

## Executive Summary

The United Kingdom (UK) shares rich historical, economic, and social relations with the Association of Southeast Asian Nations (ASEAN) and its Member States. The UK applied to become a Dialogue Partner of ASEAN and formally established a mission to ASEAN in 2020. The year 2020 was also witness to an extraordinary pandemic of the coronavirus disease (COVID-19) which, besides bringing untold misery and death, has resulted in restrictions or limitations on the movement of people and goods across borders. The resilience of trade mechanisms and the global and regional value chains are being tested for stress and shocks, as the pandemic continues in most parts of the world.

In this backdrop, both the UK and ASEAN have reinforced the will to work in partnership for rebuilding and recovery, and sustainable growth, in the post-COVID-19 phase. The UK is looking towards greater integration into Asia and playing a significant role in the emerging economic architecture in the Indo-Pacific in which ASEAN has a central role. Towards this, the UK initiated this study to

- understand the performance and resilience of supply chains in ASEAN during COVID-19
- implement the expansion and deepening of the UK–ASEAN trade and investment relationship, and
- deepen integration with the goods and services value chains in ASEAN and East Asia.

Through these, the UK will also support ASEAN’s strategy for strengthening its economic resilience in the post-COVID-19 recovery and rebuilding.

The Economic Research Institute for ASEAN and East Asia (ERIA), Jakarta, has conducted this study for the UK, drawing data and evidence from its existing research and policy studies on trade and supply chains in the ASEAN region and East Asia. Evidence from ERIA’s studies on COVID-19 and its effect on the regional economy has also been used.

### **ASEAN’s Economic Resilience in Response to the Outbreak of COVID-19**

ASEAN economies experienced overall growth of 4.6% in 2019. The COVID-19 pandemic in 2020 significantly affected trade and supply chains around the world, including ASEAN, resulting in the weakening of international trade. Except for China and the United States (US), ASEAN’s trade with all the major trading partners declined during 2020.

According to ASEAN Secretariat publications, in 2020, the region’s economy was projected to contract by 3.8% – the first contraction in 22 years. Fortunately, the quick restoration of supply chain activities after the first few months of negative supply shocks has ensured that the ASEAN region will regain positive growth in 2021. Before the pandemic, ASEAN’s supply chains witnessed US–China trade tensions. However, the stable foundation of trade and investment links, and the absence of non-traditional trade policies from both the US and China to discriminate against international suppliers from the ASEAN region, have prevented the trade tensions from causing any significant alteration to supply chain linkages. Comparatively, the pandemic has brought about far more changes in firms’ supplier and customer relations. These changes were made in response to the shocks encountered by the supply chains.

The ASEAN economies experienced three types of economic shocks caused by the COVID-19 pandemic. The first type is negative supply shocks experienced at the beginning of the COVID-19 pandemic in 2020 when the economies of the ASEAN Member States (AMS) experienced a shortage of intermediate inputs originating in China. The second type is negative demand shocks where lockdown measures brought about a demand shortage. The third type is positive demand shocks to the goods and services supplied in response to the demands arising from the COVID-19 pandemic, such as healthcare supplies, work-from-home requirements (e.g. information and communication technology (ICT) equipment), and internet-based services. These positive demand shocks are pressures on the current production network and service suppliers, but at the same time, are opportunities for firms to expand their business.

The AMS have seen that health policy, i.e. lockdown and social distancing, halts both supply and demand. ASEAN's production facilities and supply chains are still there – almost intact. After taming the disease, however, ASEAN must confront the negative demand shock because persistent low demand may decay its supply chains in the long term. Planning for a scenario in which the disease is brought largely under control will be important.

### **Policy Guidance for ASEAN's Economic Resilience and Rebuilding**

Since the onset of the pandemic, the policy direction in ASEAN has shown unequivocal resolve to support ASEAN's core economic dynamism. The ASEAN Economic Ministers resolved to strengthen long-term supply chain resilience and sustainability, and to remain committed in keeping the ASEAN market open for trade and investment. They also recognised the importance of economic cooperation with external and development partners for strengthening regional supply chains.

The 'Hanoi Plan of Action on Strengthening ASEAN Economic Cooperation and Supply Chain Connectivity in Response to the COVID-19 Pandemic' stresses cooperation in enabling trade in important goods and the production of and access to COVID-19 medicines and vaccines through the strengthening of supply chain connectivity.

These policy measures provide a template to preserve the ASEAN supply chains' resilience and to enhance the trade and economic cooperation mechanisms within ASEAN and with its Dialogue Partners during and in the post-COVID-19 recovery phase.

