

STABILITY AND SECURITY IN THE INDO-PACIFIC



STABILITY AND SECURITY IN THE INDO-PACIFIC THE US, JAPAN, THE EU AND THE ELEPHANT IN THE ROOM

War has come back to Europe just as the world's centre of gravity was shifting from Europe to Asia. If today's focus is on supporting Ukraine's fight to resist the Russian invasion, long-term concerns for European security remain centred in Asia. It is past time for Europe to discuss whether to step up its economic and strategic presence in Asia, especially the Indo-Pacific region; the urgent challenge is to figure out how such a game will be played. The activism of AUKUS and QUAD (Quadrilateral Security Dialogue) members has forced the EU to quickly develop a complete strategy towards the region encompassing its relationship with emerging countries in ASEAN, the US, China and Japan. Is the Joint Communication enough or are more steps needed? How can European national and communitarian interests be made to coexist? And what can Russia's invasion of Ukraine teach us about the new order in the making in the Indo-Pacific region?

This booklet is promoted within the fourth edition of the Asia & Europe Initiative "Stability and Security in the Indo-Pacific: The US, Japan, the EU and the Elephant in the Room" which gathers together leading experts, Asian and European think tank representatives, as well as Italian companies and agencies to discuss the increasing geopolitical interest in the Indo-Pacific Region.

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SETTING SAIL FOR THE INDO-PACIFIC: THE SEARCH FOR AN EU PIVOT TO ASIA

by **Filippo Fasulo**

ASIA & EUROPE INITIATIVE STABILITY AND SECURITY IN THE INDO-PACIFIC



The main terrain of confrontation between the US and China is the Indo-Pacific, but Europe has also found renewed interest for the region, as seen with the publication of the "EU Strategy towards the Indo-Pacific".

As the eyes of the world are focused on Ukraine and on the return of war in Europe, senior officials from the US and China, Jack Sullivan and Yang Jiechi, met in Rome on 15 March to discuss "a range of issues in **US-China relations**", according to US sources. The Chinese side stressed the fact that the aforementioned meeting was scheduled before the war and that the reason for it was mainly to follow up the **Xi-Biden** video-summit of 15 November. What does this mean? It means that the primary concern for China and the US, even during the worst **crisis in Europe** in decades, is the bilateral relationship with each other, two superpowers now intertwined into

a long-term competition for XXI century economic primacy. Bilateral relations were also the first issue raised during the **video call between Biden and Xi Jinping** held three days later, a confirmation that the war in Ukraine should be read within a broader context.

The main terrain for this confrontation is the Indo-Pacific, a theatre that rose to the top of the agenda of the key global policymakers in 2021, before the war in Ukraine understandably diverted the attention of the Europeans. At least three crucial relevant events affected the **Indo-Pacific in 2021**: the upgrading of the **Quadrilateral Dialogue (QUAD)** to the

leaders' summit, the birth of **AUKUS** and the publication of the **EU's Strategy**.

Originally created in 2007 mainly to coordinate military exercises between Japan, India, Australia and the US, the QUAD held its first summit at the leader level in a virtual format on 12 March 2021 and in person on 24 September. By that time, the focus of the QUAD shifted from being just a security dialogue to a broader discussion encompassing "some of the world's most pressing challenges", like the pandemic, climate change, and critical and emerging technologies. Such an evolution opens the possibility of a further expanding its scope and membership to those who shared the so-called "Spirit of the QUAD" under the QUAD Plus format. However, the different members' reactions to the Russian invasion of Ukraine cast a shadow on the stability of the framework as India decided not to condemn Russia given its historical political and military relationship with Moscow.

The AUKUS is a trilateral security pact between the US, the UK and Australia that further strengthens a regional security architecture already characterised by the above-mentioned QUAD and by the Anglophone intelligence alliance named Five Eyes, also comprising New Zealand and Canada. **The creation of AUKUS**, announced a few hours before the

publication of the EU Strategy towards the Indo-Pacific, caused a **diplomatic incident** between the EU and the AUKUS members. This was not only due to the timing of the launch of the new pact but also **to the Canberra's decision supported by its two other AUKUS partners to cancel a defence contract with France** to acquire nuclear-powered submarines. Such a decision demonstrates how pressing it is for the US to strengthen its military presence in the region, as it searches for an ever more **stable security infrastructure there even to the detriment of its relationship with the European Union**. The reason for such behaviour lies in the worsening of **US-China relations** and in the intensification of **their geopolitical rivalry after the power centralisation process that began in China in 2017**. The result of this process is that the *Indo-Pacific Strategy of the United States* published on 11 February 2022 is without any doubt targeted at containing China since it states that US and allied efforts are aimed at preventing China from succeeding "in transforming the rules and norms that have benefited the Indo-Pacific and the world".

The **European approach**, contained in the *EU Strategy towards the Indo-Pacific* presented on 16 September 2021 is different. Rather than directly confronting China it prefers to focus on extending cooperation with regional partners. However, the need to



protect communication lines and freedom of navigation is acknowledged by the EU strategy, as is the existence of **geopolitical tensions, partly due to China's growing militarisation. EU Member States' interest in the region emerged for the first time in 2018 when France adopted its Indo-Pacific strategy**, followed by Germany and the Netherlands which published their Indo-Pacific strategies in 2020. While the latter two have put a stronger focus on trade, France has territories in the region that make it – and consequently the EU – a regional power. **France remains at the forefront of the EU's own pivot to Asia also in 2022.** Indeed, it is taking the rotating Presidency of the Council of the EU as a chance to put its spin on European policies towards China and the Indo-Pacific. **22 February 2022 will go down in history** as the day after the Russian recognition of the self-proclaimed Republic of Donetsk and Luhansk, but on that day foreign ministers from Europe and the Indo-Pacific gathered in Paris to attend the **Ministerial Forum for cooperation in the Indo-Pacific** organised by the French presidency – a meeting to which the **US and China were not invited**. It represents so far the maximum expression of the EU's attempt to find its own place in the current rush for influence in the Indo-Pacific, both as a way **to contain China's rise and to establish strong partnerships with the world's most dynamic economies.**

Confrontation with China and cooperation in the Indo-Pacific involving Asian players, the EU and the US is therefore not only limited to building a new security architecture through new or renewed pacts like AUKUS and QUAD, but it heavily relies on economic tools. Regional actors have already promoted several trade agreements such as **TPP** (Trans-Pacific Partnership), **CPTPP** (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), and **RCEP** (Regional Comprehensive Economic Partnership), and both the QUAD framework and the EU give a great importance to securing supply chains for critical and emerging technologies. As the EU aims to build more resilient value chains and complete trade agreements with various regional partners, in the first half of 2022 the US plans to unveil its economic strategy for the region called "*Indo-Pacific Economic Framework*".

Long term commitments over the Indo-Pacific seems to prevail, at least partially, even during the war in Ukraine. Europe was on the verge of shaping a broad-based policy towards the region before the war erupted. As soon as the most urgent issues in Europe will be solved, hopefully peacefully, it will have to restart its dialogue in the region standing on its economic strength and on its territorial presence.

Section I

Security in the Indo-Pacific: A Common Agenda or Every Country for Itself?

1. AUKUS, THE QUAD AND THE EU: INCLUSIVE AND EXCLUSIVE VISIONS FOR THE INDO-PACIFIC

by **Rory Medcalf**



The EU should take a multi-layered approach focusing not only on military commitment, but also using its diplomatic reputation to bolster the capacity of smaller powers to safeguard their own sovereignty against Chinese coercion.

The Indo-Pacific concept has become a useful organising principle for a **wide range of nations seeking to manage and balance Chinese power**. This is not automatically about excluding China from the regional order, but about **incorporating China into a regional order where the rights of others are respected**, while balancing against China when those rights are not. The Indo-Pacific idea recognises a two-ocean strategic system of connectivity and contest, a maritime, multipolar region centred on Asia but not exclusively Asian.

The **QUAD** and **AUKUS** are strong manifestations of balancing strategies

in the Indo-Pacific. However, the challenge now for their member states is to reconcile these exclusive balancing arrangements with the more inclusive approach advocated by ASEAN and the EU. This will require **nations like Australia to be more effective at articulating** why AUKUS serves the interests of many partners. At the same time, EU nations will need to openly acknowledge why balancing and deterrence postures **may be increasingly necessary in a world where China-Russia collaboration** threatens stability at both ends of Eurasia.

The diplomatic storm of the Australian-British-American technology pact called



AUKUS has become a familiar story. It involved Australia's sudden abandonment of the program with France's Naval Group to build a fleet of advanced diesel-electric submarines. Instead, in September 2021, Australia announced an extraordinary agreement with the United States and the United Kingdom to acquire nuclear-powered vessels, either the US Virginia-class or UK Astute-class SSN.

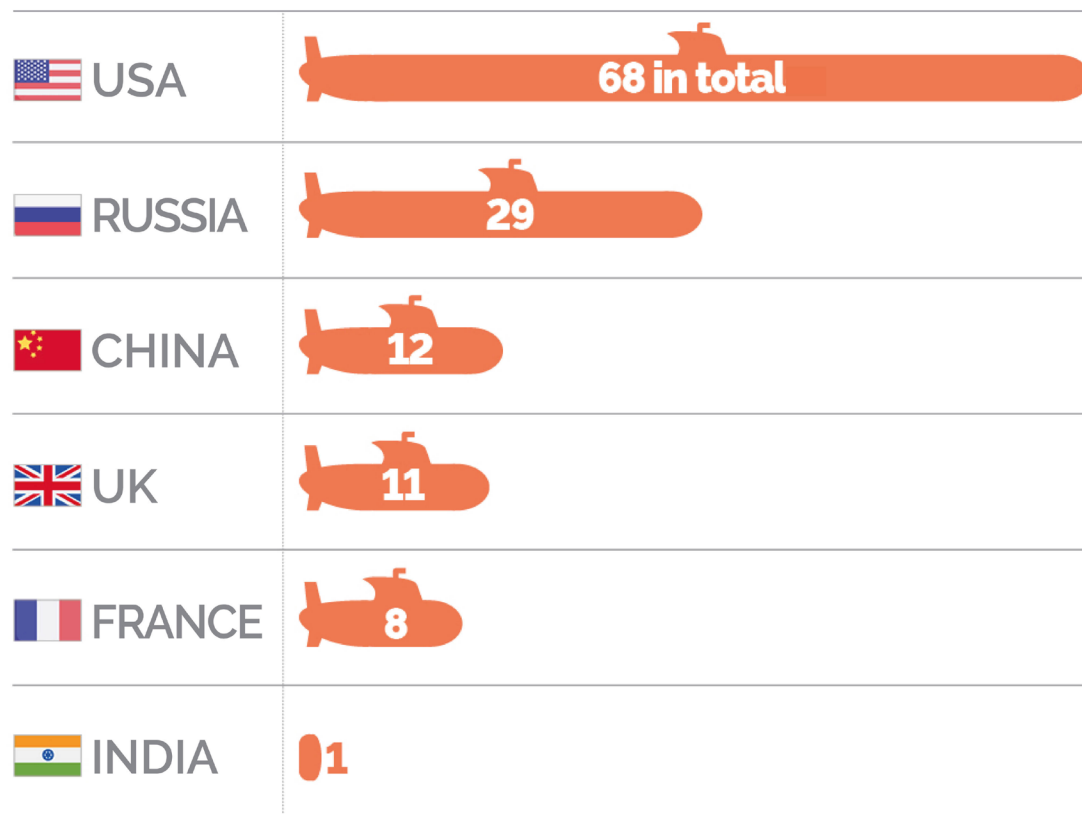
The French government cried betrayal and deception over the termination of a contract that reflected a wider strategic partnership. **Australia insisted it was simply pursuing the best military capability to protect its national interests in response to growing threats from China.** The mistrust will be slow to subside. But deeper ocean currents were revealed. For another character in this drama was something called the Indo-Pacific. This is a word barely heard in international affairs just a few years earlier, but now a powerful diplomatic mantra, a term with many useful meanings, including a code for what to do about a powerful and assertive China.

