

Interview with Dr. Muhamad Chatib Basri, Senior Lecturer, Department of Economics, University of Indonesia & Former Minister of Finance of Indonesia

How Can We Achieve Regional Peace & Prosperity in the Asia-Pacific Area Against Rising Geopolitical Crises?

By *Japan SPOTLIGHT*

Asia-Pacific economies, in particular Southeast Asian economies, have been a driving force behind world economic growth for decades, and they currently maintain the highest growth potential. But this is being challenged by the global pandemic and geopolitical crises, as well as their economies having reached maturity, which makes it difficult for them to achieve outstanding higher growth.

Dr. Muhamad Chatib Basri from Indonesia, a distinguished leading thinker in this region, kindly responded to our questions in the following interview.

(Online interview on Sept. 7, 2022)

Economic Outlook for the Southeast Asian Economy

JS: What is your current outlook for the Southeast Asian economy in light of rising energy and food prices caused by Russia's invasion of Ukraine, and US monetary tightening?

Basri: Let me answer from two perspectives. The first is the short-term perspective. If you look at the current situation in the Southeast Asian economy, I would say that currently the impact is still relatively minimal. For example, inflation in many Southeast Asian economies is still low compared with countries in Europe and the United States; even though inflation is rising, it is still relatively low. If you look at the growth of Southeast Asian economies, including countries like the Philippines, where growth is about 8%, and Indonesia has growth of 5.4%, so many Southeast Asian countries remain resilient despite the current situation. At this stage we still haven't really seen the spillover from the war in Ukraine, the tightening of US interest rates, and high energy and food prices. I believe the reason behind this is a lag effect. The US is technically in a recession, with negative growth for two consecutive quarters, but the impact on the rest of the world may appear sometime next year.

Another reason is that countries like Indonesia benefit from high energy and commodity prices, and that explains why our exports were still relatively strong despite the tightening cycle in US monetary policy. The third reason that Southeast Asian countries are not facing inflation like in advanced economies is that the stimulus was relatively low compared with Europe and the US, so the inflationary impact is relatively lower at this point. But these are only the short-term issues.

My second perspective is the long-term perspective. I believe the Federal Reserve will continue with the tightening cycle to combat

inflation in the US, and I wouldn't be surprised if, in the next round, it continues to raise interest rates by 50 or 75 basis points. The US somehow needs a recession to contain inflation. Similar things also apply in Europe. With the two major economies – the US and the EU – facing the possibility of a recession, there will also be an effect on countries like China and Japan. Once China and Japan are affected, we will probably see a slowdown in the Southeast Asian economy sometime next year. Given the fear of a recession, there is a possibility that energy prices and commodity prices will not be as high as in 2022. This has implications for countries like Indonesia that might face slower growth. My point is that the short-term outlook looks OK, but there are a lot of challenges that many Southeast Asian economies need to anticipate, including social and development issues like the K-shaped recovery and the scaling effect of the pandemic.

Industrial Policy to Save Global Supply Chains from Geopolitical Crises

JS: Thank you. My next question is about global supply chains. Current geopolitical crises appear to be having a significant negative effect on global supply chains. What do you think will be the key roles for major countries' industrial policies in containing this negative impact?

Basri: This is a very important question. With regard to the fear of disruption of supply chains, I see two competing forces here. The first is that many countries around the world will probably start to think about the importance of economic security. One thing they've learned from the pandemic is that they could not rely on other countries or be fully dependent on other countries. Look at what happened when China became the hub of the production network.

When the pandemic hit China in Wuhan, for example, we witnessed the collapse of global supply chains. This also contributed to stagflation. From this experience, many countries will probably learn that they need to diversify risk. They cannot rely entirely on one particular country or be entirely dependent on a global supply chain. The implication is that we will probably see the diversification of investment and production hubs and networks away from China to Southeast Asian economies, for example. This is because it's too risky to rely on your production network being based entirely in one particular country, so you need to diversify the production base. I wouldn't be surprised if we see many investors reallocate their investment from China to Vietnam and other Southeast Asian countries to diversify the risk. That is the first one.

The second force is that probably, in terms of this policy, some producers will change their strategy from "Just in time" inventory management to "Just in case", in the sense that you cannot afford to have supplies just in time. If something happens, you need the security, you need inventory. This has the implication that inventory costs could increase, because you need a certain level of stock in these situations. In short, I would say there is a tendency that due to economic security, supply chains will not be as integrated as what we had in the past.

But there are competing forces here. I do not think any country can afford to become an autarky, to rely only on their own domestic resources. This is because consumers will prefer high-quality goods and services that are relatively cheap. Therefore, I do believe that the role of supply chains will continue to be important. The question is how we strike a balance between those two.