For its collective and long-term socio-economic recovery, the ASEAN Comprehensive Recovery Framework (ACRF) was adopted at the 37th ASEAN Summit in Ha Noi, Viet Nam. It also serves as the consolidated exit strategy from the COVID-19 crisis.

The five broad strategies that are deemed most impactful to take the region through the recovery process and its aftermath are (i) enhancing health systems, (ii) strengthening human security, (iii) maximising the potential of the intra-ASEAN market and broader economic integration, (iv) accelerating inclusive digital transformation, and (v) advancing towards a more sustainable and resilient future.

The ACRF address both ASEAN's immediate needs during the **reopening** stage for a successful transition to the 'new normal', as well as its medium- and long-term needs through the stages of COVID-19 **recovery** and for longer-term **resilience**.

## **UK–ASEAN Partnership for Recovery and Building Back Better**

Broad strategy 3 of the ACRF – maximising the potential of the intra-ASEAN market and broader economic integration – emphasises the importance of increased trade in ASEAN in the post-pandemic recovery. UK trade with ASEAN and enhanced trade relations with ASEAN’s major trading partners in the Indo-Pacific (Australia, China, India, Japan, the Republic of Korea, New Zealand, and the Pacific) will provide an important platform for supporting this critical strategy in the ACRF.

The UK upholds the policy for keeping markets open for trade and investment as it deepens its economic relations in ASEAN and the larger Indo-Pacific region. The ASEAN Economic Community is a natural partner for the UK in this exercise. Streamlining the investment facilitation process, eliminating non-tariff barriers, and creating regulatory coherence between the two economies (or at least with some AMS initially) are important next steps as they will create a conducive environment for deepening and expanding the UK–ASEAN supply chain, and support the post-COVID-19 rebuilding process. Infrastructural and institutional connectivity plans outlined in the Master Plan on ASEAN Connectivity 2025 should also attract new investments between the UK and ASEAN.

UK support to the priority areas of economic integration strategy of the ACRF must be based on the UK’s own core policy on post-COVID-19 recovery and rebuilding. The principle of ‘build back better’ should lead the UK’s economic engagement with ASEAN for recovery in the near term while enhancing the bilateral trade in goods and services on both sides.

The UK’s international policy to firmly establish itself as a global science and technology and responsible cyber power would be its signature contribution to partnership with ASEAN. This contribution would lie in investments and capacity building for greater participation of ASEAN in the supply chains of the digital economy, especially in manufacturing industries that utilise automation, robotics, and artificial intelligence. Creating capacities and markets for diversifying ASEAN’s trade in services into finance, ICT, and other services components of goods trade would be a strategic choice for both sides. Similarly, investments in the manufacturing of environmental products and green technology would forge a future-ready partnership. Bringing ASEAN’s core strength in manufacturing to the UK market would be a reciprocal step.

AMS, including the least developed countries, face the challenge of recovery from COVID-19 induced disruptions to the economy. AMS must rapidly undertake digital transformation and structural reforms to remain engaged in the value chain of a more digitalised global economy. COVID-19 instigated a beta test for ASEAN’s integration into the digital economy value chains and underlined the need for increased investment in digital connectivity and human capital. Concerted UK–ASEAN cooperation is required to cover a spectrum of needs, with infrastructure, regulatory frameworks, and data flow and security being the immediate challenges.

Demand for environmental and green products will continue to grow. The twin strengths of research and development and technology (UK), an established base in sectors such as electronics and motor vehicles (ASEAN), and the existence of an effective supplier network and integrated supply chains could be an important advantage for both partners in building back better supply chains for the future. The UK’s Ten Point Plan for policies and public investment in low-carbon technologies and services could be linked with ASEAN for supply chains and markets. This would ensure supply chain efficiency, trade integration, jobs, and growth on both sides.

ASEAN's trade in services relies greatly on the travel and tourism sector. Travel accounted for 33% of ASEAN's total services exports in 2019. The UK is a global player in the services sector, especially in finance, logistics, and ICT, which have important roles in the digital economy as well as being a component of goods trade. Investments and technical cooperation in these sectors would facilitate AMS diversifying into other sectors of services trade. On the UK's part, research and development (defined as 'other business services' in services trade) is a core strength of its economy. The future of work and employment growth in ASEAN requires greater expenditure and technical collaboration in education and innovative learning. Collaboration in higher education and research and development activities in medicine, agriculture, robotics, and low-carbon technologies would be the UK's quintessential role in the UK–ASEAN cooperation plan.