Also in September 2021, the leaders of the so-called **QUAD countries – America, Australia, India and Japan** – convened in Washington for their first in-person meeting of this important new strategic

grouping, widely seen as a diplomatic balance to China. With a less confronting agenda than AUKUS (spanning vaccines, technology, environment and infrastructure) they committed to "a region that is a bedrock of our shared security and prosperity – a free and open Indo-Pacific, which is also inclusive and resilient". This program has continued into 2022, with **QUAD leaders** convening again at short notice in March of that year to maintain momentum on the public goods agenda while also managing differences over responses to Russia's invasion of Ukraine. The leaders reiterated that the primary focus of the QUAD should remain the Indo-Pacific.

The main contest for the Indo-Pacific is of course the struggle between China and other powers for strategic influence and domination. But now there is a second contest for the Indo-Pacific: **a competition between different interpretations of this regional concept as a basis for external policy.** Canberra's diplomatic activism has effectively propagated the Indo-Pacific as a unifying idea. Australia has become the centre of a family feud in which different democracies are preaching their own versions of the creed. France defined its outcry over the sunken submarines deal, not in the crude business terms of the

Countries with nuclear submarines



Source:
BBC, IISS



global arms trade but as a regretful "lack of consistency" in efforts to uphold shared interests and values in *la région indo-pacifique*. After all, on the very same day as the AUKUS bombshell, the European Union, long accused of ignoring the tense geopolitical realities of Asia, had released its own "strategy for cooperation in the Indo-Pacific".

For Indo-Pacific democracies such as Australia, Japan and India, it is **welcome that the EU is taking a renewed interest in the region, and that it is embracing a two-ocean framework**. However there is a risk that the European focus on multilateral diplomacy, inclusiveness and non-confrontation sidesteps the hard question of what to do if China has other ideas, with its growing **coercion of Taiwan**. Moreover, China's support for Russia, ahead of and during the Ukraine invasion, suggests that EU countries will not permanently be able to overlook the question of whether China poses a systemic challenge globally rather than just a regional threat to resident powers in the Indo-Pacific.

In the 2020s, **European policy ambitions in the region should be informed by the need to maintain an order where power is tempered by principles**, where the rights and interests of all nations are respected, and where short-term

commercial imperatives do not obscure strategic balance or democratic values. At that same time, there are risks of excessive expectations. European nations will have difficulty sustaining their Indo-Pacific strategies if those detract from addressing problems close to home – especially the Russia threat – and if a key measure of success in the Indo-Pacific becomes the **projection of military power**.

What does this mean in practice? It means taking a **multi-layered approach to regional engagement**, and in particular not letting the whole game rise or fall on any one dimension of activity, particularly military commitment. **The trend towards European force projection into Indo-Pacific waters is welcome**, from the regular French presence to the 2021 UK carrier strike group (with Dutch and American elements) and the separate voyage of a German frigate.

However the biggest and most sustained difference Europe can make to the Indo-Pacific dynamic is likely to lie in an aggregate of non-military contributions. Although Europe's strategic weight remains substantial, we can only anticipate that a relatively small proportion of it will ever be allocated to Indo-Pacific contingencies for any

sustained time. On the other hand, **European diplomatic reputation** and credibility is strong in this region, marked for instance by high levels of trust from [Southeast Asian elites](#). Concerted diplomacy – especially in support of rules, normal and international law – along with strategically directed development assistance will help bolster the resolve and capacity of small and medium powers to safeguard their own sovereignty in the face of blandishments or coercive signals from Beijing.

2. GEOPOLITICAL CHALLENGES AND THE POWER OF COALITION BUILDING

by **Ryo Sahashi**

ASIA & EUROPE INITIATIVE STABILITY AND SECURITY IN THE INDO-PACIFIC



China is considered a geopolitical threat to the liberal international order, and it could use its economic power to influence neighboring countries. Minilateralism in the Indo-Pacific could have positive effects in stabilizing the region.

In the wake of Russia's aggression against Ukraine, there is no doubt that the international order that has developed throughout the XX century **is facing a crisis**. In order to protect the liberal international order, human rights, democracy, **the principle that the status quo should not be changed** by force and that peaceful conflict resolution is necessary are all essential and are now being challenged. It will be imperative not only for the **G-7** but also for the rest of the world to show unity, **to delegitimise Russia's actions**, and to strengthen economic sanctions. Japan, too, is taking a step forward from its traditional

diplomatic stance toward Russia and is boldly joining the economic sanctions imposed by G-7 and EU Member states.

Still, China's rise poses the gravest geopolitical threat to the United States, Europe and Japan, and its challenge to the **liberal international order** remains crucial. Of course, if Russia disrupts the existing international order, it will set a dangerous precedent for China's future actions. Nevertheless, China has the potential to redraw the global balance of power in terms of military power in nuclear and conventional forces, economic power, scientific and technological power and political influence. Moreover, in addition



to its geopolitical importance in the Western Pacific, Taiwan is a powerful productive force in the global supply chain. The attention of the United States and its allies to dealing with Russia, and the strategic advantage that China has gained, must not hasten the arrival of a China-centric world.

Over the past year, since taking office, the Biden administration has followed the general framework of the Trump administration's China strategy. It has developed a raft of policies that weaken China's innovation and favour the US and its allies instead. Indeed, the **US has published its Indo-Pacific Strategy and will soon reveal the contents of its Indo-Pacific Economic Framework**, leaving something to be desired. While it is understandable that the US is continuing its stance of **dialogue with China** to avoid conflict and **cooperate with China** on global issues, it still seems to be placing higher expectations on dialogue than necessary. Furthermore, there is a hint of unease in the logic of foreign policy for the middle class behind the US policy of avoiding conflict and prioritising its domestic industry.

Nonetheless, the Biden administration's emphasis on allies and partners in building the international order is hopeful. There is a strong sense in the Biden administration's thinking that creating a **favourable**

international environment is best achieved through the layering of sectoral and regional frameworks by countries that advocate a liberal international order. The Biden administration is shaping new frameworks, behaving with a 'forum mania' similar to Secretary of State John Foster Dulles' alliance strategy known as 'pactomania'.

The **QUAD between the US, Japan, Australia and India** essentially centres on summit meetings, but working-level talks are taking place not only on Covid-19 but also on the future of technology. The **AUKUS agreement between the US, the UK and Australia** has certainly provoked opposition from France, but from Japan's perspective, there is no reason to oppose the cooperative development of sensitive technologies by these three countries. Some argue that Japan should make preparations to join such a solid international framework for advanced technology development as AUKUS. The US government is also setting up new frameworks for export control and human rights and for secure information networks. The fact that multilateralism has been reinvigorated during the Biden administration, albeit in the form of 'minilateralism', is a favourable development.

Japan, which this year marks the 50th anniversary of the normalisation of

diplomatic relations between Japan and China, **is undoubtedly placing importance on economic and social relations with its neighbour China.**

However, security concerns about China are not limited to the defence of remote islands but are growing into a fear that China will fundamentally redraw the Indo-Pacific order and the liberal international order. More than the United States or any other US ally, **Japan desperately wants peace and stability in the Taiwan Strait** since a contingency in Taiwan would inevitably involve Japan. It is well known that disinformation campaigning is practiced on a large scale in Taiwan, but influence operations using disinformation has also been observed in Japan.

In a long term perspective, China's economy has many negative elements, but in the meantime, China will undoubtedly use its **economic power to build a network of power in its neighbouring countries** and bring about significant change in the discourse space on universal values. That China's influence is expanding is evident from the fact that the diplomatic stance of Southeast Asian countries toward the United States and China has not changed in the past five years or so, when the rivalry between the United States and China has become fierce, and from the fact that voices

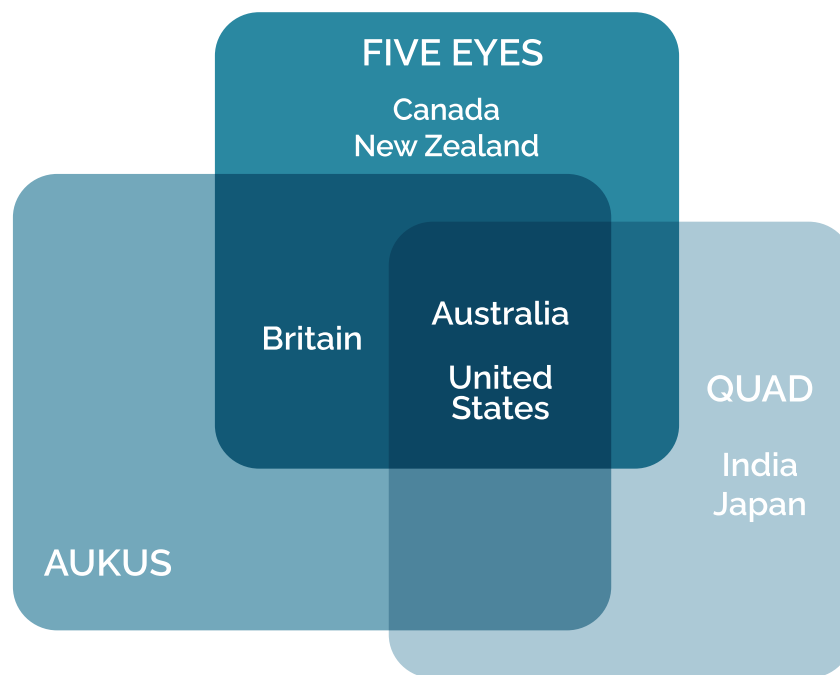
supporting China's position at the United Nations are growing stronger.

Japan is preparing for a multifaceted response to China's challenge. In 2022, a bill on economic security is expected to pass in the **Japanese Diet**, and the Kishida administration will also revise critical documents such as the National Security Strategy and the National Defense Program Guideline. In addition to strengthening the **Japan-US alliance** and **diplomatic and security cooperation with Australia and the UK**, there are **high expectations for Japan to strengthen its relations with EU countries.** They are not limited to exercising military presence but also include export control, building secure information networks and robust supply chains, and setting rules for emerging technologies. It remains to be seen what the Indo-Pacific Economic Framework will look like, but it is thought that the US-EU Trade and Technology Council will serve as a reference point, and cross-regional policy coordination will be inevitable.

