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POSITION PAPER

Trade, global value chains and industrialization in an era of rising protectionism: implications and opportunities for Italy-ASEAN relations

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Although the ASEAN economic outlook remains positive and its trade is becoming more diversified and high-tech based, the growing **bilateral tensions between the United States and China** could pose serious concerns for regional economic growth. The effects of the trade war could have both direct and indirect impact on the ASEAN economy, bringing not only challenges, but also opportunities, especially due to the strict commercial partnership with the two economic powers involved, and the **value chain realignment** spurred by trade competition.

Trade tensions are capable of disrupting existing value chains and dampening investor confidence, especially in sectors more affected by tariffs, in which importers in China and the US are looking for alternative suppliers. Specifically, the sectors potentially most impacted could be electronics components and products, automotive and car components and apparel and textiles. Potential benefit to ASEAN countries will depend on the specific degree of trade exposure to China and the US in the industrial sectors involved, in addition to the quality of the socio-economic and regulatory framework.

Italian companies and expertise in the industrial sectors potentially impacted can function as an important asset for ASEAN countries within the context of a rearrangement of the value chains. Moreover, in a forward-looking approach, Italian companies should look to the ASEAN region as a new partner with which to work while aiming to boost the domestic market.

The ASEAN trade and industrial ecosystems are making the region a global power

1. The ASEAN region is currently in 5th place among global economies in terms of Gross Domestic Product (around $2,923 billion in 2018), and over the past 10 years it outperformed global growth (5.4% in 2018).[1] Growth prospects for the ASEAN region are expected to remain robust in the near future, albeit at different paces: the GDP of all countries is predicted to grow between 32.1% (Singapore) and 70.4% (the Philippines) by 2024.[2]

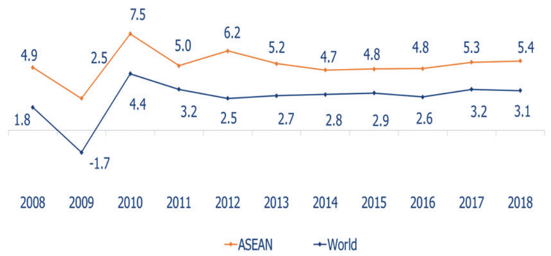

Figure 1. *GDP growth rate year on year in ASEAN and in the world as a whole, 2008-2018. (Source: The European House – Ambrosetti elaboration on World Bank data, 2019)*

ASEAN ranks 2nd for Foreign Direct Investment stock (US$2.2 trillion in 2017) and 3rd in terms of population (654 million people, 60% of whom are under 34 years of age).[3]

2. ASEAN also ranks 4th in export value (US$1.6 billion in 2017) and 3rd in import value (US$1.5 billion in 2017). Trade in goods reached US$2,574 billion in 2017, a 15% increase with respect to 2016. Meanwhile, ASEAN trade in services increased by 6.1%, from US$663 billion in 2016 to US$703 billion in 2017.[4] **ASEAN's main trade partners are China** (17.1%), the European Union (10.1%) **and the US** (9.1%). Intra-ASEAN trade accounted for the largest share of ASEAN's total trade (22.9%).

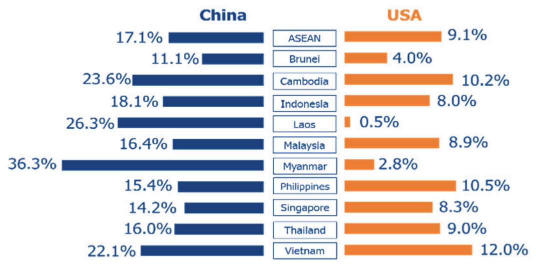

Figure 2. *Trade with China and the US as the share of total trade for ASEAN countries, 2017. (Source: The European House – Ambrosetti elaboration on ASEAN Secretariat data, 2018)*

3. Even if intermediate goods absorbed more than half of ASEAN exports (**53%**) in 2016, the share has declined since 2011, when it accounted for 61%. However, basically all ASEAN countries experienced an increase in their share of

[1] Source: The World Bank, 2019.
[2] Source: IMF data, 2019.
[3] Source: ASEAN Statistical Highlights, 2018.
[4] Source: ASEAN Secretariat, 2018.

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consumer goods, from 16% in 2011 to 21% in 2016, partially reflecting the growing internal demand of the population in the region. Capital goods showed a similar trend, rising from 19% in 2011 to 26% in 2016.[5]

4. The share of **medium and high-tech product** exports to the total of manufactured exports has increased, reaching 63% in 2016, (5 percentage points higher than in 2010). [6] This indicates a "catch-up" process through technology transfer that facilitates the shift from a low-technology consumer goods economy to a medium/high-technology capital goods economy. This phenomenon of product sophistication is mainly driven by the medium-technology industries that are contributing to a technological shift.

