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A Chinese perspective

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REGIONAL ECONOMIC INTEGRATION IN THE POST-PANDEMIC ERA

RSIS Monograph No. 37
August 2022

Edited by
Xue Gong

RSiS

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INTERNATIONAL
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**NANYANG
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SINGAPORE

RSIS MONOGRAPH NO. 37

REGIONAL ECONOMIC INTEGRATION IN THE POST-PANDEMIC ERA

Edited by Xue Gong

S. Rajaratnam School of International Studies

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Published by

S. Rajaratnam School of International Studies

Nanyang Technological University

Block S4, Level B3, 50 Nanyang Avenue

Singapore 639798

Telephone: 6790 6982 Fax: 6794 0617

Website: www.rsis.edu.sg

First published in 2022

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Produced by **BOOKSMITH**

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ISBN 978-981-18-5350-0

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A Chinese Perspective

Henry Gao

Many factors have been driving regional economic integration in the Asia-Pacific in the past two decades, but the main driving force in the past decade has been the strategic competition between the two biggest powers in the region — the United States and China. This paper discusses the Chinese perspective of how the US-China strategic competition has shaped regional economic cooperation, along with the disruptions brought by the COVID-19 pandemic. It concludes with some thoughts on post-pandemic economic cooperation in the region.

US-CHINA STRATEGIC COMPETITION

In the history of US-China strategic competition, 2008 was a watershed year. Before then, the United States largely welcomed China's participation in global economic governance as a new member of the WTO and encouraged it to play a bigger role in the multilateral trading system. However, the relationship started to become acrimonious after the WTO mini-ministerial held in July 2008 failed to revive the ill-fated Doha Round of negotiations. When the United States, in an attempt to salvage the round, requested China to provide additional concessions on special products in agriculture and in sectoral negotiations on industrial goods, China declined as the same demands were not made of India or Brazil.¹ The United States subsequently accused China of walking back on the text despite getting “a seat at the big kids’ table” as it had requested,² which drew an angry retort

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- 1 For details of the US request and China's reaction, see Henry Gao, “From the Doha Round to the China Round: China's Growing Role in WTO Negotiations”, in *China in the New International Economic Order: New Directions and Changing Paradigms*, ed. Lisa Toohey, and Jonathan Greenacre (Cambridge University Press, 2015), 79-97.
 - 2 Paul Blustein, “Misadventures of the Most Favored Nations: Clashing Egos, Inflated Ambitions, and the Great Shambles of the World Trade System,” (Public Affairs, 2009), 274. See also Gao, “From the Doha Round”.

from China's WTO ambassador Sun Zhenyu, who gave a diatribe outlining China's contributions in various areas to the Doha Round as a response to the US "finger pointing".³

After the Western world plunged into a financial crisis later that year, China was able to avoid the contagious effects from the global crisis by maintaining its restrictions on foreign exchange and capital flows. This bolstered China's confidence in the so-called Beijing Model, a model of economic growth that relies heavily on government intervention.⁴ Its incomplete market reform, long regarded as an embarrassing failure, is now hailed by China as a unique feature of the Chinese system. Moreover, with the country's emergence as the biggest exporter in 2009 despite the 13% contraction in global trade, Chinese leaders started to question the wisdom of more market-oriented reforms.

Concerned over the continued rise of China, the United States announced its "pivot to Asia" and launched negotiations to join the Trans-Pacific Partnership (TPP) to "make sure that the United States — and not countries like China — is the one writing this century's rules for the world's economy".⁵ While the TPP does not target China directly, the attacks on China became more blunt after Donald Trump became US president in early 2017. The president's push for "decoupling" from China escalated into a bilateral trade war, with much of the bilateral trade becoming subjected to additional unilateral tariffs. Even with the signing of the Phase One Agreement between the United States and China in 2020, the bilateral trade relationship has not fully recovered.

3 Sun Zhenyu, H.E. Ambassador, Permanent Mission P.R.C. to the WTO, Statement at the Informal Trade Negotiations Committee Meeting (Aug. 11, 2008), cited in Henry Gao, "China's Changing Perspective on the WTO: From Aspiration, Assimilation to Alienation," *World Trade Review* 21, no.3 (2022): 346.

4 For more on the Beijing Model, see Gregory Shaffer and Henry Gao, "A New Chinese Economic Order?" *Journal of International Economic Law* 23, no. 3 (2020): 607–635.