One potential solution that I might see in the future is that the role of technology and digital become very important. Perhaps, if something happens in one particular country, artificial intelligence (AI) can help to identify the countries in which that kind of stock or inventory is available. One country cannot rely only on one particular country, but they do have information on inventory that is available in other countries. The second is that I wouldn't be surprised if, in the future, the role of technology becomes very important. For example, 3D printing could become very crucial to minimizing the impact of disruptions. This is because with 3D printing, you really don't need to send the product – as long as you have the design and raw materials, you can print it in your country. These could be roles for technology and digital in the future.

In this kind of situation, industrial policy becomes very important, because somehow the government needs to induce innovation. You cannot rely entirely on the private sector for this. Maybe there is a role for government, for example tax credits for innovation to

minimize supply chain disruptions.

Rules-Based Trade & Investment Regime

JS: You've mentioned two important things for avoiding disruption in global supply chains. One is diversification, and the other is technology, and I agree these are very important. One more thing that might be necessary, however, is a rules-based trade and investment system. Private companies are very concerned about policy unpredictability and unpredictable business situations. Rules-based mechanisms could be very important for avoiding this situation. What are your thoughts on this?

Basri: I couldn't agree more. Being rules-based is very important, because that can help to ensure certainty. The main challenge for investors is always related to the issue of uncertainty. I think this is very important, especially if you look at the case of the conflict between Russia and Ukraine, for example; investors or countries need to ensure that there will be some kind of guarantee that supply chains will continue and that agreements will be honored. You can see in the case of the current situation, many countries are afraid of potential issues from this kind of crisis. They may try to mitigate this issue by issuing export bans – for food, for example. In the case of the vaccines, we also learned of vaccine nationalism where they banned exports. This kind of situation, in game theory, is what economists call prisoner's dilemma. Every country focuses on its own self-interests for the short term, but the best payoff would be from cooperation in the future. That is why a rules-based approach is very important for ensuring that the international order will be in place.

Otherwise, I am afraid there is a risk that many countries will start to impose export restrictions. This would make energy prices and food prices even higher, so I entirely agree with you that this is the kind of thing we need to work out. Unfortunately, I would say that we are in a situation where we desperately need global cooperation, but the global situation right now is very fragmented, so we badly need cooperation but cooperation is not there. One way to solve this situation is to bring back order, bring back certainty about being rules-based as well, to avoid the uncertainty faced by many investors.

Role of RCEP, CPTPP & IPEF

JS: As you mentioned, multilateral cooperation is very

important, but unfortunately the WTO does not seem to be functioning very well in the area of trade and investment. Work is being done on several regional free-trade agreements to supplement the functions of the WTO. In the Asia-Pacific region in particular, countries are very keen on the restoration of a trade and investment regime. The RCEP, CPTPP, and IPEF are three attempts that seem to stand out as frameworks for the restoration of a rules-based international economic order. What is your assessment on the possible contribution from these regional mechanisms toward the restoration of a rules-based international system?

Basri: This is also a very good and very important question. Let me share my pragmatic view on this. The ideal one would be multilateralism, exactly as you said. But I think we have to be realistic about the prospects for the WTO probably being rather gloomy. We have to continue to fight for this multilateralism, but as you said, it may take some time for many countries to work this out again and continue to make the WTO work. In this kind of situation, therefore, we have two other possibilities because the prospect of multilateralism is still unclear. The second is unilateral; every country going it alone to reform by opening trade. This would also be ideal, but unfortunately, nowadays this is rather utopian in this kind of world. I can imagine many politicians asking why should we open our economy when other parts of the world are imposing protection? If a leader were to try to pursue unilateral reform, they probably wouldn't get political support. Politically, it will be very difficult to expect unilateral reform.

Therefore, the in-between, most-plausible solution to this would be open regionalism or regional trade agreements. This is exactly what you said about the RCEP and CPTPP. The way I look at the situation is that even though the ideal solution might be multilateralism, this could be used as a kind of starting point for ensuring that a rules-based framework is in place. As people feel the benefit you gain more political support, then you move to the more complex and difficult, more open; and then later on you can go to multilateral. I think this is very important.

Let me be strong and honest with you. There is a feeling or concern about geopolitical tension – not only between Russia and Ukraine but also about the US and China. This may have an impact. The trade war between the US and China will significantly affect many developing and emerging economies, including ASEAN countries. Somehow, we need to address this issue. Let me give an

example regarding the RCEP, one of the trade agreements being discussed. One of the important features of the RCEP, for example, is ASEAN as a single entity. They position ASEAN as a hub. We understand that it is not easy to deal bilaterally with economic superpowers like the US and China, so they made ASEAN the hub – ASEAN plus China, ASEAN plus Japan, plus South Korea, plus the US, and so on. This kind of model attempts to balance tension from the geopolitical perspective, while also ensuring that many Asian countries benefit from trade. Similarly, with the CPTPP, for example, the spirit is also to try to make sure that many Asian countries will continue to benefit. The difference is perhaps this issue of ASEAN as a single entity. I agree with you, however, that we have to be very realistic and pragmatic. If we cannot achieve rules-based multilateralism, then let's start with something that can be done and will still provide benefit and welfare to many Asian countries.

