

Chapter 2

UK–ASEAN Trade: Strengthening the Supply Chain Linkages

August 2021

This chapter should be cited as

Study team (2021), 'UK–ASEAN Trade: Strengthening the Supply Chain Linkages', in Prakash, A., A.G. Herrero, and D.M. Turégano (eds.), *UK-ASEAN Trade: Strengthening the Supply Chain Linkages*. ERIA Research Project Report FY2021 No. 11, Jakarta: ERIA, pp.5-15.

Chapter 2

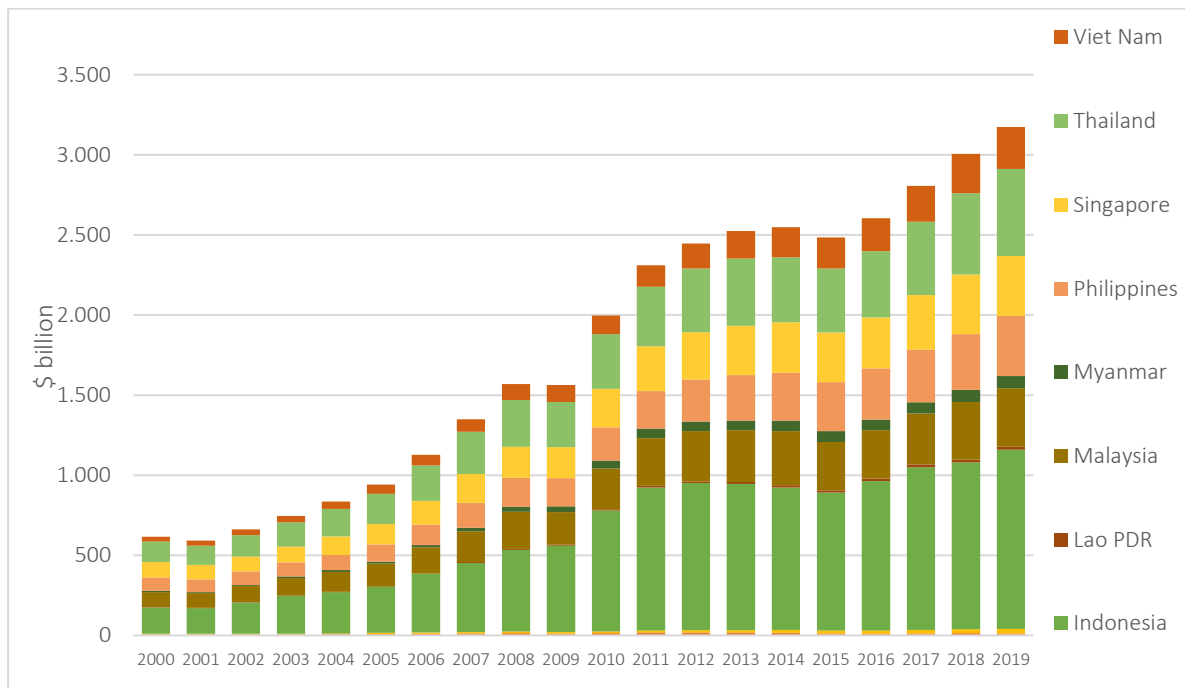
UK–ASEAN Trade: Strengthening the Supply Chain Linkages

This chapter sets the context for studying the supply chain linkages between the United Kingdom (UK) and the Association of Southeast Asian Nations (ASEAN). It covers the prevalence of supply chains in ASEAN, their performance and competitiveness, and institutional partnerships with major economies. It describes supply chain resilience and performance since the outbreak of the coronavirus disease (COVID-19), and policy directions for maintaining the supply chain dynamism in ASEAN – both at the government level and at the firm level. It describes the ASEAN Community framework for strengthening supply chains and rebuilding during and after COVID-19, and the likely support from the UK in specific areas. It outlines the policy convergence and pathways for UK–ASEAN supply chain linkages in goods and services, especially in the post-COVID-19 rebuilding phase.

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

Before the outbreak of COVID-19, ASEAN economies experienced overall growth of 4.6% in 2019. Figure 2.1 indicates the diversity in economic size amongst ASEAN Member States (AMS) – with Indonesia as the largest, accounting for 35.4% of the region’s gross domestic product (GDP) in 2019, followed by Thailand (17.2%), the Philippines (11.9%), and Singapore (11.8%) (ASEAN, 2021).