5 White House (archives), "President Obama: 'Writing the Rules for 21st Century Trade'", 18 February 2015, <https://obamawhitehouse.archives.gov/blog/2015/02/18/president-obama-writing-rules-21st-century-trade>.

IMPACT OF US-CHINA STRATEGIC COMPETITION ON REGIONAL ECONOMIC INTEGRATION

The US-China strategic competition not only resulted in a fundamental change in the bilateral economic relationship, but also significantly altered the course of regional economic integration. For a long time, the contours of regional economic integration in East and Southeast Asia had been largely shaped by the players from within the region. This started with China's courtship of ASEAN in 2000, which led to the launch of negotiations for a free trade agreement (FTA), a first for both parties. China's aggressive FTA strategy⁶ resulted in a wave of "competitive regionalism" among ASEAN's neighbours, as all of its external partners started to negotiate FTAs with the 10-country bloc.

As the US-China strategic competition heated up, the United States started to realise the strategic value of the region, a realisation reflected in its new "pivot to Asia" approach. The centre piece of this strategy was the TPP, which was used by the United States as a key instrument to rally allies in the Asia-Pacific. Two features in the TPP are of particular relevance to China.

The first is the rules-of-origin feature. Such rules can be found in every FTA to make sure that the benefits available under it would be enjoyed only by its members. What is different about the TPP, however, is that it contained some of the strictest rules of origin in an effort to ensure that non-members like China would not have a free ride. One example is the notorious "yarn-forwarding rule", which states that a final apparel product would be considered as "originating [from the country concerned] only if such fabrics are both formed and finished from yarn that is formed and finished in the territory of one or more of the Parties."⁷ Essentially, this provision was put in place to make sure that China would not be able to piggyback on the preferential access created under the TPP by exporting yarn to TPP members. Even though a short-supply list was later added at the request of Vietnam

6 Henry Gao, "China's Strategy for Free Trade Agreements: Political Battle in the Name of Trade" in *East Asian Economic Integration*, eds. Ross P. Buckley, Richard Weixing Hu, and Douglas W. Arner (Edward Elgar Publishing, 2011), <https://www.elgaronline.com/view/edcoll/9781849808682/9781849808682.00012.xml>.

7 Government of Canada Website, "Consolidated TPP Text — Annex 4-A — Textiles and Apparel Product — Specific Rules of Origin", n.d., accessed 10 February 2022, <https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/04-ad.aspx?lang=eng>.

to create an exception for yarn that is not readily available within the TPP countries, the yarn-forwarding rule was widely recognised as having the effect of excluding China from the TPP and artificially cutting it out of the supply chain network in the Asia-Pacific region.

Second, the United States pushed for the inclusion of rules on state-owned enterprises (SOEs), competition, and electronic commerce. These rules answer then president Barack Obama's call to make sure that it is "the United States — and not countries like China — [that] is the one writing this century's rules for the world's economy".⁸ Such rules "up the game"⁹ for regional economic cooperation by pre-empting the China challenge and informing future discussions on these issues in other regional and global fora such as the WTO.

With the United States reaching across the Pacific to assemble its allies in the TPP to contain China, China started to make its own moves, which involve two components.

The first component is rebuilding the supply chains interrupted by the United States. This was mainly done through the launch of negotiations on the Regional Comprehensive Economic Partnership (RCEP) in November 2012.¹⁰ China had long advocated for regional economic integration between East and Southeast Asia, but its preferred set-up was ASEAN+3, i.e., China, Japan and South Korea. Japan, on the other hand, preferred to add three more countries, i.e., India, Australia and New Zealand, as counterbalances to China. China's willingness to go with the ASEAN+6 model reveals its sense of urgency following the US accession to the TPP, which could severely disrupt China's supply chains in the region with provisions such as the yarn-forwarding rule that makes it difficult for TPP members to use inputs from non-members in the production process.

Moreover, in 2013, China announced two major initiatives: the Silk

8 White House (archives), "President Obama: 'Writing the Rules for 21st Century Trade'".

9 Reuters, "Obama Praises Business Deals, Touts US Enterprise", 28 April 2014, <https://www.reuters.com/article/uk-obama-praises-business-deals-idUKBREA3R0DM20140428>.

10 ASEAN, "Joint Declaration on the Launch of Negotiations for the Regional Comprehensive Economic Partnership", n.d., <https://asean.org/wp-content/uploads/2016/10/SEOM-AFPs-Bali-Annex-4-Joint-Declaration-on-the-Launch-of-Negotiations-for-the-RCEP.pdf>.

