivity and to generate wealth. From Eastern Europe to China – and most recently Viet Nam – the process has lifted millions out of poverty. Indeed, GVCs have shaped the world beyond trade, from the increasing importance of efficiency as a key objective of the production process – and the development of new business models to accommodate it – to the surge in foreign direct investment to set up production plants overseas to produce parts and components.

ASSESSMENT

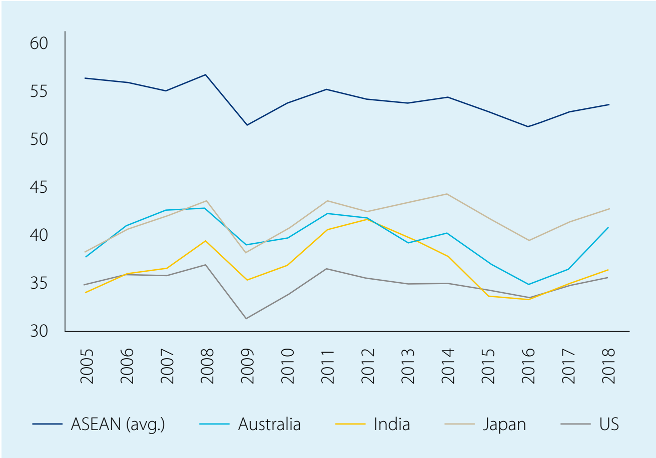
There are a number of relevant regions for GVCs, such as the European Union (EU) with its single market but also the Association of Southeast Asian Nations (ASEAN), which is closely intertwined with China in the Asian supply chain. A new geographical area, which is growing its geopolitical importance, is the Indo-Pacific. This concept was introduced by Japan as the 'Free and Open Indo-Pacific', and endorsed by the United States (US). It is security-related and are anchored in the Quadrilateral Security Dialogue, to which Australia, India, Japan, and the US have participated since 2007. More recently, with President Biden's official 2022 visit to Asia, the concept of the Indo-Pacific has been expanded in terms of the countries involved through the *Indo-Pacific Economic Framework for Prosperity* (IPEF)[1] and towards a more economic domain – although it falls short of a trade and investment deal. The countries that have signed on to the IPEF in Asia are Australia, Brunei Darussalam, India, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, and Viet Nam, as well as the US.

When looking into the degree of economic integration, through GVCs, of Indo-Pacific countries, namely Australia, India, Japan, and the US, a number of issues come to light. First and foremost, China remains the key player with a global market share in manufactured goods which has grown further since the Covid pandemic started to more than 20% in 2020 according to Comtrade data. The question, thus, is whether a new economic area – the Indo-Pacific – can be developed in Asia with growing trade and investment relations among its members, even if China is not part of this geography.

The first thing to note is that participation of Indo-Pacific countries in the GVCs have stagnated for long before a rebound in 2016. The speed of recovery also diverges with Australia's integration in GVCs jumping above 40% of its gross exports as of 2018. The other members of the Indo-Pacific, such as India, Japan, and US, have seen moderate improvements since 2016, but less than Australia. As for ASEAN Member States, many of which are now members of the IPEF, the trend is similar, but their level of integration into GVCs is much higher than for all Indo-Pacific members (Figure 1).

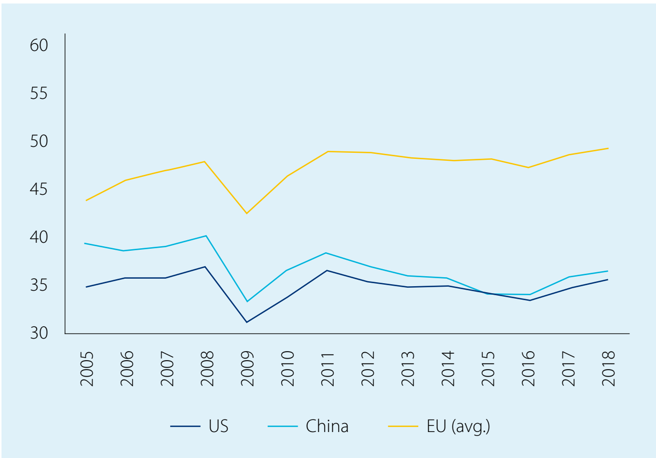
Outside of the region, the EU is very integrated into GVCs, which contrasts with the much lower participation of the US and China (Figure 2).

Figure 1. GVC Participation by Economic Area (% of Gross Exports)



ASEAN = Association of Southeast Asian Nations, avg. = country weighted average, GVC = global value chain, US = United States.
Notes: 1. Data for ASEAN include intra-region trade. 2. See Box 1 for the definition of GVC participation. ASEAN refers to eight of its 10 Member States: Brunei Darussalam, Cambodia, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam (no data were available for the Lao People's Democratic Republic and Myanmar).
Source: OECD (2022).