Figure 2.1: Total GDP Growth in ASEAN Member States, 2000–2019 (\$ billion)



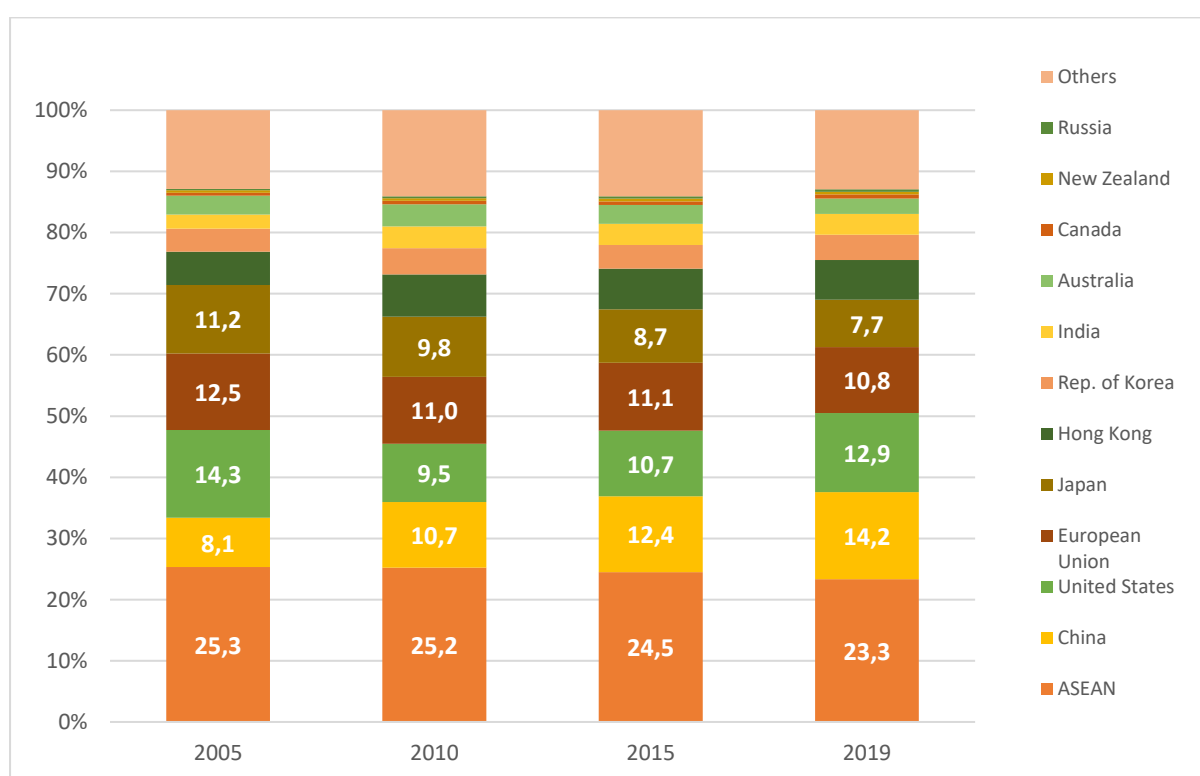
ASEAN = Association of Southeast Asian Nations, GDP = gross domestic product, Lao PDR = Lao People’s Democratic Republic.

Source: ASEANstats (ASEAN, 2021).

In terms of real GDP growth, Myanmar, the Lao People’s Democratic Republic (Lao PDR), and Cambodia were the best performers, with average annual growth of 13.2%, 7.7%, and 7.6%, respectively.

Intra-ASEAN trade has continuously accounted for the largest share of ASEAN total trade. In 2019, the year preceding the pandemic, intra-ASEAN trade accounted for 22.5% of total merchandise trade in the region – constituting 23.4% of ASEAN’s total merchandise exports and 21.5% of its imports. However, the share of intra-ASEAN trade in 2019 (22.5%) was lower than in 2018 (23.0%). The shares of ASEAN trading partners also indicated a slight decline in 2019 from the previous year, except for China (18.0% in 2019 from 17.1% in 2018) and the United States (US) (10.5% in 2019, from 9.3% in 2018). The largest external markets for ASEAN exports in 2019 were China (14.2%), the US (12.9%), the European Union (EU) 28 (members as of 2013–2019) (10.8%), and Japan (7.7%) (Figure 2.2).