Moreover, with the military presence of European countries in the Indo-Pacific, **Japan is responsible for showing solidarity with Europe** and a willingness to resist clearly and robustly the existential threat from Russia to the international order.



Security Groupings



Source:
The Economist

ISPI

3. THE EU IN THE INDO-PACIFIC: STRATEGIC ENGAGEMENT, BUT NOT THE PRIORITY

by **Shada Islam**



While the EU is prioritizing regional concerns with the Ukraine crisis, the Indo-Pacific remains crucial to the bloc. Transatlantic relations are solid when interests align, but the US and the EU different priorities and concerns could complicate cooperation in the long-term.

The timing has certainly been unfortunate. As the European Union's foreign policy chief Josep Borrell finally went public with details of the bloc's [much-anticipated new Indo-Pacific strategy](#) on 15 September 2021, world attention was focused on the unexpected announcement of a **new trilateral military alliance** between Australia, the United Kingdom and the United States (AUKUS).

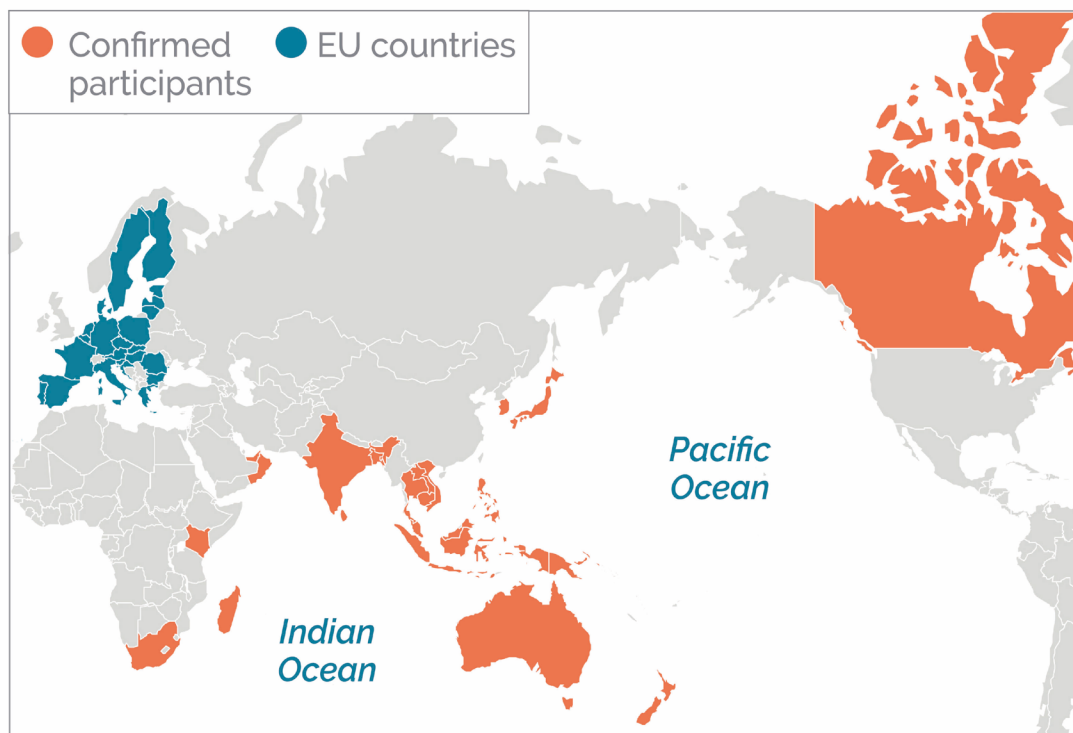
When questioned about the deal, Borrell admitted he had no previous knowledge of the "Anglosphere" security pact.

Angry French officials described the US decision to help Australia acquire

nuclear-powered submarines – a deal which scuttled their own multimillion Euro planned sale of submarines to Australia – as a "stab in the back". Fast forward to 22 February 2022 and it was rising **tension over impending Russian military action in Ukraine** which dominated the headlines as EU foreign ministers met their counterparts from 30 Indo-Pacific countries in [Paris](#) to discuss an array of security, connectivity and trade relations.

Once again, international attention was on the clouds of war gathering over Europe's immediate neighbourhood, not on the bloc's ambitious Indo Pacific agenda. Such are the vagaries of geopolitics

Confirmed participants in the Ministerial Forum for cooperation in the Indo-Pacific



Source:
French Ministry for Europe and Foreign Affairs



and the two developments underline the double challenge facing the EU as it seeks to step up its engagement in the Indo-Pacific.

First, try as it might to chart an independent course of action in the region, the **EU's ambitions in the Indo-Pacific are overshadowed by the strong US military presence in the region** Second, as long as **the EU's immediate neighbourhood remains troubled and volatile** – and the EU's relationship with Russia and most importantly NATO-Russia relations are not sorted out – the bloc's 27 nations will have to juggle their regional obligations with their aspiration to play a more powerful global role. In most cases, the regional will take precedence over the global.

Russia's war against Ukraine is of course in many ways a defining moment for the EU – with repercussions on global perceptions of the bloc.

The **27 countries have moved faster and more decisively** than many imagined possible to approve an array of financial, energy, export and travel bans **against Russia**. These have included a freeze on Russian central bank assets, the shutdown of EU airspace to Russia, the removal of a number of Russian banks from the SWIFT international payments system, and sanctions on a clutch of Russian tycoons.

In an unprecedented break with his country's traditional stance, Germany's new chancellor, [Olaf Scholz](#) has scrapped the \$11 billion **Nord Stream 2 pipeline**, which would bring Russian natural gas into Germany, bypassing several other NATO-allied countries. Scholz has also dramatically boosted defence spending by committing [\\$113 billion to a special armed forces fund](#) after years of criticism from US Administrations for failing to hit a defence spending target of 2% of Germany's gross domestic product. Additionally, in a complete reversal of Berlin's long-standing and restrictive arms export policy as regards conflict zones, Germany has agreed to send arms to Ukraine.

Looking ahead, three questions emerge: First, does the EU's focus on its neighbourhood mean reduced engagement in the Indo-Pacific? In other words, **is the EU's Indo-Pacific strategy dead on arrival?** Second, does the **newfound transatlantic unity over Russian aggression against Ukraine** also mean US-EU alignment in the Indo-Pacific, especially as regards **relations with China**? Third, will the EU find its place among regional powers playing hard security games in the Indo-Pacific or will its focus remain limited to the economic realm?

The short answer to the first question is "no". The longer answer is still no – but let's

not be naïve, the **EU's first priority and most urgent concern is to end the Russian aggression against Ukraine**. Engagement with the Indo Pacific will therefore take a backseat – at least for the moment.

There is one caveat, however. The EU has been lobbying and will continue to lobby Indo-Pacific governments to voice stronger **support for Western anti-Russian sanctions and other initiatives**, including in the United Nations.

So far, **Japan has been the strongest backer of EU sanctions**, followed by South Korea, Singapore, Australia and New Zealand. EU policymakers have voiced **disappointment at the more muted stance taken by ASEAN** (excepting Singapore of course).

India's decision to abstain in the UN General Assembly vote on 2 March is a disappointment but not a surprise to EU policymakers who have been working hard **to deepen ties with Delhi**, seeing democratic India as a counterweight to China but now recognise the limitations of India's openness to the West. Important changes in the EU's previous warm and unquestioned embrace of India can therefore be expected.

The EU is seeking to win over ASEAN countries to its point of view by focusing on Russia's disregard for the rules-

based order, conformity with the United Nations Charter and arguments linked to the violation of Ukraine's sovereignty and the inviolability of national borders, rather than the narrative of democracies vs autocracies which is favoured by the US.

Secondly, **transatlantic relations have certainly recovered from the difficult "AUKUS moment"** and Western solidarity is strong in dealing with **Russia's aggression against Ukraine**. However, transatlantic scars left by the trilateral AUKUS alliance as well as America's **chaotic retreat from Afghanistan** have not magically disappeared. There are also many who fear that Trump or someone like him could still move into the White House in the near future, once again endangering US-EU relations.

Also despite the romanticised one-dimensional view of transatlantic relations as special, solid and all-weather – a narrative often peddled on both sides of the Atlantic –, the truth is that while the US and the EU can work together when their interests align, they are also permanent competitors and rivals, with very different priorities and concerns. This is most obvious in **business and trade** – at both the bilateral and the multilateral level – but also in **geopolitics**.

The inconvenient truth is that all recent US presidents have viewed the **EU as a**



junior partner that you turn to when you need help – for instance, to present a “joint front” to China or Russia – but can safely overlook when times are good. Joe Biden and AUKUS are a continuation of this. Also, even before the Russian aggression against Ukraine, France had been spearheading discussions on **European “strategic autonomy”**, an initiative now gathering even more momentum.

As regards China, the EU has not accepted the pressure to fall in line with the US framing of China as an “existential threat” although EU attitudes towards China have been hardening following recent tit-for-tat sanctions over alleged **human rights abuses in Xinjiang** which have endangered the ratification of the [EU–China Comprehensive Agreement on Investment](#) signed last year.

Still, **China is vitally important for the EU’s economic recovery and global climate change mitigation ambitions**. The focus in Brussels remains on dealing with China as a **partner, competitor and systemic rival**.

Given the current Russia-Ukraine context, the EU is hoping – and working to ensure – that despite recent declarations of Russia-China friendship, Beijing does not align itself completely with Moscow. As such, **EU policymakers are also wary of making any**

parallels between Ukraine and Taiwan.

Finally, while the EU has now clearly developed more geopolitical clout and has announced several important security initiatives, such as the concept of a **coordinated maritime presence in the north-west Indian Ocean** which will allow the **EU to optimise naval deployments**, including through joint maritime exercises and port calls, the bloc’s **focus in the Indo-Pacific** is likely to remain on **non-traditional security and economic cooperation**.

Cooperation with the Quad in areas such as technology standards and vaccine outreach is envisaged.

As competition heats up on setting new standards for global trade, connectivity and data exchanges, the EU’s new toolbox for the region focuses on the bloc’s market and regulatory power in areas such as the **Blue Economy**, climate change-related **Green Deal initiatives**, digital transformation and the provision of “high quality” connectivity networks through the [Global Gateway](#).

Indo-Pacific countries will be able to count on EU partnership and engagement in the future, in both military and economic spheres. But domestic and regional problems triggered by the Russian invasion of Ukraine will take priority.

4. EU-ASEAN-CHINA RELATIONS: FOCUS ON SOUTH CHINA SEA AND CLIMATE CRISIS

by **Yue Yang**

ASIA & EUROPE INITIATIVE STABILITY AND SECURITY IN THE INDO-PACIFIC



Relations with ASEAN are becoming more important for the EU, but the Southeast Asia bloc remains closely linked with China. While EU-ASEAN-China have the potential to cooperate in tackling the climate crisis, contrast could rise in the South China Sea.

