

Key Messages:

- For the global economy, decoupling has a negative impact and should be avoided. It is important for each stakeholder to continue efforts to maintain an open economy.
- For the Association of Southeast Asian Nations (ASEAN) Member States, countries that do not belong to either camp would have a relative advantage if decoupling were to occur despite the efforts of economic actors. Upholding an open, rules-based international trade order is consequently in the interests of ASEAN Member States and their people. ASEAN could demonstrate to the world – through ASEAN centrality – the role that third countries should play in efforts to prevent decoupling from occurring and to avoid participating in decoupling.
- Companies should optimise and restructure their supply chains, considering the constraints both when decoupling occurs and when it does not. Small and medium-sized enterprises should continue to seek links with global supply chains, even with decoupling.
- Company actions reported in the news and in the simulation results show that companies are not trying to completely separate their supply chains between China and the rest of the world, but are slightly reducing the degree of production concentration in China. Such corporate behaviour is more appropriately interpreted as a continuation of the China+1 Policy. This calls into question the veracity of media reports about companies pushing decoupling.

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ASEAN's Role in the Threat of Global Economic Decoupling: Implications from Geographical Simulation Analysis

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The war between Russia and Ukraine since February 2022 has triggered renewed concerns about global economic decoupling. Although the face-to-face meeting between the United States and China leaders in November 2022 agreed to continue the dialogue, it is premature to assert that progress has begun in the direction of avoiding decoupling. We used the geographical simulation model (IDE/ERIA-GSM) to examine the possible economic impacts of global economic decoupling on the Association of Southeast Asian Nations (ASEAN). We define decoupling as policy changes that raise barriers to trade in goods and services and firms' responses to these changes. If policy decoupling occurs despite the efforts of economic agents, the global economy is negatively affected. ASEAN has a relative advantage through positive trade diversion effects if it does not join any of the groups. Adherence to a rules-based international trade order will ultimately benefit ASEAN Member States and people. ASEAN should demonstrate ASEAN centrality and show the world its efforts to avoid decoupling. It should also avoid participating in decoupling if it occurs.

Concerns about Global Economic Decoupling

The war between Russia and Ukraine, which started in February 2022, has triggered renewed concerns about decoupling of the global economy. How will decoupling affect the economies of the Association of Southeast Asian Nations (ASEAN)? This article presents past analyses using the geographical simulation model (IDE/ERIA-GSM) of (i) the United States (US)–China economic war and (ii) sanctions against Russia. It then presents the results of a simulation conducted in November 2022, assuming a future decoupling of the global economy, and discusses the possible economic consequences for ASEAN.¹

¹ This study does not represent the views of the Economic Research Institute for ASEAN and East Asia (ERIA) or the Institute of Developing Economies, Japan External Trade Organization (IDE-JETRO). For more information on the analysis presented here, see Kumagai, Hayakawa, Isono, et al. (2023).

This analysis is not an endorsement of decoupling, nor does it argue that decoupling is inevitable. While we appreciate the efforts of stakeholders to ensure that decoupling does not occur, it is not futile to discuss the state of the global economy in the event of a situation that could be described as decoupling.

Concerns about decoupling of the global economy have been heightened by the Russia–Ukraine war. Singapore Prime Minister Lee Hsien Loong said in March 2022 that ‘What happens in Ukraine is bound to have a big impact on US–China relations.’ He warned that if US–China relations deteriorate, it will have great consequences for the entire Asia-Pacific region and the world (Prime Minister’s Office Singapore, 2022). At a meeting between US Secretary of State Antony Blinken and Chinese Foreign Minister Wang Yi in July 2022, Blinken stated that ‘Russia’s war in Ukraine is complicating US–China relations’ and said that the US did not believe Beijing’s claim to be neutral. Yi responded that the US was responsible for the degradation of relations between the two countries (NPR, 2022).

In response to the US announcement of the Indo-Pacific Strategy in February 2022, Chinese Foreign Minister Wang Yi declared that the ‘Indo-Pacific Strategy claims to change China’s surrounding environment, but the purpose is to try to encircle China and make Asia-Pacific countries act as “pawns” for US hegemony’ (Ministry of Foreign Affairs, China, 2022a). Following the launch of the Indo-Pacific Economic Framework by the US in May 2022, Yi stated that ‘China, like other countries in the region, welcomes initiatives that are conducive to strengthening regional cooperation, but opposes attempts to create division and confrontation’ (XinhuaNet, 2022).