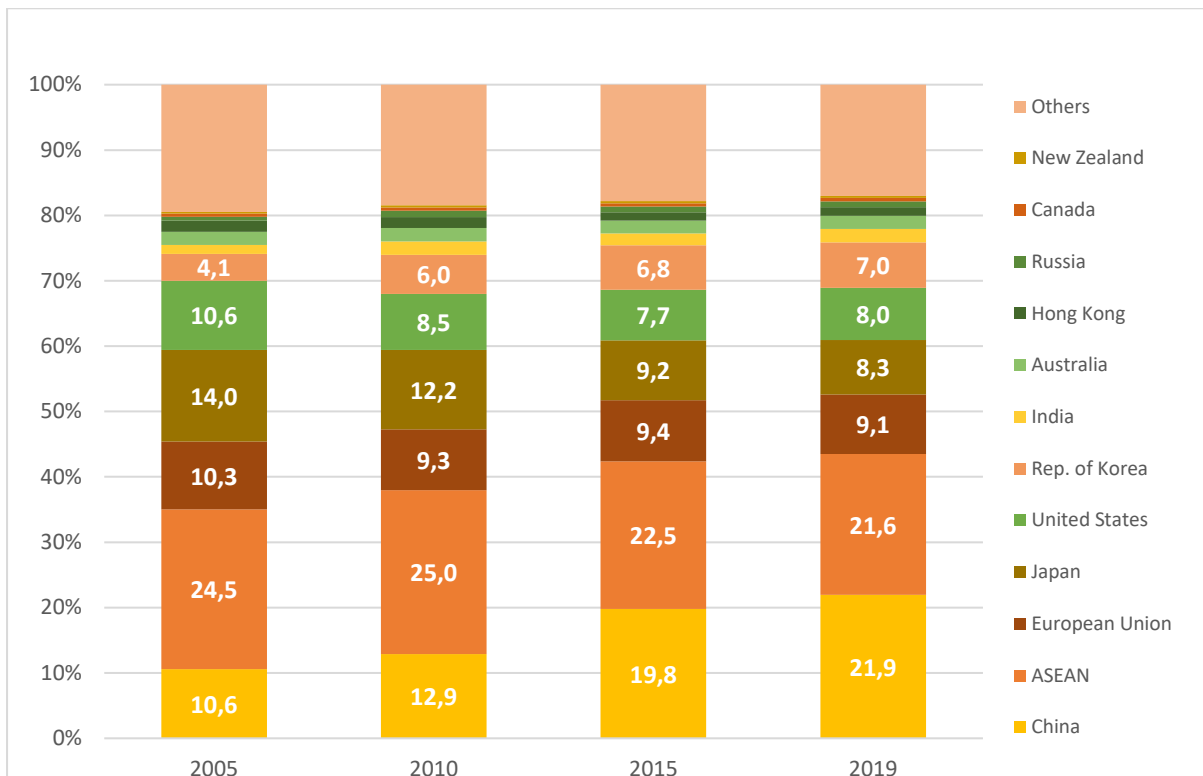
Figure 2.2: Share of Merchandise Exports of the Top 5 Trading Partners, 2005–2019 (%)



ASEAN = Association of Southeast Asian Nations.
Source: ASEANstats (ASEAN, 2021).

As for imports (Figure 2.3), China is the region’s largest external source of imports with a share of 21.9%, followed by the EU 28 (9.1%), Japan (8.3%), and the US (8.0%).

Figure 2.3: Share of Merchandise Imports of the Top 6 Trading Partners, 2005–2019 (%)



