What Will an Indo-Pacific Supply Chain Resilience Initiative Mean for China?

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The emergence of alternative global supply chains could hurt China's economic influence. Beijing must dial down its 'charm offensive' economic policies to remain an attractive trade partner.

Disengaging from the Chinese economy has emerged as a matter of serious strategic debate among the Indo-Pacific Quadrilateral Security Dialogue ('the Quad') countries – the US, Australia, Japan and India – as a result of the coronavirus pandemic and China's increasing assertiveness in the region. The trade and commerce ministers of India, Australia and Japan conducted a virtual meeting on 1 September 2020. They recognised the need to enhance an alternative supply chain network to move away from their normal mode of engagement in the region, and committed to cooperate towards the new Supply Chain Resilience Initiative (SCRI) in the Indo-Pacific. While the trilateral meeting did not mention China, its underlying agenda was very clear: to dilute the influence that the Chinese economy holds in the region and develop an alternative supply chain network centered on the Indo-Pacific.

Amid the current geopolitical, economic and technological changes impacting the region, there is a need for India, Japan and Australia to recalibrate their supply chain dependency on China and respond by creating a trade and investment environment that is 'free, fair, inclusive, non-discriminatory, transparent, predictable and stable' via regional cooperation. However, it remains to be seen to what extent a proposal to establish the SCRI is a practical one, especially since it encourages 'decoupling' from the Chinese economy which is so strongly integrated with the regional and global economic architecture.

What Does China Think of SCRI?

There have been no direct statements on the SCRI by either China's Ministry of Commerce or its Ministry of Foreign Affairs. The lack of reaction may indicate that it is not concerned by the budding initiative led by three of China's key competitors in the Indo-Pacific – states which are notably tied together through their shared democratic values and engagement on multilateral and trilateral platforms (especially the Quad). By all evidence, Beijing is confident that its economic prowess and trading capabilities will render attempts to create an alternative global supply chain nexus impossible and will have little to no impact on the country's growth. A survey of Chinese reactions across the media and strategic community, however, suggest an alternative narrative.

Since initial reports of SCRI emerged in the international media, there have been a slew of articles in the *Global Times* – a Chinese state outlet – pointing out the futility of such an effort. For instance, an article published on the heels of the Australia–India–Japan trilateral meeting argued that the three economies were not complementary, meaning that there was 'limited' room for cooperation and that the initiative would fail in terms of its economic scale. It further stated that participation in the initiative was 'a lame pivot' against China and a reckless response by the countries' politicians to provoke Beijing.

> *The coronavirus crisis has put China's monopoly of global supply chains into greater focus*

In fact, even as Indian Prime Minister Narendra Modi positions India as an attractive alternative destination to China in the new supply chain nexus, a key narrative emerging out of the Chinese media relates to India's inbility to replace China. Chinese state-sponsored media has overtly discouraged Australia from relying on India for its critical mineral needs required to boost its renewable energy economy. On a similar note, China has also explicitly 'advised' Japan that it cannot hope to replace their access to the Chinese market with that of India's; the Indian economy is still fragile and investments would be hindered by the administration's protectionist trade tendencies and an utter dearth of skilled workers. Beijing sees India–Japan ties as being 'superficial' with their current synergy being temporary.

At the same time, the Chinese media has also questioned the geopolitical motives behind the SCRI. Beijing contends that the aim of replacing China in Asia's value chains by pinning hopes on India to grow as China did in the past 20 years was motivated by geopolitics rather than any real

Prime Minister Narendra Modi meets with President Xi Jinping in 2016 to discuss India–China relations. *Courtesy of Government of India*

economic sense. In 1980, both China and India's economies were virtually the same size. Yet, since then, their growth has been on entirely different trajectories. Although India under Modi has been emphasising domestic manufacturing, Beijing has repeatedly stressed that New Delhi is incapable of reviving regional and global supply chains as it would never completely embrace an open and flexible trade environment. India's refusal to participate in the Regional Comprehensive Economic Partnership has been highlighted as proof that New Delhi is not interested in committing fully to a regional free-trade environment and would continue to prioritise its domestic markets.