The East Asia Summit, G20 Summit, and Asia-Pacific Economic Cooperation (APEC) Summit in November 2022 were expected to improve US–China relations. Indeed, the G20 saw the first face-to-face meeting between President Biden and President Xi Jinping since President Biden took office. The two leaders agreed to keep communication open and promote practical

cooperation. After the meeting, President Biden said ‘I absolutely believe there’s no need for a new Cold War’ (White House, 2022). President Xi stated that ‘The world expects that China and the United States will properly handle their relationship’ (Ministry of Foreign Affairs, China, 2022b).

On the other hand, the recent dialogue between the leaders of the US and China only confirmed the existence of intractable issues such as Taiwan, Ukraine, North Korea, and human rights. It is premature to assert that progress has been made towards avoiding decoupling. President Biden expressed US national security concerns over restrictions on sensitive US technology and raised concerns about the reliability of China’s commodity supply chain (Bose and Widiyanto, 2022). At the APEC CEO Summit, President Xi declared that ‘The Asia-Pacific is no one’s backyard and should not become an arena for big power contests’ (Ministry of Foreign Affairs, China, 2022c).

Ongoing media reports express concern about decoupling by companies. The cases of Honda Motor Company and Mazda were reported as examples of decoupling from China. In August 2022, *Sankei* newspaper reported that Honda was considering establishing an independent supply chain to reduce its dependence on China. *Sankei* stated that Honda would continue to maintain a supply chain in China for the domestic market, while building another supply chain for markets outside China. Meanwhile, a Honda spokesperson told Reuters that Honda is reviewing its entire supply chain and hedging risks, which is quite different from decoupling (Reuters, 2022a). In the same month, Mazda announced that it had begun considering ways to reduce its reliance on parts sourced via China. Mazda was forced to drastically reduce production as its supply chain was disrupted by the lockdown in Shanghai and other cities. Mazda therefore first asked its suppliers to build up their inventories and expedite establishing a system to support stable production by producing some parts in countries other than China, such as Japan (Reuters, 2022b).

Some experts consider this to be a transition from an era of economic integration to an era of economic security. In the era of economic integration, countries promoted the conclusion of free trade agreements, whereas in the era of economic security, countries have begun to impose restrictions on trade, investment, and the movement of people. Companies have responded to this by seeking to build and optimise their supply chains in the era of economic integration, but as economic security becomes the main objective of states, supply chains need to be restructured (Ishikawa, 2022).

Implications from Previous Analyses

Decoupling, where states or groups of states in two camps are economically unlinked and unaffected by each other, is often spoken of in two contexts as of the end of 2022. One is the behaviour of states or groups of states in both camps that exacerbates economic and trade frictions, which could encourage economic segmentation. The other is multinationals separating their supply chains, particularly between China and the rest of the world. Concerns about economic recession in the world today and the downturn and increased lay-offs in ICT companies, which had been said to be driving the economy, may increase the popularity of protectionist policies. With these issues in mind, we define decoupling in our simulation analysis as (i) state policies, and (ii) firms' behaviour in response to them; and see how firms in the model react to a hypothetical change in state policy.

The IDE/ERIA-GSM (Kumagai et al., 2013) is used for the simulation. The model includes both firms and consumers. For example, manufacturing firms in each region decide where and how much raw material to source, how much to produce, and how much to sell to each region, with the aim of maximising profits. Therefore, if the external environment changes, firms' behaviour will also change, resulting in economic conditions that differ from the baseline scenario.

The US–China trade war scenario by Kumagai et al. (2021) assumed that the US and China impose additional tariffs of 25% on all goods. The tariffs

are constant from 2019 to 2021, and the economic impact is calculated as of the third year (2021). Negative economic impacts would occur for the US and China, while positive economic impacts would occur for East Asia excluding China. This is because East Asia, which can import and export without additional tariffs on the US and China, is placed in a relatively favourable position. In the sanctions against Russia scenario in Kumagai, Hayakawa, Gokan, et al. (2022), many parts of the world suffer negative economic impacts because the entire world is assumed to impose sanctions on Russia.