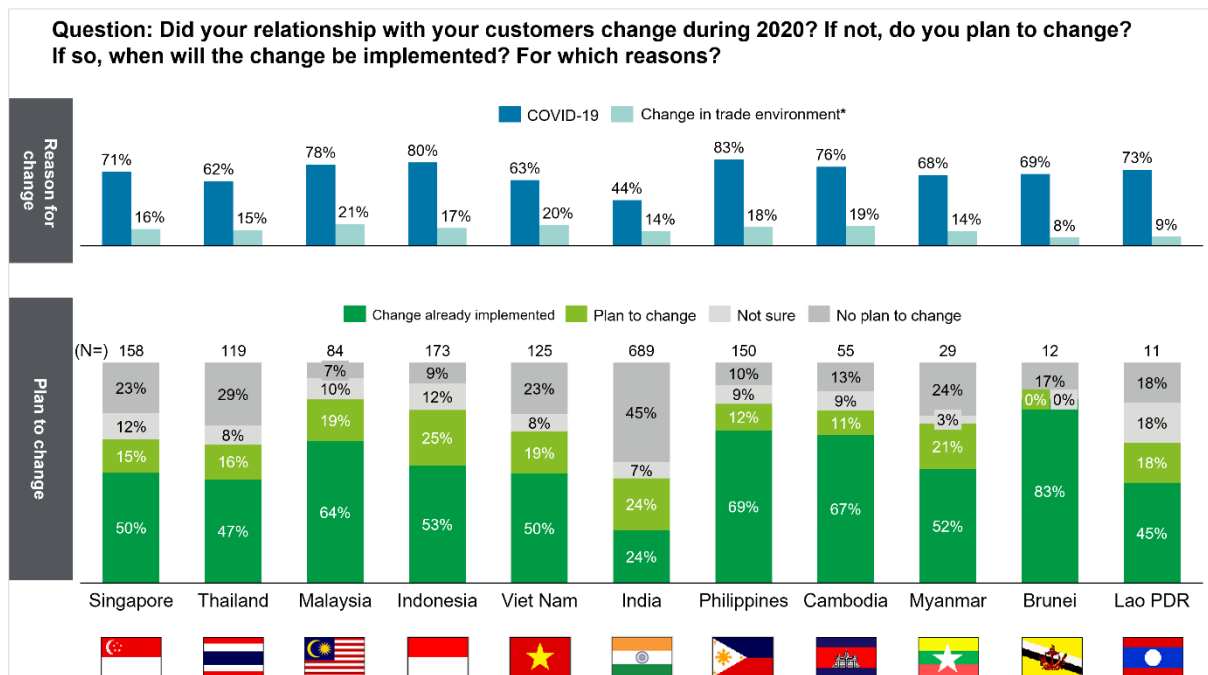
ASEAN = Association of Southeast Asian Nations.
Source: ASEANstats (ASEAN, 2021).

Since it was declared a pandemic in March 2020, COVID-19 has disrupted livelihoods around the world. ASEAN has not been spared. In 2020, the region’s economy was projected to contract by 3.8% – the first economic contraction in 22 years (ASEAN, 2020b). However, 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.

ASEAN Supply Chains Are More Resilient to Trade Tensions than to COVID-19

Before the pandemic, US–China trade tensions were forecast to affect supply chains, investments, and production locations in the region. Supply chains in ASEAN rest on a stable foundation of trade and investment links. To the extent that there are risks, they are not primarily at a macro level. So far, neither the US nor China have used non-traditional trade policies to discriminate against international suppliers from the ASEAN region. The slowdown in ASEAN’s supply chain integration with China is related in part to vertical integration of supply chains within China, and the fact that supply chain development in the region will not return to the rapid pace of integration seen in the early 2000s, at least in the short term. An Economic Research Institute for ASEAN and East Asia (ERIA) survey of domestic and international firms in ASEAN and India (Figure 2.4) showed that most firms have made changes in customer relationships due to COVID-19. US–China trade tensions and customs duties have a smaller effect on business decisions related to supply chains.

Figure 2.4: Changes Made by Firms in ASEAN due to COVID-19 and US–China Trade Tensions



ASEAN = Association of Southeast Asian Nations, COVID-19 = coronavirus disease, Lao PDR = Lao People’s Democratic Republic, US = United States. * = e.g. imposition of additional customs duties, US–China trade discord.

Source: ERIA (2021).

ASEAN economies are generally very integrated into global movements of goods, services, ideas, people, and capital. As such, the reduction in consumer spending in most high-income countries has had an effect through the channel of reduced demand for exports, which has in turn put pressure on companies’ cash reserves and led to some shedding of labour, with the attendant social costs from unemployment and lost income (Shepherd and Prakash, 2021). Think tanks and multilateral development banks have released positive forecasts for most ASEAN economies in 2021, but institutional information on the economic effects of the COVID-19 pandemic is still highly incomplete, as the situation is continuously evolving.

The ASEAN economies have experienced three types of economic shocks caused by the COVID-19 pandemic (Oikawa et al., 2021). The first type is negative supply shocks to international production networks (e.g. the Great East Japan Earthquake) where disruptions or damage in one place, including reduced production or closing of businesses, cause indirect damages to companies in other places through supply chains. If production is disrupted in company X in one country, the output production of customer company Y (that uses the parts produced by company X) in another country will also stop or decline. The negative supply shock is greater if the parts are difficult to replace. Moreover, supplier company Z’s production will also suffer because of the reduced demand from company X. In January and February 2020, the AMS economies experienced and responded to a shortage of intermediate inputs originating from China (Kimura, 2020). Thus, at the beginning of the COVID-19 pandemic, the impact was in the form of negative supply shocks.