China's attitude stems from its trade linkages with India. Beijing remains one of the largest trading partners for India with almost $82 billion worth of trade in 2019/20. Moreover, trade remains heavily skewed in favour of China, with a trade deficit amounting to about $49 billion in 2019/20. The above figures reflect India's limited manufacturing abilities, and dampen India's desires to become a global manufacturing hub. India's dependence on China in terms of consumer durables such as electronics, smartphones, industrial goods, vehicles, solar cells, and essential pharmaceutical products add to the murky picture. In fact, China accoounted for 14% of India's total imports until February 2020 – the highest share amongst all the trading partners of India, even amid the coronavirus pandemic. This only tips the economic advantage in favour of China.

Does China's Rhetoric Have Merit?

Against such strong rhetoric, it is worth looking at whether China's claims have merit – and they do, to a certain extent. Decoupling from China's economy will not be easy for either of the three countries. Given New Delhi's low-level economic engagement and relatively low trade volume with China, in comparison to the $184 billion worth of trade between China and Australia and $304 billion of bilateral trade between China and Japan, the case for India could be an exclusive one. That, however, may not be the case for Japan and Australia.

Can Japan Move Production Away from China?

In the aftermath of the pandemic, the outgoing Japanese Prime minister Shinzo Abe has especially sought to incentivise Japanese firms to move manufacturing away from China by setting up production back home or in Southeast Asia. However, this has proved difficult. While some companies may be exploring ASEAN to diversify risk within a 'China Plus One' strategy, many big names have reserved action or declared that they had no intentions to move. For many, it makes little business sense to move out of the country when they design, manufacture and sell in China. For others, the very process of moving out can be extremely costly and time-consuming – even with government subsidies. Consequently, most corporations – including big names like Toyota – have been careful in their statements to avoid retaliation from the Chinese government. Instead of abandoning the country, they are looking towards diversification strategies that would allow them to create a more flexible structure and reduce risk while maintaining a presence in China.

That is not to say that the move cannot be materialised; over 87 firms have taken up the Japanese government's incentive (to the tune of $653 million). Moreover, in light of the Japan–India–Australia meeting, Japan further expanded plans to relocate China-exiting companies to India, Bangladesh and ASEAN countries. However, the process will be slow and tedious, and the best strategy in the immediate future would be to emphasise the need for gradual diversification and a reset of China–Japan trade ties rather than a complete decoupling.

Is Decoupling a Viable Option for Australia?

Similarly, Australia's economy is extremely dependent on China, and while it is undoubtedly in Australia's political interest to diversify its value supply chains, it remains unlikely that it can decouple, even partially, from the Chinese economy. In fact, while rigorous diversification efforts with partners like US, Japan, India, Indonesia and Vietnam is a smart strategy, it still could not realistically 'offer the potential to substitute for the scale of demand that China injects into the Australian economy'.

It is vital that China alters its tactics and recalibrates its strategy to present itself as a more attractive partner

Nevertheless, China's economic leverage over Canberra and the security threat it presents to the country cannot be denied. In 2017, experts believed that reports of Chinese pressure on Australia were 'exaggerated' and that vulnerabilities could be overcome by strengthening transparency and creating and using adequate alternative business opportunities or commercial leverage. However, over the last couple of years, the debate has increasingly grown in favour of exploring other avenues to reduce Australian dependency. Reports of China's 'wolf warrior' diplomacy and numerous instances of cyber-attacks have fuelled the contested position further. So while Australia is constrained in its approach, diversification remains an important long-term strategy, to which the SCRI is a smart first step.

Can India Successfully Emerge as an Alternative to China?

Even as the initiative moves ahead, China's key argument on the unprofitability of the programme – and indeed, a central point of debate across the international community – draws on India's lack of readiness and capability to form a critical link in the new alternative networks. India has undoubtedly been slow to adopt economic reforms compared to China. Despite Modi's push to follow China's model and attract manufacturing to India, initiatives like the 'Make in India' campaign have not succeeded as expected. India's GDP per capita growth has, in fact, fallen from 6.2% in 2014 to 4% in 2019. Between April and June 2020 India's GDP growth has contracted by 23.9% as a result of coronavirus. It continues to face serious challenges in terms of ease of doing business because of bureaucratic red tape, corruption and documentary compliance.