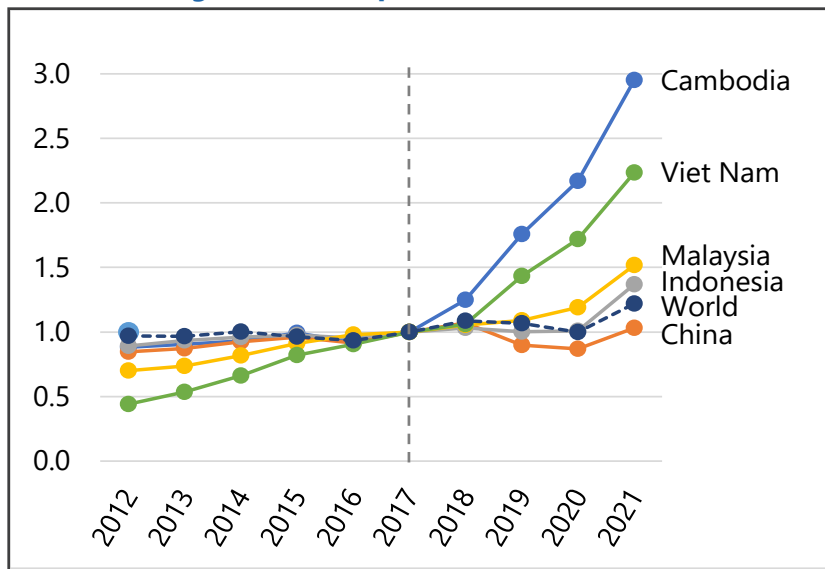
For the US–China trade war, the validity of the simulation results can be partly verified by actual trade data. Since the US–China trade conflict began, the value of exports from China to the US has decreased, while the value of exports from China to ASEAN and from ASEAN to the US has increased. For products for which the US increased its tariff rates with China, there was a significant impact on the increase in exports from Cambodia, Indonesia, and Viet Nam to the US (Hayakawa, 2022). Indeed, using US import data and normalising to 1.0 for 2017, imports from China were below the global average, while imports from ASEAN, particularly Cambodia and Viet Nam, showed higher growth (Figure 1).

Decoupling Scenario

The decoupling scenario is one in which 43 Western and three Eastern countries impose additional barriers to trade in goods and services equivalent to a 25% tariff on the other group of countries, respectively. The West comprises countries/economies defined as 'unfriendly' by Russia. The East comprises Belarus, China, and Russia. The year 2030 is used as the evaluation year, and the economic impact is compared with a baseline scenario in which no decoupling takes place.

Simulation results show that most of the countries and economies participating in both groups of decoupling will have negative economic impacts (Figure 2). On the other hand, ASEAN Member States (AMS) that do not participate in decoupling obtain a positive economic impact.

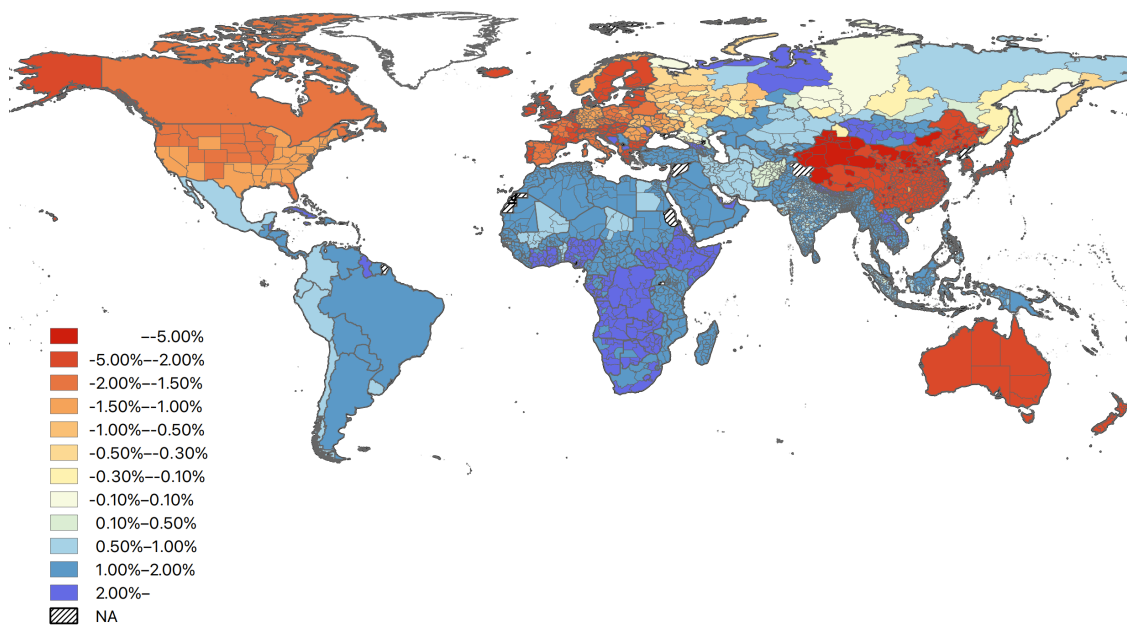
Figure 1: US Imports (2017 = 1.0)



US = United States.