The second type is negative demand shocks to the macroeconomy (e.g. the global financial crisis in 2007–2009). The global financial crisis started in the US and spread to other advanced economies,

followed by its negative impact on emerging economies (Kose et al., 2012). The subprime mortgage problem affected the soundness of financial institutions. The financial sector's vulnerability impacted the real economy through negative wealth effects (sharp drops in housing and stock prices), low consumer confidence, and a credit crunch. Small open economies faced decreases in demand for exports. Together, these constituted negative demand shocks on the macroeconomy. In the case of COVID-19, negative supply shocks caused by lockdown measures brought about a demand shortage and created negative demand shocks. Economies that could contain COVID-19 still faced negative demand shocks for exports generated by economies struggling with the containment of the disease. COVID-19 spread globally in March 2020 and has continued to suppress economic activities throughout the world. As such, the AMS economies have experienced negative demand shocks since the global spread of COVID-19.

The third type is positive demand shocks to the goods and services supplied in response to the demands from the COVID-19 pandemic. The spread of COVID-19 significantly surged demand for critical supplies and personal protective equipment. The demand spikes created widespread shortages of these goods and stressed the health care supply chains. Social distancing and work-from-home requirements resulted in a rise in demand for information and communication technology (ICT) equipment and internet-based services (De et al., 2020). These positive demand shocks are pressures on the current production network and service suppliers but, at the same time, opportunities for firms to grow now and after the COVID-19 pandemic.

The AMS initially perceived COVID-19 as the source of a supply shock in January and February 2020, due to disruptions in the supply of certain intermediate products originating in China. Then the disease spread in March and a substantial share of production activities halted across the world. Production was stopped mainly to implement health policy, i.e. social distancing, which halts both supply and demand (Kimura, 2020). ASEAN's production facilities and networks are still there – almost intact. It may be useful to plan for a scenario when the disease is brought largely under control and production can be resumed if demand returns. After taming the disease, ASEAN must prepare to confront the demand shock as persistent low demand could decay its supply chains in the long term.

Policy Guidance on Recovery and Rebuilding

With COVID-19 declared a global pandemic, the ASEAN Economic Ministers (AEM) recognised 'the adverse impacts of the COVID-19 outbreak on the economy, particularly including but not limited to the travel and tourism, manufacturing, retail and other services sectors as well as the disruption of supply chains and the financial markets,' and agreed to resolve to 'strengthen a long-term supply chain resilience and sustainability, including through better transparency, agility, diversification and, in particular, the implementation of the Master Plan on ASEAN Connectivity (MPAC) 2025' (AEM, 2020: 1–2).

All ASEAN trade partners recognised the importance of the AEM statement. The AEM further resolved to 'remain committed in keeping the ASEAN market open for trade and investment ... and enhance economic cooperation with external and development partners to include initiatives aimed at strengthening regional supply chains to make them more resilient and less vulnerable to internal and external shocks' (AEM, 2020: 2).

Furthermore, the AEM adopted the 'Hanoi Plan of Action on Strengthening ASEAN Economic Cooperation and Supply Chain Connectivity in Response to the COVID-19 Pandemic' on 19 June 2020 (ASEAN, 2020c). The action plan includes cooperation in enabling the trade of important goods (food, medicines, medical equipment, and other related products), as well as assisting in the production of and improving access to COVID-19 medicines and vaccines through the strengthening of supply chain connectivity.

The AEM statement and the Hanoi action plan underline policy measures to keep the ASEAN supply chains resilient and provide a template to enhance the trade and economic cooperation mechanisms within ASEAN and with its Dialogue Partners during and in the post-COVID-19 recovery phase. In this regard, the study of UK–ASEAN trade and supply chains seeks to enhance bilateral trade with ASEAN through closer integration with supply chains in ASEAN. Trade and investment facilitation initiatives would be the assured pathway for both strengthening regional supply chains and increasing bilateral trade in goods and services, including the trade of important goods such as medicines, vaccines, and medical equipment. This economic integration would also fulfil the objectives of the regional plans for recovery and rebuilding of the economy in the post-COVID-19 phase.