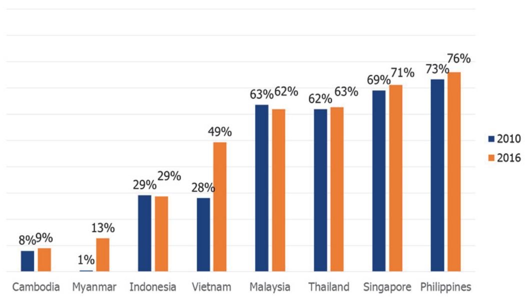

Figure 3. *Medium and high-technology exports as a share of total exports, 2000-2016. (Source: The European House – Ambrosetti elaboration on The World Bank data, 2019)*

5. ASEAN has also gained comparative advantages in different products compared with the ones in which they initially specialized. Historically, within ASEAN and its countries, electronic products and electric raw materials represented the leading area of specialization. From 2000 to 2016, the manufacturing sectors of food, beverages and tobacco; leather, rubber, wood and paper products; and miscellaneous manufacturing have increased their weight within the economy overall, making ASEAN more competitive in these fields. [7]

The US-China trade war implies complex and multi-dimensional impacts on ASEAN ICT, automotive and textile sectors

6. Although the region's economic outlook remains positive and ASEAN trade is becoming more diversified and high-tech based, the growing bilateral **tension between the United States and China** poses serious concerns for ASEAN economic growth and stability. Estimates expect the "trade war" to cost the global economy about US$400-450 billion or a global GDP decrease of 0.1-0.3%, [8] due to the decline in trade and investment, and a change in global value chains.

7. The complex and multi-dimensional impacts of the US-China trade war could have both direct and indirect effects on the ASEAN economy, bringing not only challenges, but also opportunities, especially due to the strict commercial partnership with the two economic powers involved and the value chain realignment spurred by trade competition. The final impact on each ASEAN country may vary due to different levels of dependence on US-China trade, the potential recalibration of production lines and/or redirection of trade flows due to tariffs.

8. In the medium term, the **reallocation of global value chains** is one foreseen result of the US-China trade conflict. On one hand, higher tariffs and the reduction of corporate income tax will bring some manufacturers back to the US, on the other, Chinese companies exporting to the US could find it cost-effective to relocate their facilities and production to ASEAN countries, which are not subject to tariff constraints. Nearly 20% of Chinese companies have moved or are considering moving capacity outside China. US tariffs, rising costs and slower growth are the major motivating factors. Among the top destinations of the relocation activity is Southeast Asia. [9]

9. The Foreign Direct Investment (FDI) trend corroborates this phenomenon. The FDI inward flow in ASEAN has constantly increased since 2008, reaching US$133.8 billion in 2017, with a 11.7% compound annual growth rate. The Chinese FDI outward flow to ASEAN has strongly increased in recent years, passing from US$7.9 billion in 2012 to US$11.4 billion in 2017, respectively 6% of total FDI inward flow in 2012 to 8.4% in 2017.[10] This trend is an example of the opportunities for ASEAN resulting from the reallocation of production lines. The trade war has indeed accelerated the necessity for Chinese companies to find a solution to a shortage of labour, increase in wages and demand for raw materials.

10. Trade tensions could disrupt existing value chains and dampen investor confidence, especially in sectors more affected by tariffs, i.e., electronics components and products, automotive and car components and apparel and textiles. In these sectors, trade is expected to shift since importers in China and the US are looking for alternative suppliers and new opportunities will open for exporters in third-party markets. For these reasons, ASEAN countries are receiving considerable attention.

11. Currently, US tariffs are largely applied on intermediate components, primarily in the electronics and machinery sectors. The **ICT industry** has been a particular focus for US policy makers, with a constant increase in the tariffs imposed on imports from China. The sector is the most important in terms of Chinese imports, with electronics and related component imports amounting to around US$150 billion, accounting for 29% of total imports from China.[11]

12. Vietnam and Malaysia could benefit from the escalating trade tensions, particularly in low-end manufacturing of ICT products, such as intermediate components and manufacturing of consumer goods like mobile phones and laptops. Indeed, some major international electronics companies have already established their production activities in these countries. In addition, the signing of trade partnership agreements (e.g., CPTPP and the ASEAN Economic Community) will increase

[5] Source: Asian Development Bank, 2018.
[6] Source: The World Bank, 2019.
[7] Source: Asian Development Bank, 2018.
[8] Source: International Monetary Fund (IMF), 2019.
[9] Source: American Chamber of Commerce in China, 2019.
[10] Source: UNCTAD, 2019.
[11] Source: The World Trade Organization, 2018.

the potential attractiveness for firms considering investing in these countries.