Figure 2. GVC Participation by Economic Area (% of Gross Exports)



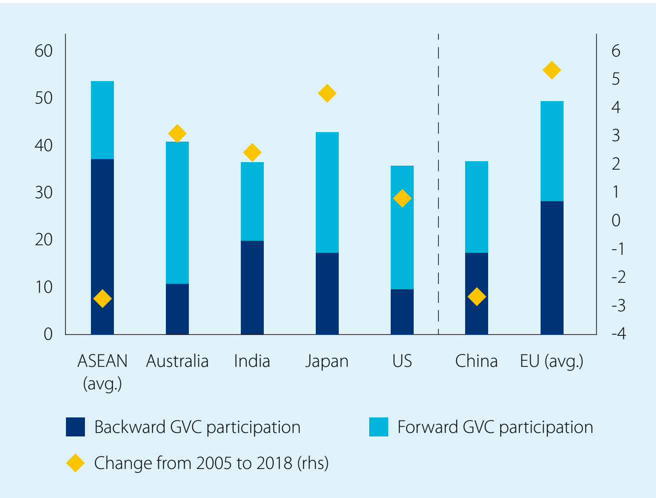
EU = European Union, avg. = country weighted average, GVC = global value chain, US = United States.
Notes: 1. Data for EU include intra-region trade. 2. See Box 1 for the definition of GVC participation. EU refers to the member countries as of 2013-2019.
Source: OECD (2022).

[1] "Statement on Indo-Pacific Economic Framework for Prosperity," The White House, accessed September 15, 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/23/statement-on-indo-pacific-economic-framework-for-prosperity/.

Participation in GVCs, however, can come from two different angles. The first occurs from the foreign value added in exports (FVA), also called backward participation, which is the share of exports that stems from imports of intermediate goods and for which there is no domestic value added imbedded. The second is the mirror of the FVA – the domestic value added in exports (DVX), also called forward participation. Countries able to produce higher value-added goods will tend to have a larger share of forward participation in GVCs, as they do not need to import as many intermediate goods to be able to export.

As Figure 3 below shows, the key difference between ASEAN and the EU is not the level of participation in GVCs – which is similarly high – but the composition, as downstream participation is much more pervasive for ASEAN than for the EU. Thus, the core Indo-Pacific countries are relatively less integrated into GVCs than ASEAN or the EU – but are in line with China. At the same time, relatively large shares of the value of their exports are produced domestically, especially for the US. That makes ASEAN complementary to Indo-Pacific countries, as their participation in GVCs is mostly through exports of imported intermediate goods.

Figure 3. GVC Participation by Economic Area and Type, 2018 (% of Gross Exports)



ASEAN = Association of Southeast Asian Nations, avg. = country weighted average, EU = European Union, GVC = global value chain, US = United States.
Notes: 1. Data for ASEAN and EU include intra-region trade. 2. See Box 1 for the definition of GVC participation. Forward participation means domestic value-added in foreign exports. Backward participation means foreign value-added in domestic exports. 3. ASEAN refers to eight of its 10 Member States: Brunei Darussalam, Cambodia, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam (no data were available for the Lao PDR and Myanmar). EU refers to the member countries as of 2013-2019.
Source: OECD (2022).

Delving deeper on ASEAN, their members have been reducing its integration with developed economies' supply chains since 2005, and especially with Japan and Australia, although the trend is slightly better with the EU and US. This trend contrasts with ASEAN's rapidly increasing integration with China's supply chains, which nearly doubled during 2005 to 2018. India, too, has been increasing its bilateral integration with ASEAN but from a very low level, which makes it hardly relevant compared to China. Furthermore exploring supply chain data, it remains clear that ASEAN is mostly an assembly platform with a large share of imported intermediate goods and rather limited value added in exports. This is particularly the case of ASEAN's trade with the US, EU, and, to a lesser extent, Japan and China.

Australia stands out for its much lower level of bilateral integration. Still, one trend seems to stand out, namely that Australia's growing value added in Japanese exports, meaning that Australia is stepping up to be a major upstream supplier for Japan. China is also crucial for Australia, with rapid growth like Japan and with a very similar pattern. Australia's integration with other members of the Indo-Pacific, like the US, remains very low and is mostly backward.

India has been increasing its bilateral integration with all of the countries except those of the EU, although these countries remain more important than the US. Interestingly, India's supply chain exchanges with ASEAN are now the largest – even bigger than that of China – although the speed at which supply chain linkages are growing is faster for India–China bilateral trade. In contrast to India, Japan's bilateral integration with other Indo-Pacific economies has been flagging over the period – except with Australia. This is because Australia is playing an increasingly important role in Japan's upstream supply, a nation that requires raw materials to manufacture its exports of intermediate goods. Japan is also experiencing a moderate increase in its bilateral supply chain relations with the EU, while they remain stagnant with the US. This might be explained by the institutional improvement in Japan-EU relations through a free trade deal signed in 2018. In contrast to these trends, a sharp decrease can be seen in Japan's bilateral trade linkages with ASEAN, as far as intermediate goods are concerned. Such a reduction in Japan's participation in GVCs is also occurring for China.

Finally, the US's bilateral linkages, in terms of global supply chains, with Indo-Pacific countries, China, and the EU were generally stable during 2005 to 2018, with slight declines seen with ASEAN and China and a sharp increase with India.

RECOMMENDATIONS

All in all, GVCs – which have been key to the process of rapid economic globalisation of the last few decades – seem to be reshuffling. While China has a central role, there are new trends within the Indo-Pacific which are worth watching. Their linkages are clearly not uniform, with ASEAN more integrated relative to India, and with the US and China dominating in their own value added into other countries' exports. Australia is still rather isolated in terms of supply chain integration but with growing linkages with Japan while those with China are well established. Much more integration can be possible with a trade agreement or framework – like the IPEF – which facilitates trade exchanges, among other objectives. It is still too early to tell whether IPEF's impact will be large enough for a region that still remains quite heterogenous, in terms of supply chain integration.

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