JS: I see. One additional question – what are your thoughts regarding the IPEF? It's an American initiative, but appears to be lacking very important elements including market access. Some countries are therefore somewhat skeptical about this attempt. What is your candid opinion of the IPEF?

Basri: I completely agree with you. When we look at a trade agreement, we have to look at both perspectives – the supply side and also the demand side. If you are talking about the demand side, while it is true that this will provide benefits in terms of an overall regional impact, we cannot forget the issue of the distributional impact as well. If you are talking about the effect of the distributional gain, then we are talking about the self-interest question: "What's in it for me?" If the market access is not there, what's the point of my joining this trade agreement? Somehow, this kind of issue needs to be addressed as well. One of the important features of the RCEP and CPTPP is the importance of market access, so that if a country looks at this it can see that it can benefit if it joins. So I fully agree. I think it is also important to address this from the supply side, in the sense that a country is able to participate, but will also ask "What's in it for me?"

Role of APEC as a Soft-Law Approach

JS: In these circumstances, with increasing uncertainty but when there doesn't seem to be any specific international organization like the WTO that can function well to achieve compromises among

major countries, a hard-law approach might not necessarily be a good way to promote multilateral cooperation. Instead, we may as well adopt a sort of soft-law approach. In that sense, how do you view the role of APEC? You mentioned the RCEP and CPTPP as possible venues for achieving a rules-based mechanism. An APEC free trade agreement could be built up by integrating the RCEP and CPTPP, so APEC might be a good venue for achieving international cooperation.

Basri: I agree, and especially if you look at it in terms of coverage, in terms of market access, that is one of the potentials. Of course, the biggest question is that when you involve an organization that is nonbinding, it is always difficult to expect realization. The important feature of the CPTPP, and the RCEP, is that countries that participate can expect a benefit. APEC is a very important organization but it's more of a forum for dialogue. We could probably use APEC as the avenue, because the idea of the RCEP, for example, is quite similar about open regionalism as well. Exactly as you said, in these circumstances where perhaps we cannot achieve the first, best solution, the ideal solution of the WTO, we have to find many venues or avenues that can help us achieve open regionalism. At the same time, don't forget that our resources are also limited. If we get involved in too many trade agreements, our resources will be diverted as well. Therefore, it seems to me that this has potential, but try to work it out on something that possibly will be on the table. That's one of the important methods.

JS: May I ask what you think about the peer review aspect of APEC? It's not binding, but there is peer review.

Basri: We have to revitalize this peer review somehow, because even though it's not binding, it can give pressure. Otherwise, it will be a kind of situation where more items will be excluded so that the countries can agree. If we can strengthen the role of this peer review for cooperation, then maybe APEC can be effective.

ASEAN Expectations of Japan in Asia-Pacific Regional Cooperation

JEF: As a final question, what do you expect from the Japanese government in achieving Indo-Pacific or Asia-Pacific regional cooperation?

Basri: This is a very important question, because I am speaking from an Indonesian perspective and Southeast Asian perspective. Let me be frank and honest with you. There is this issue of geopolitical tension about rising power in Southeast Asia, and the tension between the US and China, for example. ASEAN countries are not in a position to choose between those two; we cannot afford to choose either China or the US. This is because inevitably China is one of the largest trading partners for many ASEAN countries. Japan's role is therefore very important here, to provide balance. If there are more options available for many ASEAN countries, that would be something that would be useful for us, rather than having two elephants in the room where we are in a very difficult situation.

Japan's role here is very important, and I would expect that if Japan could be more aggressive – perhaps that is too strong – in terms of this investment cooperation and trade cooperation, I believe there would be many ASEAN countries that would like to cooperate with Japan. For a country like Indonesia, for example, we could diversify and be a part of this production network. Automobiles are very important, and Japan could play a very important role as part of a global production network. If we could not only rely on China, for example, like what happened during the pandemic, this would help to reduce somewhat, although it would not entirely eliminate, but reduce and mitigate the geopolitical tension and diversify the risk as well.

To me, cooperation with Japan is very important – it's crucial. We've experienced and witnessed the strong ties of Japanese investment in the past. This has helped many countries in ASEAN, for example, so I would hope that Japan could play a more active role in the region. This would not only diversify the risk, it would also help to minimize the geopolitical tension.

JS: Thank you very much for your time, we've learned a lot from your remarks today. **JS**

Written with the cooperation of David S. Spengler, who is a translator and consultant specializing in corporate communications.