ASEAN's Framework for Resilience and Rebuilding Measures of Supply Chains in the Post-COVID-19 Recovery

Given the scale and impact of the pandemic, ASEAN recognises that addressing the crisis requires coordinated actions within the region as well as cooperation with its partners. While the immediate priority for the region is to overcome the pandemic, ASEAN has concurrently planned its collective and long-term socio-economic recovery strategy. Thus, the ASEAN Comprehensive Recovery Framework (ACRF), adopted at the 37th ASEAN Summit in Ha Noi, Viet Nam, serves as the consolidated exit strategy from the COVID-19 crisis (ASEAN, 2020a).

ASEAN's recovery efforts will focus on five broad strategies that are deemed most impactful to take the region through the recovery process and its aftermath. The broad strategies will be pursued through several key priorities. The five broad strategies are:

1. Enhancing health systems
2. Strengthening human security
3. Maximising the potential of the intra-ASEAN market and broader economic integration
4. Accelerating inclusive digital transformation
5. Advancing towards a more sustainable and resilient future

Given the unprecedented nature of the current health and economic crisis, the ACRF and its implementation plan (ASEAN, 2020a) identified several cross-cutting enabling factors: (i) policy measures and responses, (ii) financing and resource mobilisation, (iii) institutions and governance mechanisms, (iv) stakeholder engagement and partnership, and (v) effective monitoring.

Optimal utilisation of resources and effective cooperation with partners will determine the progress on these fronts and the shape of the recovery. The UK–ASEAN partnership could be an important element of the international cooperation required for the implementation of the ACRF.

Supporting the ACRF for Broader UK–ASEAN Economic Integration

The ACRF and its implementation plan are intended to 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 the COVID-19 **recovery** and for longer-term **resilience**.

Broad strategy 3 – maximising the potential of the intra-ASEAN market and broader economic integration – focuses on priorities that intensify intra-ASEAN trade and investment and establish ASEAN as a competitive and contestable market. It is designed to normalise the movement of goods and people and to rebuild the disrupted goods and supply chains. From the UK perspective, supporting this strategy will feed equally and spontaneously into strategies 4 and 5: accelerating inclusive digital transformation in ASEAN, and supporting ASEAN’s advancement towards a more sustainable and resilient future.

Given the importance of trade in ASEAN, the post-pandemic recovery will require more, not less, trade. Intra-ASEAN trade is largest amongst the trading partners, followed by China, the US, the EU, and Japan. The UK partnership with ASEAN – along with a renewed trade engagement with ASEAN’s major trading partners in the Indo-Pacific (Australia, China, India, Japan, the Republic of Korea (henceforth, Korea), New Zealand, and the Pacific) – provides a useful policy platform for supporting critical economic elements in the implementation of the ACRF.

The UK is a global proponent of keeping markets open for trade and investment. This policy is important for the UK as it forges new economic relations and deepens existing ones in the Indo-Pacific region. The ASEAN Economic Community is a natural partner for the UK to forge freer movement of goods, services, labour, and capital between the two. Evaluating, streamlining, and expediting the investment process and facilitation will create a conducive environment for deepening and expanding the UK–ASEAN supply chain, and help in the rebuilding process after COVID-19. Eliminating non-tariff barriers and creating regulatory coherence between the two economies (or at least with some AMS initially) is an immediate and important step in this direction.

Supply chain connectivity, both infrastructural and institutional, will be at the core of new investments between the UK and ASEAN. This may well extend into plans outlined in the Master Plan on ASEAN Connectivity 2025.

However, UK support to the priority areas of economic integration strategy in the ACRF must be based on the UK’s own core thinking on the post-COVID-19 recovery and rebuilding. The principle of ‘build back better’ should lead UK economic engagement with ASEAN – for recovery in the near term and for resilient trade and investment in the longer term, besides enhancing bilateral trade.

Further, science and technology are an integral element of UK international policy to firmly establish itself as a global science and technology and responsible cyber power (HM Government, 2021). The UK has unique or significant strengths in areas of medical science, green technologies, and aspects of data and artificial intelligence, where it is well placed to support ASEAN in leading the advance towards the future.

