

Reorganizing Global Supply Chains Central to “Upgrading the Free Trade System”

By Masakazu Toyoda

METI's White Paper on International Economy and Trade 2021 highlights “enhancing the resilience of supply chains” as a key to realizing economic recovery from the pandemic. The need to reorganize supply chains with a heavy dependence on China was often mentioned in Japan early in the 2000s. When the pandemic disaster first broke, China implemented an early lockdown policy and subsequently had to suspend work at many factories, causing a shortage in supply of parts and components for automobiles and electric and electronic appliances. Businesses in many countries were affected, and have now begun to consider reorganizing their China-centered supply chains much more seriously than ever.

In addition, with “teleworking” and “nesting consumption”, byproducts of the pandemic, digitalization is rapidly underway, and this has created a serious shortage of semiconductors, an issue that is not completely resolved yet. Furthermore, although Japan is believed to have highly advanced medical technology, its failure to be properly prepared for vaccine manufacturing and even importing sufficient amounts of vaccine have made promoting “resilience of supply chains” even more vital.

In view of these points, this White Paper's aims are particularly relevant. China is celebrating the 100th anniversary of the Chinese Communist Party after seeming to have emerged from the pandemic earlier than the rest of the world last year, but its aggressive foreign policy is now causing concern, and there are good reasons from a geopolitical standpoint why nations should not depend excessively on China, considering that the US-China conflict appears to be one of the two different political systems that some people call a second Cold War .

The White Paper notes that the Japanese manufacturing industry presence in China has started to decline, with its peak in 2012, while its presence in ASEAN and India is rising. The Japanese government has advocated for a “China+1” policy for 20 years and it seems to have had some effect since the beginning of the 2010s.

So what are the principles for achieving greater resilience of supply chains? Let me think about them in the light of the White Paper's analysis.

First, enhancing the resilience of supply chains would not necessarily mean reshoring. As is indicated in the “China+1” policy, there are rationales for the relocation of manufacturing sites within regions such as Asia, North and South America, or Europe. This is inevitable in the light of rising labor costs in China. On the other hand, reshoring of production sites to Japan, the United States or Europe would generally lead to higher-cost

production and thus would make it necessary to reorganize supply chains fundamentally.

Second, digitalization would lower labor costs. In this light, reshoring could be a key option as the natural outcome of trade liberalization rather than protectionism. It is true in the case of Japanese companies that they develop new products and production processes mostly in Japan, so reshoring would not be so difficult for them. European firms may be similar to Japanese ones in this regard, but in the case of US firms their supporting industries, a vital factor in achieving reshoring, might have disappeared in some cases and a rather long time may be necessary to rebuild them.

Third, what the White Paper calls “upgrading the free trade system” is a core concept in their analysis. It refers to the importance of a multi-layered approach meaning “creating norms and rules in the OECD or APEC as a venue for formulating soft laws, in addition to making hard laws at venues like the WTO and EPA”. Based on this concept, it might be worth creating a loosely connected union of nations, such as a “West Pacific Union” advocated by Dr. Shinichi Kitaoka, chairman of the Japan International Cooperation Agency, something rather like the EU. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) could also be a basis for this idea, and would be better still if the US was ready to join it, and it could work towards concluding comprehensive rules on trade and investment, including stable supply chains. Of course, we would welcome China's agreement with such rules and then the US-China confrontation could be greatly mitigated.

Overall, what matters is to ensure a rule-oriented world. In 2008, the last Ministers Meeting of the Doha Round ended in rupture. It was a pity as the member nations agreed upon almost all the issues. Thereafter, we entered an age when trade agreements were concluded either as bilateral or regional FTAs. But what matters most in achieving resilient supply chains is creating multilateral rules agreed upon by many countries beyond the limits of region. Rules should resolve all issues such as raising or lowering tariffs in trade, protection of intellectual property rights, freedom of investment, and even human rights protection or territorial dispute settlement. This is why we need to upgrade the free trade system. **JS**

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