Source: United Nations (n.d.), UN Comtrade Database. <https://comtrade.un.org/> (accessed 19 November 2022).

Figure 2: Economic Impact of Global Economic Decoupling (2030)



Source: IDE/ERIA-GSM simulation result.

The economic impact of the automobile sector is high when looking at the impact by industry in ASEAN (Table 1).

Contrary to intuition, Russia experiences a positive economic impact in this simulation

result. This is mainly due to reduced dependence on goods and services from the EU, leading to domestic industrial adjustment, and China being in the same camp. In fact, Figure 2 shows a relatively positive economic impact in the regions

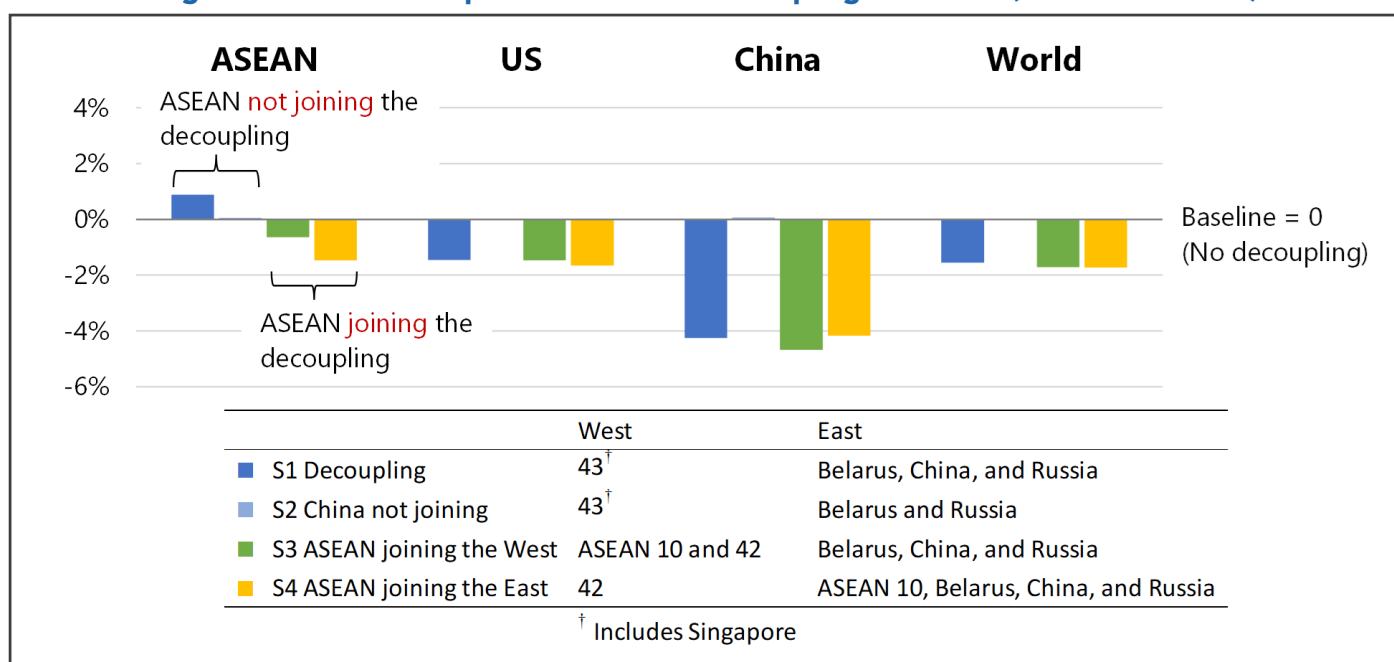
Table 1: Economic Impact of Global Economic Decoupling by Industry (2030)

Sector	Russia	China	US	EU	Japan	ASEAN	World
Agriculture	1.0%	0.3%	-0.7%	-3.1%	-4.2%	0.8%	0.2%
Automotive	5.2%	-5.8%	0.8%	-2.3%	-1.8%	3.2%	-1.2%
E&E	-3.3%	-12.2%	-1.6%	-2.2%	-2.3%	-0.3%	-6.6%
Textile	-8.1%	-11.2%	0.1%	-1.1%	1.1%	1.0%	-7.6%
Food Proc.	-9.9%	-11.9%	-2.3%	-1.7%	-1.5%	-0.2%	-4.3%
Oth. Mfg.	-9.3%	-12.0%	-1.1%	-2.0%	-1.0%	-0.4%	-5.6%
Services	2.9%	2.0%	-1.5%	-1.9%	-2.7%	1.3%	-0.5%
Mining	0.9%	-0.4%	-0.3%	-3.8%	-2.4%	0.9%	0.2%
GDP	0.7%	-4.3%	-1.5%	-1.9%	-2.5%	0.9%	-1.6%

ASEAN = Association of Southeast Asian Nations; E&E = electronics and electric appliances; EU = European Union; GDP = gross domestic product; Oth. Mfg. = other manufacturing; US = United States.