### **Bilateral Trade and Integration**

Trade flows between the UK and ASEAN are modest at present, with the UK comprising about 1.26% of ASEAN's total trade. This is similar to other key European economies, even though the European Union (EU) is ASEAN's third largest trade partner from outside the region. The UK competes with the EU member countries for most export items – machinery and equipment, textiles, and chemicals and pharmaceuticals. A trade agreement with ASEAN (or with some key AMS) would put the UK at an advantage in the ASEAN markets.

Since 2010, China has emerged as ASEAN's top trading partner, replacing Japan, the EU, and finally the US. This reflects the intricate supply chains in ASEAN and East Asia, in which trade in parts and components is very high. This factor will resonate repeatedly in all bilateral trade plans and supply chain participation between the UK and ASEAN. From the UK perspective, the share of trade with ASEAN is higher and has increased on the export side, reaching around 3% of total UK trade in 2019. Still, the share of UK exports to ASEAN remains rather modest, particularly when compared with the size of ASEAN economies globally and, most importantly, their fast growth. The UK may note that the ASEAN region has also emerged as a market for finished goods. Machinery and equipment are the largest traded sector between the UK and ASEAN, followed by textiles. ASEAN's exports in the agriculture and food sector to the UK are important too, but are low compared with its agricultural exports to China, Japan, and the US.

On a bilateral basis, there are deviations in the sectoral composition of UK exports to ASEAN. The share of machinery and equipment is particularly large to Cambodia, the Lao PDR, Malaysia, and Singapore, while the share of metal products exported to Indonesia and Viet Nam and agricultural products to Myanmar is higher. The sectoral structure is more heterogeneous for UK imports across AMS partners, reflecting to a large extent the product specialisation of each ASEAN economy.

Apart from Singapore, UK trade in services with AMS is also low. At the country level, the UK has a trade surplus with Malaysia, Singapore (although sector-wise, Singapore has a favourable balance in business services, including professional activities), and Indonesia. Given the UK's large trade in services with other areas of the world, especially the US and the EU, ASEAN's growing markets provide an ideal opportunity for expanding trade with ASEAN. Japan is an existing competitor in financial services, so the UK must offer competitive and innovative products to ASEAN, especially to youth, start-ups, and new entrepreneurs.

Planning ahead, ASEAN offers an important opportunity for greater integration of the UK in the trade flows of Southeast and East Asia. The UK's decision to apply for accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is an important signal to the whole Asia-Pacific region, and will help the UK to participate in developing common standards and shaping the economic architecture of the region. Overcoming the gravitational forces that dictate value chain participation would be possible through deft and forward-looking policy arrangements with ASEAN. The Regional Comprehensive Economic Partnership (RCEP) will accelerate interconnectivity in ASEAN and East Asia, even though it is mostly concerned with trade in goods and tariffs. For greater trade integration, the UK must closely follow ASEAN's trading agreements, including ASEAN's own mechanisms such as the ASEAN Single Window (now open for Dialogue Partners) and the Guidelines for the Implementation of ASEAN Commitments on Non-Tariff Measures on Goods.

Trade integration is very important for ASEAN, especially participation in global value chains (GVCs). Significantly, ASEAN's trade integration has progressively shifted away from developed to developing economies. China-ASEAN and intra-ASEAN GVC integration is more prevalent, although a partial recovery with the EU has been noticeable since 2010. Structurally, GVC integration of ASEAN with other economies predominantly corresponds to backward participation, especially with the US and Japan. However, ASEAN's bilateral integration has changed over the years, positioning ASEAN more upstream with respect to the EU and downstream with respect to China – accounting for greater participation of Chinese inputs in ASEAN exports.

GVC integration between ASEAN and the UK is asymmetrical in both its characterisation and evolution. Backward participation accounts for the largest share for ASEAN, while forward participation contributes more for the UK – emphasising its input export specialisation. From a country perspective, the most significant bilateral integration is with Singapore.

## **Planning Ahead**

### **Supply Chain Performance in ASEAN: Opportunities for the UK**

An ERIA survey of domestic and international firms in ASEAN and India shows that the COVID-19 pandemic significantly impacted manufacturing and non-manufacturing firms in the AMS. While the impact was negative on average, most of the firms were able to quickly adjust trade with their customers and suppliers across countries and globally. Manufacturing firms showed better performance in 2020 than other industries, which suggests that international production networks in the region have been relatively robust to negative supply shocks. Additionally, ICT services firms experienced better business outcomes and are more likely to expand their businesses and to increase recruitment than other industries. Positive demand shocks have benefitted the ICT industry, and its growth will continue. Businesses that encountered increased sales have a positive outlook for 2021, with plans for expansion. However, firms expect greater support from the government in the form of tax rebates and restoration of the mobility of people across borders.