Road Economic Belt, which connects China with Europe through the Eurasian continent,¹¹ and the 21st Century Maritime Silk Road, which links China with the Southeast Asian countries, Africa and Europe across the Pacific and Indian Oceans.¹² Later, combined together as the Belt and Road Initiative (BRI), this initiative has since become the centrepiece of President Xi Jinping's foreign policy. Spanning 65 countries in three continents with a total population of 4.4 billion,¹³ the BRI reportedly accounts for 29% of global GDP and 23.4% of global merchandise and services exports.¹⁴ By "linking up the interests of China with those of developing countries in Asia, Africa, and Latin America",¹⁵ the BRI helps China to build its own supply chain without direct confrontation with the United States in the Pacific.

Second, contrary to the US approach, which keeps introducing new and stricter rules, China lowers the bar for regional economic integration. The BRI is a good example, as many of the countries in the initiative are low-income developing countries or even least-developed countries that have difficulties meeting even the basic rules under the WTO. Unlike the United States, China adopts an open approach and does not prescribe any conditions for participation in the BRI. This is also reflected in RCEP, where the

-
- 11 First suggested by President Xi Jinping in a speech titled "Promote People-to-people Friendship and Create a Better Future" at Kazakhstan's Nazarbayev University on 7 September 2013. See Ministry of Foreign Affairs, PRC, "President Xi Jinping Delivers Important Speech and Proposes to Build a Silk Road Economic Belt with Central Asian Countries", 7 September 2013, http://www.fmprc.gov.cn/mfa_eng/topics_665678/xjpfwzysiesgjtffshzsfh_665686/t1076334.shtml.
 - 12 First proposed by President Xi in his speech to the People's Representative Council of Indonesia on 2 October 2013. See Wu Jiao, "President Xi gives Speech to Indonesia's Parliament", *China Daily*, 2 October 2013, https://www.chinadaily.com.cn/china/2013xiapec/2013-10/02/content_17007915.htm.
 - 13 www.scio.gov.cn, "Yidai Yilu Tichu de Beijing ji Juti SiluZhanlue de Tichu he Xingcheng [The introduction and implementation of the Belt and Road Initiative]", 14 April 2015, <http://www.scio.gov.cn/ztk/wh/slxy/31200/Document/1415297/1415297.htm>.
 - 14 For a detailed review of the Belt and Road Initiative, see Gregory Shaffer and Henry Gao, "A New Chinese Economic Order?" *Journal of International Economic Law* 23, no. 3 (2020): 614–20.
 - 15 Xi Jinping, "Tongchou Liangge Daju, Hangshi zou Heping Fazhan Daolu de Jichu [Coordinate Two Grand Schemes and Lay a Solid Foundation for the Path of Peaceful Development]", speech at the third joint study session of the 18th Politburo of the CCP, 28 January 2013, http://www.gov.cn/ldhd/2013-01/29/content_2321822.htm.

rules are diluted to ensure the maximum participation of all countries. For example, the chapter on e-commerce comes with extensive exceptions and is excluded from the dispute settlement chapter. Similarly, China also agreed to the removal of the investor-state dispute settlement (ISDS) mechanism from the investment chapter even though China has shifted from shunning investment disputes to embracing the ISDS in recent years and proposed texts on ISDS during negotiations for the RCEP.

While the US-China strategic competition resulted in disruptions for firms in the United States and China, it could be a boon for firms in South-east Asia as both countries aim to enhance their economic links with the region. Already, in the midst of the US-China trade war, many Chinese firms started to shift their production to Southeast Asia to evade additional tariffs. However, due to the lack of skilled labour and infrastructure networks in the region, many firms found that the tariff costs they saved were offset by the additional costs of operating from Southeast Asia and some even relocated back to China. However, should the trade tensions grow, many firms may make more permanent moves to the region and start to invest additional resources to upgrade their human resources and infrastructure in the region.

COVID-19 PANDEMIC AND BEYOND

Other than the US-China trade war, the COVID-19 pandemic also has brought “unprecedented disruption to people’s lives, the global economy and world trade”, as noted by the WTO.¹⁶ What is interesting, though, is that the impact of the pandemic on the two largest economies in the world has been uneven, with China seeing its trade surplus jumping 30% in 2021 from the year before to set a new record of US\$676 billion,¹⁷ while the United States recorded a 27% increase in its trade deficit to an all-time high of US\$859.1 billion.¹⁸

16 WTO, “COVID-19 and World Trade”, n.d., https://www.wto.org/english/tratop_e/covid19_e/covid19_e.htm.

17 Stella Yifan Xie, “China’s Export Machine Notches New Record as Pandemic Grinds on”, *Wall Street Journal*, 14 January 2022, <https://www.wsj.com/articles/chinas-export-machine-notches-new-record-as-pandemic-grinds-on-11642150270>.