Source: IDE/ERIA-GSM simulation result.

Figure 3: Economic Impact of Different Decoupling Scenarios (2030 vs baseline)



ASEAN = Association of Southeast Asian Nations; E&E = electronics and electric appliances; EU = European Union; GDP = gross domestic product; Oth. Mfg. = other manufacturing; US = United States.

Source: IDE/ERIA-GSM simulation result.

of Russia close to China.

How would the results change if China were to leave the East or if ASEAN were to join either camp? Simulation analysis is suitable for comparing such hypothetical scenarios. If China leaves the East, Russia's economic impact turns negative, while the economic impact of the

other countries is considerably smaller. ASEAN continues to receive a positive economic impact because of its lack of affiliation with either grouping.

By joining either camp, ASEAN's economic impact turns negative (Figure 3). This result shows that ASEAN finds it difficult to rely solely on the West

or the East. On the other hand, China and the US have greater negative impacts when ASEAN joins the other camp. For China, if decoupling with the West is inevitable, the negative impact can be slightly mitigated by ASEAN joining its camp. Thus, even with an exclusively economic focus, we can see the incentives for China and the US to entice ASEAN into their camps.

Policy Recommendations for the World and ASEAN

The results have different implications for the world as a whole, ASEAN, and individual companies. For the global economy, decoupling should be avoided as it has a negative impact. It is important for each stakeholder to continue efforts to maintain an open economy. This may sound simplistic, but it is the most important message reflected in the simulation results. The East Asia Summit, G20 Summit, and APEC Summit in November 2022, chaired by Cambodia, Indonesia, and Thailand, respectively, provided opportunities for discussion to address regional and global issues. This shows the world that AMS are important players in sustaining open economies.

For AMS, if decoupling occurs despite the efforts of economic actors, countries that do not belong to any of the groups will have a relative advantage. The simulation results clearly show that joining one of the camps results in a worse economic situation than in the baseline case where no decoupling occurs, while not joining results in a positive economic impact due to trade diversion effects.

For individual companies, it is necessary to optimise and restructure their supply chains, taking into account the constraints both when decoupling occurs and when it does not. It is worth noting that the actions of certain companies reported in the news and in the simulation results show that those companies are not trying to completely separate their supply chains between China and the rest of the world, but are slightly reducing the degree of production concentration in China. It is more appropriate to say that company actions are not decoupling in the sense

of separating China's supply chain from the rest of the supply chain – they are a continuation of the China+1 Policy, which reduces overdependence on China. There have been moves to ban certain patents, companies, and components, but these have not spread to all items or industry as a whole. Completely decoupling the supply chain between China and the rest of the world is not the optimal action in this context. As well as clarifying what is meant by the term decoupling, policymakers, experts, and people should not be misled by narrow-minded arguments in the media. Companies have continued to optimise not only in response to trade frictions, but also in response to various changes in the external environment, such as economic crises, disasters, the coronavirus disease (COVID-19), and rising transport prices, as they occur. In this sense, it is more appropriate to regard supply chain restructuring as part of ongoing optimisation rather than a new phenomenon.

The results of this simulation do not claim that this decoupling has made it meaningless for small and medium-sized enterprises to seek links with global supply chains. Supply chain linkages remain valid. Supply chains as a whole are robust and resilient and have withstood disasters and epidemics. The problem is that the future is uncertain, and it is difficult to imagine not only the current optimal state of global supply chains, but also the future optimal state. ASEAN and AMS need to continue their efforts to uphold an open economy, provide accurate information, and present a credible roadmap of what future economic integration will look like. Kimura (2021) explained, for example, that binding free trade agreements can help increase future predictability.

As discussed above, while decoupling concerns exist and protectionist policies are likely to be popular, maintaining an open, rules-based international trade order is ultimately in the interests of countries and people. ASEAN can demonstrate ASEAN centrality and show the world the role that third countries can play in both efforts to avoid decoupling and to avoid participating in decoupling.

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