The upgrading of **EU-ASEAN relations** from a dialogue partnership to a strategic partnership in December 2020 marks a turning point in their diplomatic relations, signifying not only that the previous donor-recipient dynamics have disappeared, but that both sides now seem to need each other more than ever. Facing the intensifying major-power rivalry, **ASEAN needs to expand its strategic space by diversifying its external partners.** The EU seems to be a trustworthy partner for ASEAN to reach out to since it perceives the EU differently from treaty-based, threat-driven and

security-oriented US in the region. With the changing geopolitical dynamics and declining US influence, the **EU faces multiple challenges and opportunities** in Southeast Asia and it seemingly needs ASEAN more than ASEAN needs the EU.

ASEAN is at the top of China's diplomatic agenda and Southeast Asia is an important area for jointly promoting high-quality development of the Belt and Road Initiative (BRI). ASEAN-China relations involve robust economic and functional cooperation, and were upgraded from strategic partnership to comprehensive strategic partnership in 2021. China for the first time endorsed

the principles of the ASEAN Outlook on the Indo-Pacific (AOIP) and expressed a willingness to seek high-quality cooperation between the BRI and AOIP when both sides declared the upgrading of their relations last year.

EU, ASEAN and China are key players in the Indo-Pacific. Given the constantly deepening EU-ASEAN and China-ASEAN relations, the peace and prosperity of the region would not be possible without benign and constructive EU-ASEAN-China interactions. Two key challenges that would devastatingly jeopardize regional security if they cannot be properly managed are the South China Sea issue and the climate crisis. The EU, ASEAN and China actually have the wisdom, potential and capability to work together to tackle these said challenges. ASEAN is also willing to serve as an honest broker for its external partners to seek cooperation in the region as mentioned in the AOIP.

THE SOUTH CHINA SEA ISSUE

The fact that some EU Member states have followed the US lead by starting to patrol the South China Sea in recent years is a cause of **grave concern** for countries in the South China Sea, and has been perceived as further complicating the issue and even exacerbating an already very tense situation in the region.

It is noteworthy that ASEAN has actively accommodated itself to the situation in order to **reduce the intensity of China-US competition and prevent the South China Sea from becoming a battleground for a hot war between major powers**. During the Obama era, when China-US relations were relatively stable, ASEAN tended to get closer to the US and to put pressure on China, while, when China-US rivalry intensified, ASEAN wielded its agenda-setting power to avoid sensitive issues which would make it an arena for bickering between China and the US. The ASEAN countries' lukewarm attitude toward the US State Department's statement on the South China Sea issued in July 2020 shows that **ASEAN does not want to lean towards either side on the focal issue of China-US rivalry**. ASEAN realizes that with the intensification of great-power competition, the only way for ASEAN to maintain its centrality is to respond in an innovative manner.

Since **Biden** took office, the frequency of US military and reconnaissance activities in the South China Sea has exceeded that of the same period in 2020, and the continuation of such a hard-line stance toward China on the South China Sea issue will increase the risk of a local conflict between the two



countries. In contrast, the willingness of ASEAN and China to maintain peace in the area is increasing. The two sides have maintained active consultations on the full implementation of the **Declaration on the Conduct of the Parties (DOC)** amid the pandemic, while promoting practical maritime cooperation. At the 2020 East Asia Summit (EAS) Foreign Ministers' video meeting, State Councillor and Foreign Minister Wang Yi reiterated that China has persistently pursued joint development while setting aside disputes. More importantly, ASEAN and China started to reframe the South China Sea issue by working together on building the **ASEAN-China Blue Economy Partnership**. This is attributed to the fact that both ASEAN and China have consistently prioritized **development and security** in their policy agenda.

It is important for EU policymakers to recognize the said regional dynamics, accommodate the regional countries' concerns and work to lower the temperature on the South China Sea issue and not heat it up. With its market size and regulatory power, the **EU is in a good position** to reframe the theme of Indo-Pacific strategy away from the US' hard security and anti-China orientation and towards its own focus on economics and trade, climate change, cybersecurity

and sustainable development. The strategic value of ASEAN itself should be clearly recognized and strongly appreciated by its partners rather than being perceived, as it often is by some powers, as a tool to address threats posed by the third party. As important players in the Indo-Pacific, the EU, China and ASEAN **should work hand in hand to maintain the peace and prosperity** of the region.

THE CLIMATE CRISIS

The **climate crisis is a major threat to international peace and security**. This threat is more challenging and urgent in Southeast Asia than elsewhere. Kelly Sims Gallagher, who served as Senior Policy Adviser in the White House Office of Science and Technology Policy during the Obama administration, [has argued that](#) "the top emitting countries of the future could come largely from the developing world, such as Brazil, India, Indonesia. These countries are facing the herculean task of bringing millions out of poverty while simultaneously adapting to the harsh realities of climate change". Even **Indonesia**, the largest economy in Southeast Asia, in its new 2030 climate targets and first long-term climate strategy submitted to the UN, has set a 41% reduction target contingent on

sufficient international financial support. Actually, seven out of ten ASEAN Member States (AMS) have set more ambitious carbon emission reductions conditional upon receiving international assistance from advanced economies in their most up-to-date Nationally Determined Contributions (NDCs)

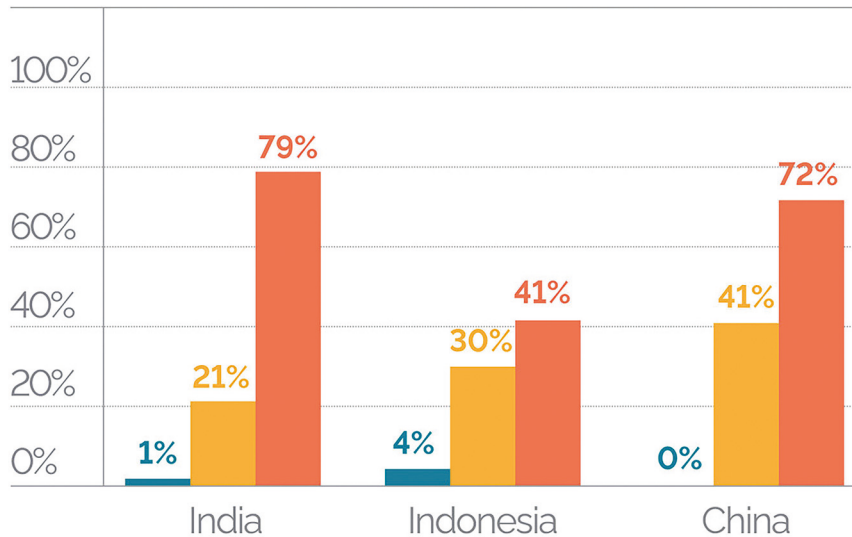
submitted to the UN. This fact makes EU-China cooperation in the region imperative.

Climate change is high on the EU and China's policy agenda, for themselves and for the EU-China, EU-ASEAN and China-ASEAN cooperation agenda. In recent years, the EU and China have

The coming century of Asia's Middle Class

Middle Class as % of total population

● 1995 ● 2020 ● 2030



Source:
JP Morgan



launched more and more green projects in the region, such as an EU-funded initiative of the **Smart Green ASEAN Cities program**, the ASEAN-China Partnership for **Eco-Friendly Urban Development scheme**, and the Action Plan on China-ASEAN **Green Agriculture**. The EU and China have also worked together to support the **ASEAN Catalytic Green Finance Facility**, a regional green investment fund designed to mobilize capital for green infrastructure projects in Southeast Asia, though some observers believe that EU-China cooperation could be difficult because of the drift away from China by some EU members. Despite the hardening of EU-China relations, it is exciting to note that the climate crisis is an area witnessing robust bilateral cooperation. Both EU and China's policymakers are well aware that **climate change cannot and should not be sacrificed** at the altar of major power rivalries.

China has decided not to build new coal-fired plants abroad and is cooperating with the EU on harmonized green investment standards. The first publication of the **Common Ground Taxonomy** was released by both sides last year, which is "a milestone work resulting from an in-depth comparison exercise that puts forward areas of

commonality and differences between the EU and China's green taxonomies". **The efforts of the EU and China on climate mitigation are well-received in Southeast Asia.** In the *Southeast Asia Climate Outlook 2021 Survey* conducted by the ISEAS – Yusof Ishak Institute, a think-tank based in Singapore, the EU and China were ranked first and the third respectively by Southeast Asians in helping the world achieve Paris-aligned goals. This is a good position from which the **EU and China can work together to fund green initiatives to help AMS adopt a new growth model** before it is too late, abandoning the model of developing first and protecting second. NDCs and Biennial Update Reports (BURs) submitted by AMS to the United Nations Framework Convention on Climate Change (UNFCCC) contain details of the climate finance needed for each country to fulfil its conditional targets. What the EU and China should do is to provide their green finance in the sectors most needed by AMS so that their finance can better match their contribution to the Paris Agreement.

5. NEW SECURITY FRAMEWORKS IN THE INDO-PACIFIC TO COUNTER CHINA'S AMBITIONS

by **Axel Berkofsky**

China should be regarded as an expansionist power in the Indo-Pacific. Strengthened US-Japan cooperation and the creation of AUKUS and the QUAD are a response to Beijing territorial ambitions in the region.

The gloves are off. There is very little disagreement among (non-Chinese) scholars and analysts that China is the elephant in the room in the Indo-Pacific. **China is challenging and indeed changing the territorial *status quo* in the South China Sea.** has increased its unlawful intrusions into Taiwanese-controlled airspace and intrusions into Japanese-controlled territorial waters in the East China Sea. Furthermore, Beijing has – in violation of an international agreement adopted in 1984 – more than once unlawfully interfered in Hong Kong's political and judicial affairs over recent years. Internally, Beijing has increased

the oppression of the Muslim minority in the Chinese province of Xinjiang and taking advantage of its technological edge is building-up a surveillance state that George Orwell would be envious of. And there is unfortunately (much) more. As regards Russia's invasion of Ukraine, Beijing has firmly positioned itself on the wrong side of the argument. And judging by the recent official apologetic and indeed morally bankrupt statements coming out of Beijing this is unlikely to change anytime soon, i.e. is not going to change at all, period. The Fact that Wang Yi, the Chinese Foreign Minister, recently announced his country's intention to

"stand by Russia in these turbulent times" says it (almost) all. "Turbulent times" – if one chooses that term to describe Putin's brutal attack onto Ukraine – of Russia's very own making, China's chief diplomat (conveniently) forgot to mention. Either way, declaring *de facto* solidarity with a military aggressor has put an end to the initial hope that Beijing could – as a country with the ability to bolster but also damage the Russian economy – act as mediator and convince the Russian President to end the attack on Ukraine.