13. Thailand could also experience correlated benefits from the relocation of export-oriented ICT manufacturing (its exports in electronics were worth ~US$35.6 billion in 2017[12]), although more modest compared with Vietnam and Malaysia. Moreover, the government's policies to promote industrial upgrading (the Industry 4.0 development plan), may also reduce the cost for foreign companies seeking to establish a presence in that country.

14. The Philippines and Singapore, on the other hand, could be hit negatively. Indeed, the tenuous regulatory and business environment in the Philippines, mixed with a slow digital ecosystem, could undermine investment inflow, despite shipments of ICT intermediate components from the Philippine to the Chinese market play an important role in the economy. Singapore is also expected to experience potential negative impacts, particularly in the short term, since China is one of its major destinations for intermediate and final ICT goods. Indeed, high taxes, limited land and expensive labour will prevent significant reshoring of ICT manufacturing operations from China back to Singapore. However, the production of high-end ICT components that are not easily replaceable through import substitution, will substantially limit the negative impacts on domestic exports and value chains.

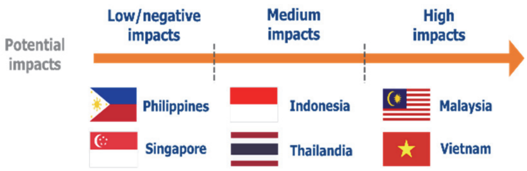

Figure 4. *Potential impacts by country on the electronics component and product value chains. (Source: The European House – Ambrosetti elaboration on The Economist Intelligence Unit data, 2018)*

15. The impact of the trade war on China's **automotive sector** will be modest. This is largely due to the country's automotive supply chain which is mainly localized, with most local vehicle production organized for local consumption. Finished vehicle exports accounted for only 0.3% of China's total exports in 2017 (US$7.2 billion). However, the impact of the trade war on Chinese **car component** exports (US$31 billion in 201713), will be greater. The US represents the largest destination for Chinese car component exports by value, meaning that disrupted access to that market will be particularly painful for China-based exporters.

16. Thailand and Malaysia will benefit the most from production diversion caused by the trade war. Thailand is the most important ASEAN automotive and parts manufacturing player, with over half of its production devoted to export. Therefore, local producers could be able to erode market shares from Chinese rivals as the trade war progresses. In addition, a number of luxury marques already operate in Thailand and are expected to increase their local output to support shipments to China.[14] Despite finished vehicles and car component exports are a small part of its total exports, Malaysia has over 800 auto component manufacturers, as well as a similarly diversified export network. This condition could position the country as a beneficiary of the disruption in value chains.

17. Indonesia, the Philippines and Vietnam could experience modest impacts as well. Indonesia, for instance, is ASEAN's largest passenger car market, and it has a strong position in car component exports, but the infrastructure and the business ecosystems could work as a deterrent in attracting companies to invest. The Philippines has a strong automotive and export sector, historically built to support Japanese supply chains, but its legal and foreign investment regimes could also prove to be not particularly attractive. Finished vehicles and car components are also a small part of Vietnam's total exports. The country is looking to attract more foreign investors in the sector, but the relatively protected nature and small size of its domestic automotive market make it less competitive compared to the ASEAN alternatives.

18. Singapore could see relatively low levels of trade war-related disruption in the automotive sector, since, on the one hand, finished vehicles are generally a small percentage of total exports and, on the other, only a small portion of the national car component shipments are destined to China. However, the low relevance of these export industries implies a limitation to the economic opportunities for Singapore.[15]

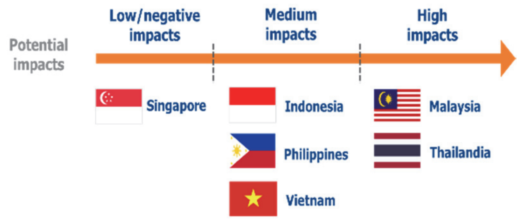

Figure 5. *Potential impacts by country on the automotive and car component value chains. (Source: The European House – Ambrosetti elaboration on The Economist Intelligence Unit data, 2018)*

19. Despite low-end **apparel and textile manufacturing** has been moving out of China in recent years, China still dominates the sector. China's textile and apparel exports amounted to around US$257 billion in 2017 (of which 15% to the US market).[16] Meanwhile, in 2016, China accounted for 36.2% of global textile exports and 34.5% of global clothing exports.[17] The imposition of tariffs on Chinese garments exported to the US could create significant opportunities for rival producers that are able to position themselves as competitive alternatives. Moreover, China's declining interest in producing low-value exports such as apparel, as it prioritizes higher-value products such as electronics and machinery, will provide further impetus to this trend.