Towards this, the UK’s signature contribution to partnership with ASEAN and for ACRF implementation would lie in

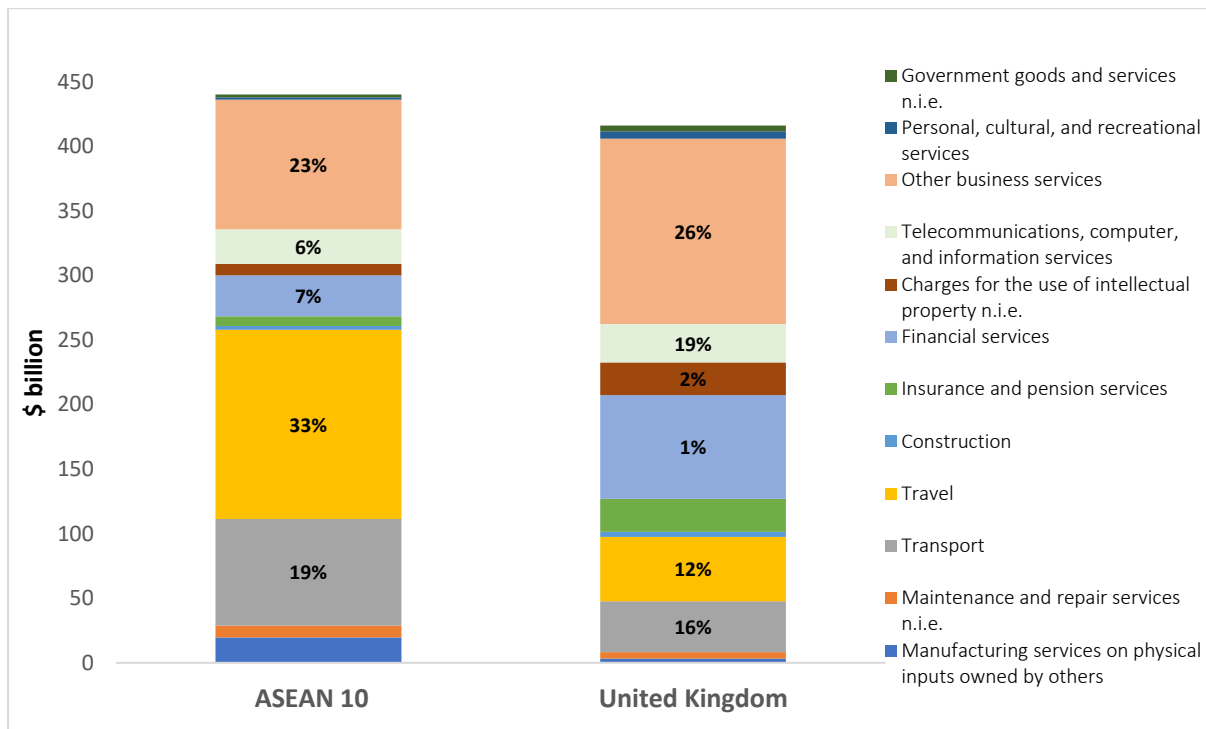
- (i) investments and capacity building for greater participation of ASEAN in the supply chains of the digital economy, especially in manufacturing industries that utilise automation, robotics, and artificial intelligence;
- (ii) investments in the manufacturing of environmental products; and
- (iii) diversifying ASEAN's trade in services into finance, ICT, and other services components of goods trade.

The major potential change in conditions facing supply chains is the rise in new sectors and modes of delivery (Shepherd and Prakash, 2021). The digital economy looms large in this regard, but so too do environmental products such as renewable power generation equipment (e.g. solar cells) and electric vehicles. AMS, including the least developed countries, have deepened their integration in regional value chains and embarked on trade-led growth. They now face the challenge of recovery from COVID-19 induced disruptions in the economy in general and in supply chains in particular. Concurrently, they must rapidly undertake digital transformation and structural reforms to remain engaged in the value chain of a more digitalised global economy, whose adoption of digital technology for production and supply chain management has accelerated due to the pandemic. This transformation cannot be delayed any longer. COVID-19 instigated a beta test for integration into the digital economy value chains and spotlighted a need for increased investment in digital connectivity and human capital for ASEAN's continued participation in production networks. Concerted UK–ASEAN cooperation is required to cover a spectrum of needs, with infrastructure, regulatory frameworks, data flow, and security being the immediate challenges.

Consumer tastes have been shifting towards environmental and green products for some time, and it is plausible that recovery programmes in high-income markets will favour this shift through incentives and other measures. If markets remain relatively open, ASEAN is well positioned to take advantage of these opportunities, given its established base in related sectors, such as electronics and motor vehicles. While retooling will be necessary, the existence of an effective supplier network and integrated supply chains could be an important advantage in building back better supply chains for the future. The UK has an ambitious target for net zero carbon emissions, and has adopted a Ten Point Plan (HM Government, 2020) that brings together ambitious policies and public investment in low-carbon technologies and services. Partnership with ASEAN for supply chains and markets will bring together supply chain efficiency, jobs, and growth on both sides.