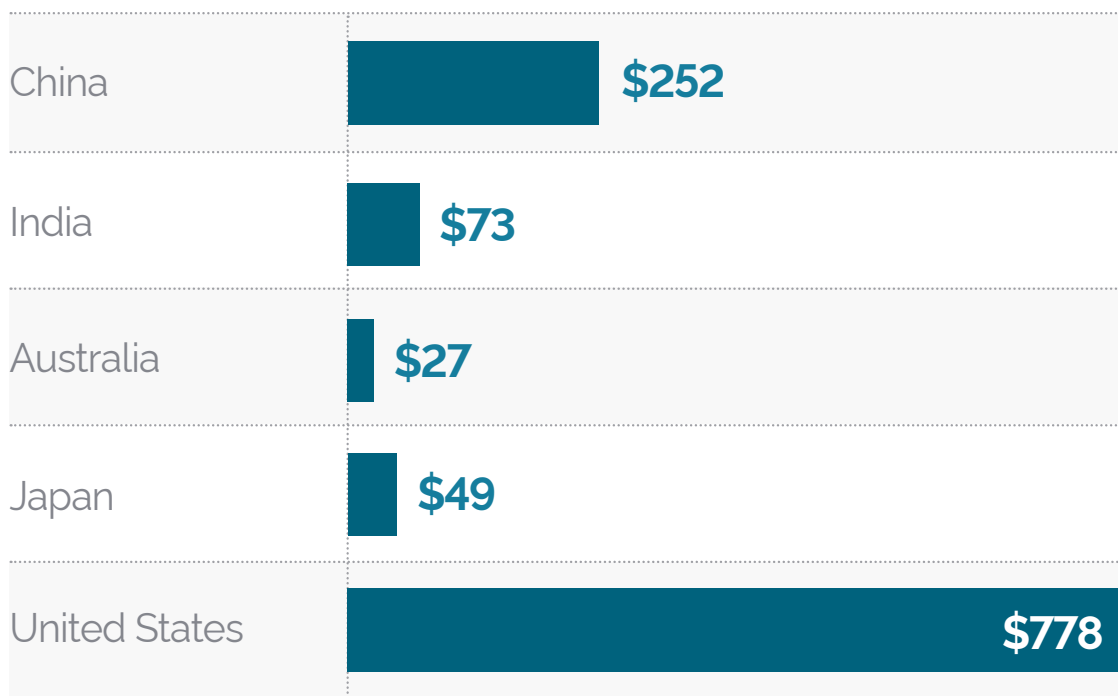
In short, Beijing is to be reckoned with as a disruptive expansionist actor in the Indo-Pacific, and there is little doubt that Taiwan's political leaders and its allies (and semi-allies) in the West are currently watching very carefully whether Russia invading another country it believes "belongs" to Russia is whetting Beijing's appetite to decide that Taiwan too is fair game. "Fair game" as allowing Beijing to forcefully "re-unify" a democratic country (Taiwan) with a dictatorship (mainland China). To be sure, Western economic and political sanctions imposed onto Russia in no time might have deterred Beijing from risking attracting Western sanctions with the potential to create enormous economic damage (in both China and the West, without a doubt). Then again, who can know that for sure?

The possibility of Chinese nationalism and Beijing's obsession with making Taiwan part of Chinese territory one day (soon) should indeed not be underestimated. This is why, throughout 2021, **Washington and Tokyo** put bilateral military cooperation in the case of a Taiwan Strait crisis scenario onto the agenda of various official encounters. In fact, the terms "Taiwan Strait" and "security in the Taiwan Strait" were mentioned in each and every official US-Japan encounter in 2021 and because China will not be deceasing but instead increasing the military pressure onto Taiwan in the months and years ahead, Washington and Tokyo will in 2022 (and beyond) continue to prepare themselves on how to deal militarily with an unprovoked Chinese attack on Taiwan. Whereas, until the very recent past, Tokyo has been reluctant to spell out that it would – on the legal and instrumental basis of the US-Japan bilateral security alliance first adopted in 1951 – provide the US with active military cooperation to repel a Chinese attack onto Taiwan, today the Japanese government leaves next to no doubt that it indeed would do just that. In the past, the officially pacifist Japan committed itself to providing Washington with so-called "rear area support" in what the US-Japan defence guidelines of 1997 refer to as "Areas Surrounding Japan". Today, the officially pacifist but



Military expenditure in billion, 2020

Current USD



Source:
SIPRI Military Expenditure Database,
<https://www.sipri.org/database/milex>

ISPI

in reality heavily armed Japan (with a defence budget amounting to \$50 billion) is preparing and arming itself to provide much more than the aforementioned "rear area support" – with the US but also with India and Australia within the framework of the QUAD: the Quadrilateral Security Dialogue established in 2007.

The QUAD brings together the US, Japan, India and Australia as a quasi-alliance aimed at – you guessed it – containing Chinese military and territorial ambitions in the Indo-Pacific.

While the QUAD refers to itself as a group of like-minded democratic countries upholding the rule of international (maritime) law in the Indo-Pacific, Beijing smells bad old containment and conspiracy. To be sure, it must not go unmentioned that the QUAD and **AUKUS, a trilateral US-UK-Australian defence pact adopted in September 2021**, would not exist without Chinese aggressive territorial expansionism in the region in general and the South China Sea in particular. In other words: **Washington and its allied countries in Asia would not feel obliged to invest resources and energy** into containing and encircling the country unless it was building military bases and runways on artificially-built islands close to disputed islands in the South China. Undoubtedly, **QUAD and AUKUS are about securing US military**

supremacy and indeed hegemony in the Indo-Pacific. However, supremacy and hegemony exerted by a democratic country (since 2021 no longer ruled by the disruptive and erratic Donald Trump) committed to the rule of international law is arguably better than Chinese-style hegemony and/or Pax Sinica in the region.

But not all is roses among the allies. India recently abstaining from the vote in the **UN General Assembly condemning Russia's invasion of Ukraine is certainly a setback for the QUAD** when it comes to showing unity as regards its determination to deter and indeed contain authoritarian states like Russia and China. India not calling Russia's attack on Ukraine an "attack" is without any doubt linked to the fact that Russia has over decades been India's most important provider of weapons and weapons technology. So business has trumped principles for India, and it can be assumed that India's credibility as a reliable, trustworthy US ally helping to keep China in check has taken a hit.

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1. 'Pacifist' as Article 9 of Japan's constitution does not allow the country to maintain armed forces. The reason why Tokyo calls its armed forces are 'Self-Defence Forces.'

Section II

Securing the Supply Chain Along the Indo-Pacific

6. JAPAN'S INITIATIVES TO SECURE SUPPLY CHAINS AND ITS KEY CHALLENGES

by **Shino Watanabe**



Japan has worked to put in place policy instruments to securitize supply chains but relocating production away from China is posing a complex challenge.

The Covid-19 pandemic **disrupted supply chains and economic activities** across the globe. Japan is no exception because of its global supply chain vulnerability, notably its high concentration of production bases in China. This paper first explains recent developments in Japanese supply chain policy over the past few years. It argues that Japan's efforts in securing supply chain resilience have not been successful. It then highlights key challenges faced by the Japanese government in strengthening supply chain resilience.

JAPAN'S POLICIES OF SUPPLY CHAIN SECURITIZATION

The Japanese government has been taking measures to regain **supply chain resilience** since early 2020. In 2020, the Ministry of Economy, Trade and Industry of Japan (METI) initiated two subsidies programs to assist Japanese companies **to relocate production back to Japan and countries in Southeast Asia**: (1) the Program for Promoting Investment in Japan to Strengthen Supply Chains, and (2) the Program for Strengthening Supply Chains.

The Program for Promoting Investment in Japan to Strengthen Supply Chains

The first program aims to strengthen supply chain resilience by supporting Japanese companies in **building new plants and introducing new facilities** for critical products and materials in Japan. In 2020, METI selected 57 projects totaling around \$530 million (57.4 billion yen) in July, and 146 projects totaling around \$2.3 billion (247.8 billion yen) in November.

The adopted projects fell into two types. **The first group targeted projects for producing strategically essential products, parts, and materials** that were largely produced overseas, such as aircraft parts, automotive molds, chemical fertilizer, displays, electric vehicle battery parts or materials, medical equipment, pharmaceutical ingredients, rare metals, and semiconductor parts, materials, and products. **The second group targeted projects for manufacturing products and materials essential for people's wellbeing**, including antiseptic alcohol, Covid-19 test reagent kits, medical gowns and gloves, nonwoven masks, surgical masks, and vaccines.

In July 2021, METI also adopted 151 projects, totaling around \$1.9 billion (209.5 billion yen). This time, the program added a particular category for small

and medium-sized enterprises, and 66 projects were selected in this category, along with the previous two categories. METI will call for applications for the third round of the program from February to April 2022, and the total budget will be around \$5.2 billion (60 billion yen).

The Program for Strengthening Supply Chains

The second program aims to assist Japanese companies in **diversifying their production lines**. It is part of Japan's strategy to reduce overreliance on China as "the workshop of the world" and offers Japanese companies **financial support** to cover expenses for facilities and equipment and feasibility studies. The program is not designed to facilitate the relocation of companies' production bases from China to other countries, however. It supports companies seeking to construct new or "additional" manufacturing plants and enhance production or logistical efficiency by utilizing digital technologies.

This program adopted 92 projects in total: 30 projects in July 2020, 21 projects in November 2020, 30 projects in December 2020, and 11 projects in June 2021. The graph below summarizes the adopted projects, and suggests that Southeast Asia is the primary destination for

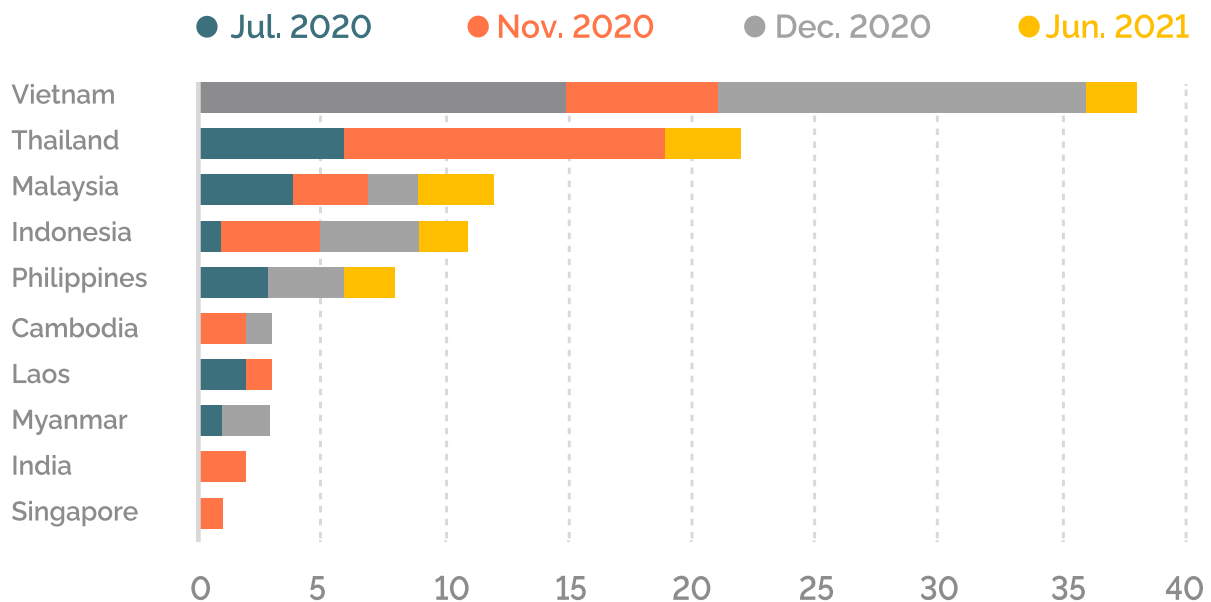


Japanese companies to diversify supply chains. The X-axis at the bottom indicates the number of destinations of adopted projects. The Y-axis on the left indicates countries where Japanese companies seek to build manufacturing plants using government subsidies. The most popular destination country is Vietnam, followed by Thailand, Malaysia, and Indonesia. Because some projects involve building facilities in more than one country, the

number of destinations is larger than 92, the total number of projects adopted by METI.