The better than average performance of the ASEAN markets – supported by policy measures such as the Hanoi Plan of Action to keep the market open to trade and investment – can help ASEAN's trading partners, including the UK, to plan and invest in the value chains of production in the region. The changing patterns of customer and supplier relationships amongst the firms in ASEAN present an opportunity for UK businesses to diversify their supply of goods and services as well as markets away

from the EU into the ASEAN region, and into the larger East Asia region with which ASEAN shares an intimate supply chain network and market. Increased mutuality between two economies will help to mitigate the negative supply shocks and negative demand shocks on both sides. Importantly, for the UK, the positive demand shocks create an opportunity to provide its goods and services in the ASEAN region.

### **The UK and ASEAN: Trade Policy Convergence for Enhanced Trade and Strong Partnership**

The promise of building back better should be at the core of UK–ASEAN policy engagement in the months ahead, while the ASEAN Economic Community will be the UK’s most appropriate partner in the regional architecture. The ASEAN Economic Community Vision 2025, the Master Plan on ASEAN Connectivity 2025, and the ASEAN Outlook on the Indo-Pacific are important guides for implementing UK objectives of expanding and deepening its trade relations in ASEAN and the Indo-Pacific. Like all important economic partners of ASEAN, an ASEAN+1 process for the UK is the next step.

As ASEAN is already a manufacturing hub, closer trade relations with ASEAN would improve the UK’s integration in GVCs outside the EU, in particular those of Asia. GVCs are partial to efficiency, therefore product matching can be achieved only through supply chain efficiencies and market demand, as seen in the case of reduced trading in petroleum. Close evaluation of the future needs of the region will help grow the basket of traded goods between ASEAN and the UK. ASEAN is preparing to play a larger role in the value chains of the new digital economy. The UK’s competitiveness in the digital economy, services components of goods trade, research and development, financial services, and low-carbon and green products is an important channel for integrating the UK economy into both existing and pipeline supply chains in ASEAN and East Asia. Accession to the CPTPP would be helpful in this regard. More immediately, bilateral trade agreements concluded with Japan and Australia, and the forthcoming one with India, would also matter as these economies are closely networked with ASEAN’s economy. The economic and institutional diversity in ASEAN also point to the importance of bilateral trade agreements with individual AMS. Viet Nam’s free trade agreement (FTA) with the EU is a good example of mutual economic benefit and enhanced trade. The EU–Singapore FTA is similarly designed and complements the services economy on both sides.

### **The Road Ahead**

The ASEAN region has shown, so far, that its supply chains have been fairly able to withstand the supply and demand shocks. The implications of the pandemic are principally macroeconomic, with some difference across sectors. So far, Southeast Asia has shown that it is particularly well placed to take advantage of improved global demand later in 2021, in particular from Europe and the US.

Trade and investment policies will assume more significance in the coming months as they determine the ability of firms to contest foreign markets or to source intermediate inputs from foreign suppliers. For the UK and ASEAN, trade and investment facilitation will be crucial as it can increase backward and forward linkages and deepen the trade integration. Nurturing the business environment would also play a role in structuring the trade relations.

A UK–ASEAN trade and economic cooperation plan must consider China – ASEAN’s largest trading partner. Closely integrated value chains between China and ASEAN have cast a shadow on some trade and investment partnerships of ASEAN, e.g. with the EU, and most noticeably with India. The emerging economic architecture in the Indo-Pacific, in which ASEAN has a central role, also faces the inescapability of supply chain integration between ASEAN and China. The Indo-Pacific is also working

towards diversified supply chains in the region. This underlines the recommendation that the UK plan for integration in the value chains of the digital economy in ASEAN, as there is both the scope and immediate need for efficient and trusted partners. Investments in infrastructure for the digital economy and cybersecurity are the two most pressing needs in the region for it to grow as a digital economy hub. The UK should be ready and able to fulfil both the capacity needs and trust issues required in this industry. Closer alignment with new supply chains emerging in the region – such as Australia–Japan–India, the Mekong Subregion, and India–Myanmar–Thailand – will be important for UK trade missions to keep the UK’s interest active in these emerging alignments.

The UK and ASEAN are some of the most open markets for both trade and investment. However, preferential trade and investment arrangements and regulatory connectivity focusing on identified core sectors will be better than wide-ranging FTAs. Concessions in the mobility of people and capital should be favourable in all plans, given that most regional trade arrangements have nearly by-passed these issues due to their emphasis on trade and tariffs, and less than meaningful services components.

Reviving the UK’s historical presence in the businesses of Southeast Asia through contemporary and future-ready trade facilitation and investment plans – and promoting ASEAN’s core competency in manufacturing in the UK – is the practical direction ahead for UK–ASEAN bilateral trade.