18 Yuka Hayashi and Anthony DeBarros, “US Trade Deficit Hit Record in 2021 as Americans Spent on Computers, Games”, *Wall Street Journal*, 8 February 2022, <https://www.wsj.com/articles/economic-recovery-pushes-2021-u-s-trade-deficit-to-record-level-11644328979>.

What are the reasons for these differences? In a 2018 article in the *Journal of International Economic Law* contrasting Washington and Beijing's approaches to digital trade, I argued that their differing positions can be explained by the different nature of trade, with China focusing on the traditional trade in goods while the United States focuses on trade in digital services.¹⁹ The same explanation also works here. If we look at COVID-related trade restrictions around the world, they tend to be mainly restrictions on the movement of persons while the trade in goods is largely kept free of restrictions. Thus, naturally, the restrictions would affect service-oriented economies like the United States (which rely on movement of persons) more than heavy goods exporters like China.

On the other hand, as most of the Western countries, including the United States, are ending their COVID restrictions, the table might flip for China, which seems set on continuing its zero-COVID policy, at least for the next few months. This may lead to further disruptions to supply chains and regional integration efforts in the region, but there are also signs that China may readjust its position once most of the rest of the world reopens.

Going forward, however, the policy choices made by the two countries, especially those on regional economic integration, will have a bigger impact on their respective trade performances. On the one hand, since the signing of the US-Mexico-Canada Agreement (USMCA) in November 2018, the United States has not negotiated any FTA and currently does not have plans to do so. During the same period, China has signed FTAs with Mauritius and Cambodia, seen the entering into effect of upgrades to its FTAs with Chile (March 2019), Singapore (October 2019), ASEAN (October 2019), and Pakistan (December 2019), signed upgrades to its FTA with New Zealand (January 2021), concluded and launched RCEP, and applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the successor to the TPP after the United States withdrew from it,²⁰ and the Digital Economy Partnership Agreement, first signed by Chile, New Zealand and Singapore in June 2020.

19 Henry Gao, "Digital or Trade? The Contrasting Approaches of China and US to Digital Trade", *Journal of International Economic Law* 21, no. 2 (June 2018): 297–321.

20 Henry Gao and Weihuan Zhou, "China's Entry to CPTPP Trade Pact is Closer Than You Think", *Nikkei Asia*, 20 September 2021, <https://asia.nikkei.com/Opinion/China-s-entry-to-CPTPP-trade-pact-is-closer-than-you-think>.

Since coming into office a year ago, the Biden administration has been busy promoting its “worker-centred trade policy”, which unfortunately lacks substance. In view of the controversial nature of trade policy in US domestic politics, it is highly unlikely that the United States will be able to make major moves in the next two to three years. Indeed, even the widely anticipated Indo-Pacific Economic Framework could end up more hollow than it sounds as it will reportedly focus on issues including digital trade, supply chains and green technology.²¹ Given the well-known resistance to these issues by India, the biggest player among the 12 countries that joined the United States in announcing the launch of the framework in May 2022, the US plan may turn out to be mere rhetoric, making it harder for countries in the region to resist the force of gravity exerted by the Chinese economy.

21 Yuka Hayashi, “US Readies New Asia-Pacific Economic Strategy to Counter China”, *Wall Street Journal*, 6 February 2022, <https://www.wsj.com/articles/u-s-readies-new-asia-pacific-economic-strategy-to-counter-china-11644148801>.

Global and regional economic trends over the past several years have given much cause for both optimism and pessimism. On the one hand, the COVID-19 pandemic and US-China strategic competition, as well as nationalist and populist concerns, have unravelled economic cooperation and disrupted supply chains. On the other hand, there is a trend towards multilateralism. Mega-free trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) have entered into force. Also, regional governments have put forward several initiatives to strengthen regional economic institutions and resilience. In light of these developments, this RSIS monograph seeks to examine how regional countries could bolster economic integration in a post-pandemic era and to offer policy recommendations for the way forward.