20. Strong benefits are expected for Vietnam, being the country the major wapparel export player in ASEAN region. Indeed, Vietnam is the **3rd largest global exporter of apparel** and has strong trade ties with the United States, with an export value of US$12.3 billion in 2017, representing almost 50% of total exports in this

[12] Source: The World Trade Organization, 2018.
[13] Source: The World Trade Organization, 2018.
[14] Source: The Economist Intelligence Unit, 2018.
[15] Source: The Economist Intelligence Unit, 2018.
[16] Source: USA Office of Textiles and Apparel, 2018.
[17] Source: World Trade Organization, 2018.

sector. [18] However, although Vietnam is already an important apparel production center, without large-scale investment inflows over the coming years, given current production capacity, in the longer term, it may not be able to produce at a scale that matches the Chinese level, both in terms of volume and integration of supply chains.

21. The apparel sectors in Indonesia, Cambodia and Myanmar, although important for their domestic economies, are unlikely to be able to gain significant shares in the global market. For Indonesia, this is mainly due to the technological status of the system and underinvestment in the sector, whereas for Cambodia, the rapid increases in wage levels could reduce sector competitiveness. Myanmar's apparel exports are growing fast, but it is not yet a major player on the global scene. All this considered, foreign investment into apparel sectors for these countries may not be adequate for production to develop as required.

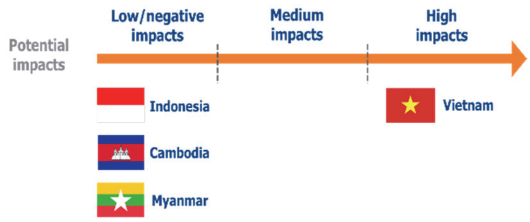

Figure 6. *Potential impacts by country on the apparel and textile value chains. (Source: The European House – Ambrosetti elaboration on The Economist Intelligence Unit data, 2018)*

22. The trade war will result in a significant shift in export-oriented manufacturing from China to other markets in Asia, a relocation that is likely to have a net positive impact in particular for many countries in ASEAN. The shift will help to drive the development of the electronic, local automotive and apparel sectors in the region, bringing in more advanced equipment and technical expertise. However, the potential impacts will be different according to the timeframe considered. Indeed, it is likely to **require at least 2 or 3 years** for the effects of the trade war to become fully evident. Multinational companies will need time to draft new global and regional strategies, find new partners, navigate different legal systems and secure the required licenses and establish new production facilities. As a result, the negative, disruptive effects of the trade war could predominate in the short-term.

The Italian industrial framework can play an important role in supporting the realignment of ASEAN value chains

23. The ASEAN industrial sectors predicted to gain are the ones whose production lines and value chains are expected to transform to support their realignment. In this context, **Italian companies and expertise** can work as an important asset in the rearrangement of industrial value chains in response to the trade war. Since the complete reallocation of the value chains could happen effectively in the medium-term, being able to start and handling the modification process in the short-term is essential to capitalizing on the growing FDI inward flow to the region.

24. The **electric components industry** is developing in Italy, registering an increase in revenues of 4.0% in 2017. The growth has been driven by the relaunching of the investment cycle (particularly in R&D), favoring the internal demand of highly-innovative technologies. In particular, productive specialization has been focused on semiconductors, with a revenue growth of 11% year-on-year, for a total value of €8.3 billion.[19]

25. When it comes to the **textile industry**, the sector still plays an important role in national manufacturing overall. On a European level, Italy is ranked as one of the main producers with a high level of specialization in the different stages of the value chain. Currently, there are 14,000 textile companies, producing over €20 billion worth of goods. As a part of what is known as the "Made in Italy" sector, if the clothing industry is also included, the production value increases to €49.2 billion, no. 1 in Europe.[20]

26. The **automotive and car component** industries are some of the historically most important ones in Italy. The automotive sector fuels the national economy, employing 165,000 direct workers and more than 100,000 indirect workers, with €93 billion in revenues (5% of the Italian GDP). As a whole, the industry registered 1.142 million vehicles produced in 2017 (+3.5% with respect to 2016) and 742,418 vehicles exported (+3.6% with respect to 2016). In the car component industry, it employed 156,463 workers in 2017 (+1.3% with respect to 2016), generating €46.5 billion in revenues. The industry is export-oriented, and over the years has been able to generate a significant surplus (e.g., +€5.7 billion in 2017).[21]

27. Therefore, Italy could look to ASEAN as a possible source of partnerships for expertise to be developed and prosper, especially in the sectors that will be most affected by the trade war between China and the United States.

[18] Source: ASEAN Secretariat, 2018.
[19] Source: ANIE, 2018.
[20] Source: Eurostat, 2019.
[21] Source: ANFIA, 2018.