MAJOR CHALLENGES FOR JAPAN'S SUPPLY CHAIN RESILIENCE

However, these programs do not necessarily help Japanese companies relocate production bases from China to countries in Southeast Asia. **China is still Japan's top trading partner.** China's



Japan's Program for Strengthening Overseas Supply Chains (July 2020-June2021)

share of Japan's total trade, exports, and imports was record high amid the Covid-19 pandemic in 2020. China accounted for 23.9% of Japan's total trade, 22.1% of Japan's total exports, and 25.8% of Japan's total imports. The U.S. ranked second, but its share was much lower than China's. China's share of Japan's total trade, exports, and imports will likely be high in 2021.

In contrast, [Japan was China's second most important trading partner in 2020](#), but accounted for only 6.8% of China's total trade, 5.5% of China's exports, and 8.5% of China's imports.⁹ Thus, Japan is asymmetrically dependent on China in terms of trade. Japan cannot live without China, and the idea of decoupling from China is unrealistic.

In sum, Japan's ties with China have strengthened rather than decoupling amid the Covid pandemic. Japan's economy is supported by exports that have grown due to China's rapid economic recovery. What is important is that the primary driving force behind Japan's growing trade with China is Japanese business and not the Japanese government. Business circles are generally interest-driven and are unlikely to prioritize security considerations.

Japanese business is likely to remain highly dependent on China in the

foreseeable future. According to an annual survey conducted by Japan Bank for International Cooperation (JBIC), **China was the most popular business destination for Japanese companies even after experiencing the coronavirus.**

This survey has been conducted since 1989. It seeks to understand the current state, issues, and prospects of overseas business deployment of Japanese manufacturing companies. The latest survey was sent to 965 Japanese manufacturing companies in July 2021 and received 515 valid responses in October.

The chart in the next page shows the ranking of promising countries and regions for overseas business over the medium term, namely the next three years. The respondents were asked to name the top five countries/regions.

China has been the most popular overseas business destination for Japanese manufacturing companies even after the Covid-19 pandemic. At the same time, [the U.S. has been gaining popularity since 2019](#).

The survey also asked the respondents to name the top five promising countries/regions in the next ten years. In 2020, India was the most popular destination with 53%, followed by China with 43.9%, Vietnam with 31.1%, and the U.S. with 27.7%. In 2021, India was again at the top



	1st	2nd	3rd	4th	5th
Export	China 22.1%	US 18.4%	South Korea 7.0%	Taiwan 6.9%	Hong Kong 5.0%
Imports	China 25.8%	US 11.0%	Australia 5.6%	Taiwan 4.2%	South Korea 4.2%
Trade	China 23.9%	US 14.7%	South Korea 5.6%	Taiwan 5.6%	Thailand 3.9%

Japan's Top Five Trading Partners in 2020

Source: Ministry of Finance of Japan

with 49.4%, followed by China with 40.7%, the U.S. with 29.2%, and Vietnam with 28.4%. [These results indicate that](#) Japan's reliance on China as a production base is likely to continue for the next ten years.

There are **several reasons for Japanese companies to maintain production bases in China.**

First, a **high level of regional clustering** has already developed in China. It is not easy to replace it in other countries in the short term. Second, the **Chinese economy recovered faster than any**

other country last year, and exports from China grew accordingly. Third, countries like **Vietnam, the Philippines, Myanmar, and Thailand were originally regarded as alternative investment destinations.** However, unfortunately they are slowing down due to the Covid-19 pandemic, while China is successful in controlling Covid-19. Therefore, finding appropriate alternative destinations to relocate production bases from China will be a tough challenge for Japanese companies and the Japanese government in the foreseeable future.

JAPAN'S NEW ECONOMIC SECURITY PROMOTION LEGISLATION

Ultimately, the business community is the primary stakeholder of Japan's economic relations with China. The Japanese government needs to find a way to get their support to strengthen Japan's supply chain. One way to solicit cooperation from Japanese companies is the Kishida administration's effort in submitting a new economic security promotion bill during the current session of Japan's National Diet. The legislation will mark a new stage in Japan's business relations with China. **The proposed legislation has the following four pillars:** 1) strengthening supply chains, 2) ensuring the security of core infrastructure, 3) promoting public-private technical cooperation, and 4) keeping secret patents on technologies that could be used for military purposes. Thus, **strengthening supply chains is one of the top four priorities of the new legislation.**

Although the specific contents of the bill are unclear, a detailed proposal submitted by the advisory panel on economic security legislation to the Minister in charge of economic security, Mr. Takayuki Kobayashi, on February 2, 2022, [helps us understand the outlines of the legislation](#). The recommendations suggested that the Japanese government take **appropriate measures to avoid**

overly relying on foreign countries to ensure the supply of strategically important materials, such as semiconductors, rare earth, storage batteries, and pharmaceuticals.

The proposal points out that Japan needs a framework that can support not only the development of domestic production infrastructure but also various initiatives, such as **diversification of supply sources, stockpiling, development and improvement of production technology, replacing products at risk of interruption, and promotion of recycling.**

CONCLUSION

The new economic security promotion legislation will likely restrict Japanese companies' business relations with China on security grounds. Nevertheless, the government's new regulations will become counterproductive if they undermine the business sector's free activity and economic sustainability. The Japanese government faces the difficult challenge of striking a balance between strengthening supply chain resilience and maintaining Japan's vigorous business activities.

Security and Stability in the Indo-Pacific



Rank	2013	488	2014	499	2015	433
1	Indonesia	44.9%	India	45.9%	India	40.4%
2	India	43.6%	Indonesia	45.7%	Indonesia	38.8%
3	Thailand	38.5%	China	43.7%	China (#2)	38.8%
4	China	37.5%	Thailand	35.3%	Thailand	30.7%
5	Vietnam	30.3%	Vietnam	31.1%	Vietnam	27.5%
6	Brazil	23.4%	Mexico	20.2%	Mexico	23.6%
7	Mexico	17.2%	Brazil	16.6%	US	16.6%
8	Myanmar	13.1%	US	13.2%	Philippines	11.5%
9	Russia	12.3%	Russia	12.0%	Brazil	11.1%
10	US	11.1%	Myanmar	11.0%	Myanmar	7.9%
Rank	2016	483	2017	444	2018	431
1	India	47.6%	China	45.7%	China	52.2%
2	China	42.0%	India	43.9%	India	46.2%
3	Indonesia	35.8%	Vietnam	38.1%	Thailand	37.1%
4	Vietnam	32.7%	Thailand	34.5%	Vietnam	33.9%
5	Thailand	29.4%	Indonesia	33.1%	Indonesia	30.4%
6	Mexico	25.9%	US	26.1%	US	28.8%
7	US	19.3%	Mexico	18.2%	Mexico	13.7%
8	Philippines	10.6%	Philippines	10.6%	Philippines	10.0%
9	Myanmar	10.1%	Myanmar	9.0%	Myanmar	8.6%
10	Brazil	7.2%	Brazil/South Korea	6.3%	Malaysia	8.4%
Rank	2019	404	2020	356	2021	345
1	India	47.8%	China	47.2%	China	47.0%
2	China	44.6%	India	45.8%	India	38.0%
3	Vietnam	36.4%	Vietnam	36.8%	US	32.8%
4	Thailand	32.9%	Thailand	31.2%	Vietnam	30.4%
5	Indonesia	25.2%	US	27.5%	Thailand	22.3%
6	US	23.0%	Indonesia	27.0%	Indonesia	19.4%
7	Philippines	11.9%	Philippines	10.4%	Philippines	9.0%
8	Mexico	11.6%	Malaysia	9.6%	Mexico	8.7%
9	Myanmar	10.1%	Mexico	9.0%	Malaysia	7.8%
10	Malaysia	10.1%	Myanmar	7.0%	Taiwan	5.5%

Ranking of Promising Countries/Regions for Overseas Business over the Medium Term

*The Respondents were asked to name the top 5 countries/regions

Source: JBIC "Survey Report on Overseas Business Operations by Japanese Manufacturing Companies"

Note: Figures on the right side of each year are numbers of respondent companies

7. THE RISK OF WEAPONIZED INTERDEPENDENCE AND THE BENEFIT OF A COOPERATIVE APPROACH

by **Françoise Nicolas**



Global value-chains have become a source of vulnerability and their resilience is a security problem for interdependence could be easily weaponized. The focus has been on moving value-chains to countries that are not seen as security threats.

Cross-border supply chains are one of the main features of a globalized economy. Such **global value-chains** (GVCs) have emerged and become more and more complex over time, but while they were long perceived unanimously as **positive developments**, they have been increasingly questioned over the past decade as sources of vulnerability. This has reached a peak with the Covid-related economic crisis. The objective of this contribution is to examine the reasons for these developments as well as the possible response to be given to mitigate

the associated costs. In so doing, the focus will be placed on the opportunities for cooperation in the Indo-Pacific region.

The paper argues that the **security of supply chains** is a relatively recent concern; until recently it was almost exclusively perceived as a technical problem (to be solved by companies), but in a context of intensifying **technological and economic rivalry** it has become a geopolitical problem. Countries in the Indo-Pacific may derive significant gains from addressing the issue in a cooperative way.

GLOBALIZED SUPPLY CHAINS AND THEIR DOWNSIDES

The rationale for developing cross-border supply chains is to make the best of comparative advantages through specialization-based fragmentation of the production process. This can be done within a given company (offshoring) or through outsourcing. Driven by efficiency considerations, this organization of production has long been considered optimal or most cost-effective.

Some doubts started to emerge following major disruptions in GVCs, such as the **Fukushima nuclear incident or the Thai floods**, both in 2011. The concentration of the production of some critical components proved to be risky and made the whole chain vulnerable. Interestingly, however, these events did not lead to a deep rethinking of the prevailing logic, and there were only minor changes (if any) in the regional production networks in East Asia as a result. The reason is that the disruption was perceived to be temporary. By definition, disruptions caused by natural disasters are **unpredictable** and call for **immediate responses**, but their impact can be expected not to be long-lasting. From the companies' perspective, although the security of the supply chain may be threatened, **cost effectiveness is a priority** that trumps all other considerations.

From the public sector's perspective, the strategy was also found to be partly flawed but for a totally different reason. The problem is that systematic offshoring is likely to lead to deindustrialization, with substantial implications in terms of dependence and vulnerability. However, the long-held liberal consensus view was that it should not be perceived as a major issue.

Over time, the exclusive focus on **economic considerations** (with cost-reduction as the number one priority) and the resulting self-imposed dependence proved to be increasingly problematic, and the **security of supply chains** gained importance together with the need to balance security (strategic) and cost related (economic) goals. As pointed out by the [OECD](#), "the relentless pursuit of efficiency gains through the specialization-based fragmentation of global supply chains has also led to vulnerabilities, some of which have been exposed in recent years".