ASEAN's trade in services relies greatly on the travel and tourism sector. In 2018, 12% of ASEAN's GDP came from this sector. Travel accounted for 33% of ASEAN's total services exports in 2019. Apart from Singapore, which is diversified into financial services and transport, most AMS require greater penetration in other sectors of services trade (Figure 2.5). 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 components of goods trade. Investment and technical cooperation in these sectors, especially in AMS where UK firms have significant presence, will forge a resilient and forward-looking partnership in which both partners build back better.

Figure 2.5: Services Exports (Sectoral) in ASEAN and the United Kingdom, 2019



ASEAN = Association of Southeast Asian Nations, n.i.e. = not included elsewhere.

Notes: Data for Brunei, the Lao People’s Democratic Republic, and Myanmar are from 2018. The International Trade Centre defines ‘other business services’ as (i) research and development; (ii) professional and management consulting services; and (iii) technical, trade-related, and other business services.

Source: ITC (2021).

Research and development (defined as ‘other business services’ in services trade) is a sectoral link with significant potential for putting in place enhanced mechanisms for cooperation. The future of work and 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 quintessentially the UK’s role in an enhanced UK–ASEAN cooperation plan for building back better.

Structure of the Study

This chapter has made a broad assessment of the resilience of trade and the performance of supply chains in ASEAN before and during COVID-19, and underlines the pathways ahead for UK–ASEAN trade and economic cooperation, which are based on the UK’s core principle for building back better even while utilising the existing core strengths of the two economies.

Chapter 3 covers bilateral trade flows between the UK and ASEAN; the evolution of gross bilateral exports and imports over the past decade, especially in key sectors (agriculture, food products, textiles, pharmaceuticals, parts & components, and machinery & equipment); and positions ASEAN–UK trade in the global context. It focuses on trade flows between ASEAN and the UK compared with EU member countries. It includes boxes on international trade in services and the RCEP and CPTPP

trade agreement in Asia, underlining the UK's policy directions for greater trade engagement with ASEAN and East Asia.

Chapter 4 assesses the degree and nature of ASEAN's trade integration with the UK and selected EU economies (Germany, France, the Netherlands, Italy, and Spain). It makes use of value chain analysis to describe the degree and nature of trade integration between ASEAN and the UK, and in the global context. It covers an overall characterisation, as well as sectoral disaggregation, of the main trading partners. It focuses on trade integration with the EU. Until recently, the UK was a member country of the EU; now it is a competitor of the EU in international trade and in trade with ASEAN. The EU is ASEAN's third largest trading partner and its fourth largest investor. The UK must forge new ground in bilateral trade and investment with ASEAN, and this chapter provides comparative data for the UK to establish its competitiveness in key goods and services sectors which have potential for further integration.

Chapter 5 maps the developments in international trade in ASEAN and the UK following the COVID-19 outbreak in 2020 and compares them with the EU and global performance during the same period. It covers an overall characterisation and, when possible, disaggregation by type of product for the main trading partners. It focuses on identifying the breaks in trade trends described in the previous two chapters.

Chapter 6 is a special addition to the study as it incorporates the results of an ERIA survey of supply chain mechanisms and trade performance amongst domestic and international firms in ASEAN during the COVID-19 pandemic in 2020. This chapter helps in understanding the types of shocks delivered to the ASEAN economy, and the subsequent performance and resilience of supply chains across major industries in the region. Data on changes made by firms in customer and supplier relations, their plans for business expansion, and government assistance to industries will help stakeholders in the UK and ASEAN to respond to and plan for trade and investment facilitation according to regional needs. The prognosis for the digitalisation of supply chains can also be sourced from these data.

The concluding chapter derives the policy directions emanating from the previous chapters and proposes a working strategy for expanding UK-ASEAN trade and deepen supply chain integration in the post-COVID-19 recovery and rebuilding months.

Faced with the twin economic and health crises, this study underlines the dynamism of businesses in the AMS. It is widely recognised that the trough of global economic performance is likely to be very deep and prolonged – causing a recession that will generate a serious demand shock which may decay the whole economy (Kimura, 2020). However, international cooperation and bilateral support is the way forward. The UK and ASEAN dialogue partnership comes at an opportune time, almost uniquely so, to contribute to economic resilience in the post-COVID-19 period, grow the bilateral economic linkages, and sustain the trade and investment plans of the future.

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