However, with China's weakening global position, India has undoubtedly accelerated its own strategies and prioritised drawing investments to the country. In the short term, it poses a strong challenge to China in sectors like telecom and technology, auto, cellular, textiles, and pharmaceutical ingredients. Programmes like Atmanirbhar Bharat (a 'self-reliant India' initiative that aims to revive India's economy), in combination with stimulus proposals and a promise of stable regulations, are already moving in this direction. In a recognition of India's successful efforts, Japan added the country to its subsidy destinations on 4 September 2020, likely as a step towards realising the SCRI.

ASEAN's Growing Role

Even if the SCRI speeds ahead, it is likely to include the ASEAN nations; ASEAN's participation will be critical for its success. However, China's rather expansive ties with the Southeast Asian region mean that China's economy will reap the benefits as ASEAN's markets grow under the scheme. The Chinese media have pointed this out, saying that an SCRI integrated with ASEAN would be a 'welcome development'.

China's Deep Economic Integration

Like with ASEAN, the reality is that China is deeply and closely integrated with the global economy. With *Xinhua* declaring Xi 'an ardent champion of globalisation', China under Xi Jinping has intricately combined its banks and markets with that of the world. Its increasingly buoyant market implies that detachment from the country would be utterly infeasible, or exceedingly expensive (in terms of both real and opportunity costs) at the very least. Despite some limitations, a McKinsey report found that the difference between less and more engagement could be as much as $22 trillion (15% of global GDP by 2040) to $37 trillion (26% of global GDP) .

Importantly, China stands to lose considerably with reduced engagement as well. Beijing is fully aware of this. The spread of Xi Jinping's authoritarian principles, China's 'wolf warrior' diplomacy, and the Belt and Road Initiative all further Chinese economic interests through bilateral and regional ties. However, the lack of transparency and threatening approach have drawn criticism and shaped the country's image as a bully and an aggressive and coercive trade partner. This is exactly what the SCRI seeks to capitalise on. By presenting a comprehensive alternative that emphasises the 'free' and 'fair' aspects of production chains and trade partnerships, SCRI offers a collaboration that is transparent and encourages mutual growth without the coercion and debt traps prevalent in Chinese outreach. The fact that the initiative can find common ground with Indo-Pacific initiatives like the US–Japan–Australia-led Blue Dot Network only adds further value.

It is also important to acknowledge the underlying insecurities of China. The coronavirus crisis has put China's monopoly of global supply chains into greater focus. The recent pushback by countries against the reinforced reality of economic overdependence on China has translated into greater challenges for the regime stability of the Chinese Communist Party and legitimacy of Xi Jinping. It must be noted that requisite growth, along with increasing living standards and employment oppurtunities remain foundational for the party's sustained credibility in the eyes of its people. If anything, a 'moving out' trend by companies, and the desire to diversify could shake the basis of China's long-standing growth model, which remains central to the functionality of Xi's domestic and foreign policies.

There is, thus, an opportunity here to consider the potential ramifications of the SCRI. China must contemplate the collective economic competence which India, Japan and Australia might bring to the initiative. Beijing would have to take note of a rising and more regionally active India. As India pursues growth, national development and regional integration (like China did in the past two decades), it holds the potential and capabilities – especially with regards to its demographics and markets – to emerge as possible alternative to China in the long term.

On a similar note, Japan has been proactive in enhancing its growth and development through 'Abenomics', the legacy of which might continue in the post-Abe period too. Notably, Japan has carved out a niche in several sectors such as artificial intelligence, biopharmaceutecials and biosimilars, renewable energy and the information and communication technology. Likewise, Australia has powerful and lucrative financial technology, renewable energy, agricultural technology and food production industries.

Inevitably, China's attempt to influence international affairs by virtue of its geo-economic power would face significant challenges, as its assertive diplomacy tactics and 'charm offensive' economic policies might have to cater to a modified post-coronavirus global environment. It is vital that China alters its tactics and recalibrates its strategy to interact with and become a part of the emerging regional dynamics by presenting itself as a more attractive partner. Will Beijing do that? Under Xi Jinping's authoritarian control, this remains to be seen.

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