The Covid-19 crisis acted as an accelerator that laid bare the **vulnerabilities resulting from the exclusive dependence on a limited number of suppliers** for some essential (or critical) goods. An important point to note is that large amounts are not necessarily the core of the problem;



even small amounts may turn out to be problematic if the products are really critical for the supply chain to operate properly.

ENTER GEOPOLITICAL RIVALRY: THE RISK OF WEAPONIZED INTERDEPENDENCE

The pandemic acted as a wake-up call, but more than the fragility of long and geographically dispersed supply chains, the problem lies with overdependence on unreliable partners. In addition to the doubts highlighted earlier, further concerns started materializing in a context of rising **geopolitical tensions**, with an awareness that **interdependence** could be easily **weaponized**. It is the fear that there may be a weaponization of interdependence that brought about a major change of mindset. And the criticality of some products makes weaponization all the more likely and powerful.

There is a widespread perception, rightly or wrongly, that **global value chains have become unsustainably China-centric and that the resulting dependence**, which is in and of itself already a problem, is further compounded by the risk of weaponization. To be fair, there are good reasons to be wary of such a weaponization (by China) of asymmetric interdependence. This has been exemplified in various recent

cases, such as South Korea and Australia. More than the existence of supply chains and their potential vulnerability, the problem lies with **China's grip** over some supply chains. In other words, the economic imperative behind resilience is compounded by strong political motives (Palit 2020). Gradually, the objective has become to restructure global chains away from China, repositioning them substantially in countries that don't pose a security threat.

In other words, **the resilience of supply chains is not only an economic problem, but also a security problem**, broadly defined, and even more so if the sectors or products at stake are critical/strategic. It is not just about the security of the company in question, but it also affects the security of the whole country. In policymaking circles, the predominant thinking about 'dependence' and 'over-reliance' on China is more about political-strategic considerations and less about actual economic resilience.

This has led to a change in the calculus and in the trade-off between efficiency (or cost-reduction) and security considerations, with a rising importance of the latter and declining importance of efficiency. However, there may be **tensions between private sector and governments' concerns**. The two sets of

China as the focal point of trade in the Pacific

Chinese share on the total trade of goods of countries in the CPTPP*



*Comprehensive and Progressive Agreement for Trans-Pacific Partnership (2020) - Source: SPI, FMI DOTS



players do not always see eye to eye on this issue, and they may have different definitions of supply chain security and different views about what can be done to enhance supply chain resilience.

MAKING SUPPLY CHAINS MORE RESILIENT – A MULTI-LAYERED STRATEGY

When discussing possible options to enhance supply chain resilience, different levels of action as well as different time horizons can be envisaged. While full independence from foreign partners remains elusive, the challenge is to combine cost-effectiveness and security in the best possible way, thus reconciling companies and government's preoccupations.

The options can be organized around two major objectives: **to reduce dependence**, and **to avoid the weaponization of dependence**. Strategies at the national level and cooperative approaches can be combined to reach these objectives.

With respect to the first objective, it is worth stressing that any form of self-imposed dependence resulting from the choice of inappropriate policies should be avoided by all means.

The usual strategies to reach the former objective include **reshoring, nearshoring and supplier diversification**. All these

actions can be taken at company level, but the snag is that these measures cannot materialize overnight; moreover they are likely to enhance resilience at the expense of economic objectives. There may thus be a tension between the government and private sector's objectives. A voluntaristic approach on the part of the government is likely to quickly reach its limits as exemplified by Japan's unsuccessful attempt to encourage or even force reshoring through subsidization.

The second objective (to avoid the weaponization of dependence) can be reached more easily through a **cooperative approach at the international level and within a shorter time horizon**. The possible options range from diversification of suppliers to the identification of reliable partners.

With its **new industrial strategy** aimed at achieving strategic autonomy in key technologies and access to raw materials, the EU has chosen the first option. However, there is also scope to complement this strategy with some form of cooperative effort with trusted and like-minded partners so as to make the best of existing complementarities and ensure regular supply of some critical inputs. This could also take place through the promotion of industrial alliances involving non-EU partners.

The **US-EU Trade and Technology Council (TTC)**, a cooperative endeavor that seeks among other things to expand and deepen trade and transatlantic investment ties (with a working group dedicated specifically to supply chain security) follows exactly this cooperative logic. It could provide interesting lessons and offer a template for **cooperation between the EU and partners in the Indo-Pacific**.

Some of the latter have themselves engaged in such minilateral initiatives, and it would certainly make sense to seek to capitalize on their experience. For instance, experience-sharing and information exchange with Indo-Pacific partners that participate in the **Supply Chain Resilience Initiative (SCRI)** is certainly a promising avenue.

Lastly, such discussions could also be included in the G7 agenda.

8. FURTHERING AN EU-INDIA SUPPLY CHAIN CONNECT IN THE INDO-PACIFIC

by **Jagannath PANDA**



The EU could become a key partner to India - and the Australia-Japan-India led Supply Chain Resilience (SCRI) - to ensure the resilience of global supply chains.

The globalized economic world order has promulgated a widespread **cause and effect impact**. As a consequence, the onset of the Ukraine crisis will not only spike oil and gas prices across the world — disrupting energy supply chains — but also have gross ramifications on other critical global value chains ranging from wheat and barley to minerals like copper and nickel. **Securing global supply chains to limit the adverse impact of the crisis** will therefore be the need of the hour, and as the focal point of global economic activity, the Indo-Pacific will once again lie at the centre of such

dynamics. What role can India and the EU, with its recent commitment to the Indo-Pacific and long held deep rooted economic interests in the region, play in securing regional supply chains? How will the EU's New Industrial Strategy be useful in this regard, and how can it work in sync with existing actors in the region and their ventures including the **Supply Chain Resilience Initiative**?

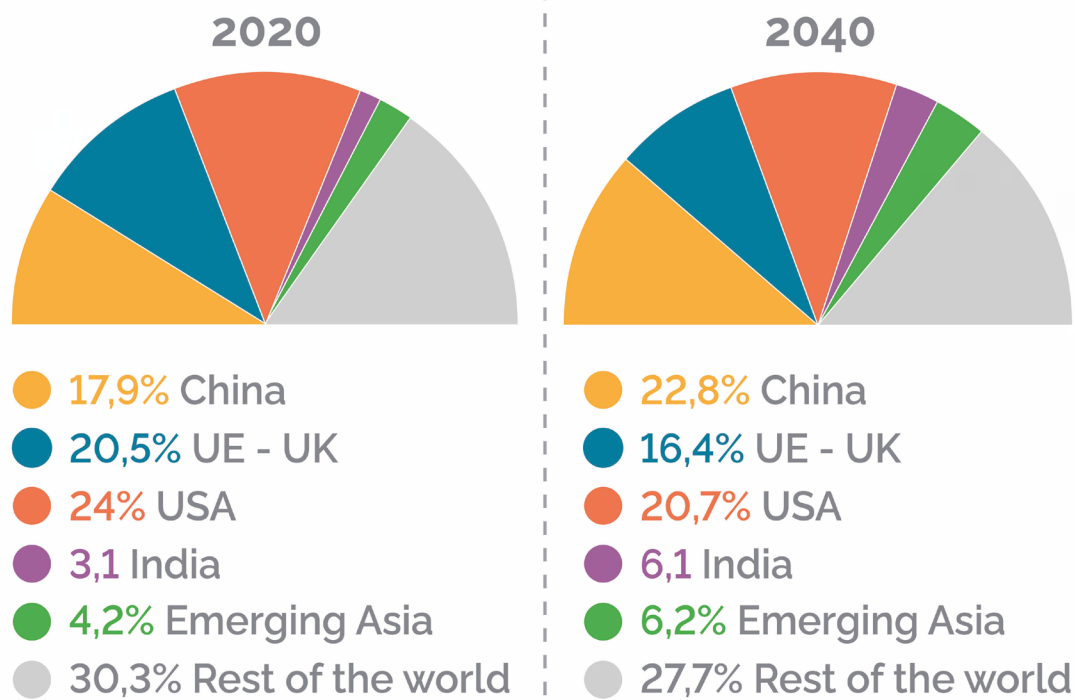
REFOCUSING ON SUPPLY CHAIN SECURITIZATION

Securitization allows for the merging of different financial assets into one group by an *issuer that designs a marketable*



China's long march to a market economy

Share of global GDP in %, 2040 projection



Source:
Oxford Economics

ISPI

financial instrument, selling such revitalized assets to investors. In the post-Covid order, in which **supply chain diversification** has emerged as a primary geo-economic goal, securitization allows for greater opportunities for investors, freeing capital and promoting liquidity in the markets. As new solutions appear with the ability to further reduce risks of a single issuer and distribute exposure across multiple suppliers, securitization emerges as a critical part of the market that can aid the diversification of risks.

Keeping such realities in mind, manoeuvring economic foreign policies to cater to supply chain sustainability and resilience becomes important in order to successfully endorse a post-pandemic fiscal recovery. International cooperation *vis-à-vis* supply chain securitization is possible via dedicated focus on multilateral initiatives, through ventures like the **Australia-Japan-India led Supply Chain Resilience (SCRI)** and the Build Back Better World (B3W) launched by the Group of Seven (G7) industrial economies. These initiatives are focused on **building sustainable, diverse and secure post-pandemic global supply chains** that take primary focus away from Chinese manufacturing. Even strategies such as the Global Gateway, released in December 2021 by the European Union

(EU), and the **UK's Global Britain are looking at building new and resilient Asia-centric cross-sectoral supply chains**. As the QUAD also looks towards supply chains – especially *vis-à-vis* vaccine transport – it is important that international cooperation in securing such essential networks continues with more policy focus.

INDIA'S STAKE IN SUPPLY CHAIN RESILIENCE

For India, which is grappling with the China threat on its border and facing increased aggression in a unilateral attempt to change the status quo, supply chain diversification has become a matter of security. New Delhi is highly motivated **to reduce dependence on China**, and building alternative global value chains that do not put China at their centre is a key long-term priority requiring immediate action. For this purpose, after beginning negotiations in 2020, in April 2021, **India launched a SCRI with Japan and Australia at the Ministerial level**. The platform presently acts as a mechanism to coordinate risk management efforts and continuity plans so as to avoid undue disruptions to supply chains in face of future 'black swan' events like the pandemic. To further this objective, the SCRI has two key strategies: *first*, the



sharing of best practices on supply chain resilience, and *second*, the holding of investment promotion and buyer-seller matching events between the three countries to encourage private sector stakeholders to explore opportunities away from China and therefore diversify their supply chains.

Although still in its nascent stages, the SCRI has significant scope for expansion and room to work with like-minded partners. While India, Japan and Australia are key to building alternative supply chains as three of the Indo-Pacific's largest economies, **diversification** requires a much broader effort; cooperation with both the private sector and third partners is hence critical for effectively achieving its objective to "create a virtuous cycle of enhancing supply chain resilience with a view to eventually attaining strong, sustainable, balanced and inclusive growth" in the Indo-Pacific.

Here, the EU can emerge as a key partner for the SCRI, and India particularly. As India's third-largest trading partner with €62.8 billion in goods trade (2020), and the second-largest market for Indian exports accounting for 14% of total Indian exports, the EU is key to **India's geo-economic vision**. The EU is also a key investor in India with almost €76 billion

in foreign direct investments (FDI) and about 6000 companies, providing almost 2 million jobs, operating across various sectors in the country.

Yet, at present, the **EU-India trade relationship remains far below its potential**. In terms of FDIs for instance, **EU's foreign stocks in India are far below those in China (about €200 billion) or even Brazil (almost €320 billion)**.

With India's impetus on expanding its manufacturing capacity and fostering a positive business environment through its *Atmanirbhar Bharat* post-pandemic recovery plan and enhanced Production Linked Incentive (PLI) Scheme to boost manufacturing within India, their bilateral potential can be tapped effectively. A focus on production in India would in turn help reduce excessive reliance on China-centric value chains and improve resilience. As political ties with China become ever-more complex, a focus on India in the EU's geo-economic vision will help further a **'China Plus' strategy and secure value chains**.

SUPPLY CHAIN COOPERATION WITH THE EU

As major global economic powers with strong cross-continental ties, India and the EU can take a lead in furthering such a supply chain agenda. Both

actors became acutely aware of their respective vulnerabilities and excessive dependencies on a single actor (China) amid the Covid-19 pandemic. Since then, both have taken key steps as part of their pandemic recovery plan to deal respond to such weaknesses, and securing supply chains is foremost objective under such thinking.

Through varied channels, like trade negotiations that resumed in May 2021 and negotiations on investment protection, India and the EU are already actively working towards a open, transparent and sound business environment with **reduce technical barriers to trade** (TBT). Supply chain resilience is an important aspect of this. Not only does building secure and resilient supply chains via a competitive global ecosystem feature under the EU-India Connectivity Partnership, but it is also a key aim under a newly launched [India-EU working group](#) on the issue and coordination that came as part of their [High-Level Dialogue on Trade and Investment](#). India and the EU have a broad-based economic agenda, and they could effectively take forward their cooperation through multilateral forums like the World Trade Organisation (WTO) and minilateral platforms like the SCRI to ensure access to supply and value chains.

Notably, cooperation with the SCRI can also emerge from the EU's New Industrial Strategy introduced in 2020 for resilient and sustainable post-pandemic recovery. The New Industrial Strategy seeks to work across sectors, with policy tools like the Circular Economy Action Plan and Renewable Energy Regulation to scale the digital economy, and [transition to carbon neutral society in an inclusive and just manner](#). Such industrial measures are inherently tied with trade policies, and can help ensure that the EU remains open and competitive in trade globally – a prerequisite to achieving supply chain resilience, [diversification and securitisation](#). With the SCRI, the EU can act as a third party participant in its investment promotion and buyer-seller matching events, which would provide the European industry critical access to inputs that help enhance its capacity to innovate and scale production, and provide the Indo-Pacific partners vital improved access to the coveted EU single market.

Similarly, supply chains are also a focus under the EU's Global Gateway which was introduced in 2021 and has swiftly become a cornerstone for the implementation of the EU's Indo-Pacific strategy, as reaffirmed at the France-led Indo-Pacific Forum in February 2022.



With a commitment of €300 billion in investments until 2022, the Global Gateway is, in some ways, Europe's modest answer to China's Belt and Road Initiative (BRI). It comes as an extension of the EU-Asia (and EU-India) Connectivity partnership and looks to improve cross-continental connectivity, which is bound to enable further diversification of supply chains.

At the same time, as with the SCRI, supply chain cooperation cannot be limited only to a handful of actors, but requires cooperation of multiple actors. An EU-India supply chain resilience partnership must necessarily advance

with key economies like Japan, Australia and ASEAN. China is increasingly stressing its Dual Circulation Strategy to safeguard its economy against a volatile global environment and become more self-reliant, in terms of resources, technology, and demand by prioritising [domestic consumption and the markets it has immense access to via the BRI](#).

This inward-looking model will only serve to make the already imbalanced trade with China more asymmetric in Beijing's favour. Here, effective broad-based cooperation between India and the EU, alongside like-minded regional partners, can help ensure that the supply chains are not made more vulnerable.

9. SEEKING RESILIENCE AND REVITALIZATION: US SUPPLY CHAIN STRATEGY IN THE INDO-PACIFIC

by **Kristi Govella**



Supply chain resilience is an essential element for the US economic security, especially in industries of strategic importance. Regional agreements could facilitate supply chain cooperation and securitization.

Supply chains have been thrust into the international spotlight by the economic disruptions of the Covid-19 pandemic, which exacerbated preexisting concerns about Chinese dominance in critical sectors. As a result, the **U.S. has come to emphasize supply chain resilience as an essential element of its economic security**, focusing particularly on key industries such as semiconductors, critical minerals, high-capacity batteries, and pharmaceuticals. To facilitate selective decoupling with China in such areas, the Biden administration is pursuing supply chain resilience through a two-

pronged strategy of domestic and foreign policy initiatives: attempting to revitalize U.S. industry through onshoring while also promoting ally-shoring or friend-shoring abroad. Essentially, **bolstering supply chain resiliency is seen by the U.S. as fully compatible with rejuvenating industries that have declined in recent decades**. However, it is not yet clear whether the American aims of resilience and revitalization will be truly complementary or whether the drive toward revitalization will lead to pitfalls of protectionism and inefficiency that eventually compromise resilience. Moreover, while the creation of new

initiatives and dialogues offers increased opportunities for coordination, a balance must be struck between the roles of governments and firms in order to formulate a coherent long-term plan for supply chain restructuring.

The first part of the **U.S. supply chain strategy, revitalization of the American manufacturing base, is driven by domestic politics and the need to clearly connect economic policies with benefits for American workers.**

For example, Biden's February 2021 Executive Order on America's Supply Chains declared that **resilient supply chains would revitalize and rebuild domestic manufacturing capacity**, maintain America's edge in research and development, and create well-paying jobs. The June 2021 White House supply chain report put forward many domestic policy recommendations such as investment, consumer rebates, tax incentives, grant programs, creation of pathways to quality jobs, support for small and medium enterprises, identification of potential U.S. production and processing locations, increased federal procurement, and strengthened domestic production requirements. These documents and other government statements clearly make the case that revitalization of American industry is an integral

component of ensuring supply chain resilience.

The U.S. Congress has passed legislation geared toward **domestic revitalization** that also includes supply chains, with a specific focus on semiconductors due to recent shortages and the strategic importance of the industry. In January 2021, Congress passed the **Creating Helpful Incentives to Produce Semiconductors (CHIPS) for America Act**, authorizing a series of programs to promote domestic research, development, and fabrication of semiconductors. It was enacted under the National Defense Authorization Act (NDAA) for FY2021; however, no funding was allocated for these programs at that time. Funding for CHIPS Act implementation is currently pending as Congressional leaders negotiate to reconcile the **United States Innovation Competition Act (USICA)** passed by the Senate in July 2021 with the America COMPETES Act passed by the House in February 2022. Both bills appropriate \$52 billion for CHIPS Act implementation, and the America COMPETES Act also appropriates an additional \$45 billion for a new **Supply Chain Resilience Program**.

The second part of the U.S. supply chain strategy seeks increased resilience through bilateral and mini-lateral



cooperation with allies and partners. This approach is also discussed in government documents such as Biden's executive order on supply chains, the White House supply chain report, and the U.S. Indo-Pacific Strategy. The Biden administration has placed more emphasis on **international collaboration** than the Trump administration, both in pragmatic recognition that onshoring is not always realistic and in an attempt to build relationships with Indo-Pacific countries. At a time when the U.S. is unable to engage its regional allies and partners in formal trade agreements, supply chain resiliency is a shared goal that can be pursued without prompting domestic opposition.

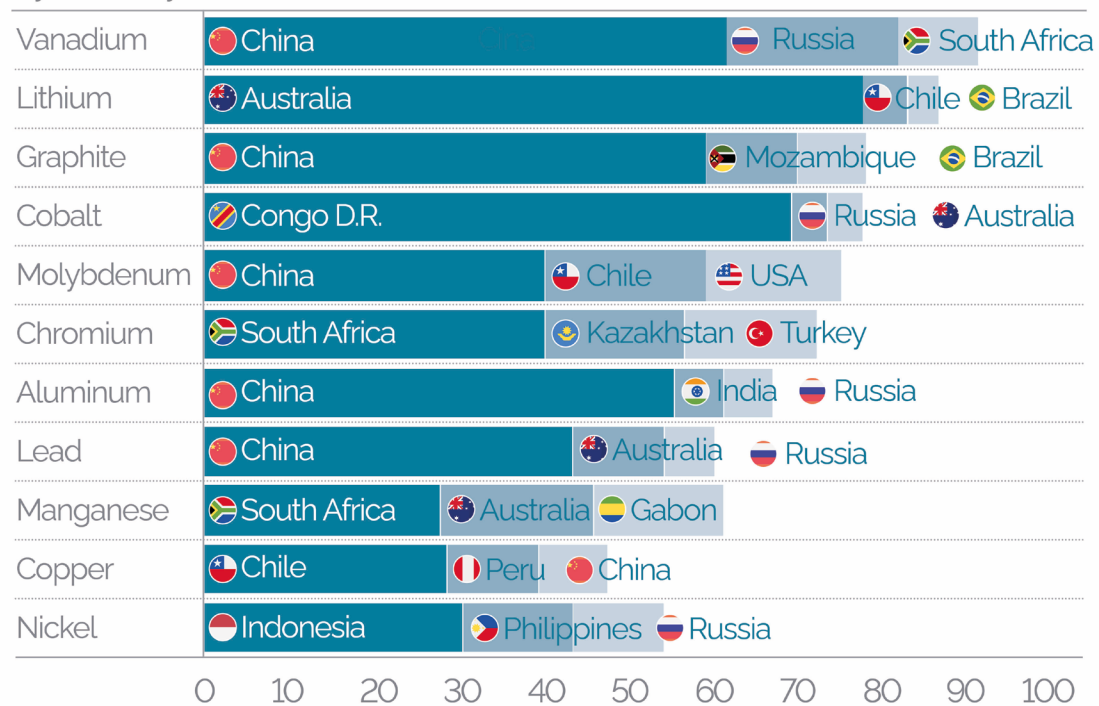
Consequently, the Biden administration has been active in launching bilateral initiatives with key Indo-Pacific allies and partners. For example, supply chains were included in the **U.S.-Japan Competitiveness and Resiliency (CoRe)** Partnership established in April 2021, and the two countries established the **U.S.-Japan Commercial and Industrial Partnership (JUCIP)**, whose activities will include promoting the resiliency of supply chains for semiconductors, 5G, and other industries. The U.S. and Australia have committed to collaborating on supply chains, with a strong emphasis

on critical minerals. In the May 2021 U.S.-ROK leaders' joint statement, **Biden and Moon agreed to cooperate to increase resiliency in supply chains**, including semiconductors, electric vehicle batteries, strategic and critical minerals, and pharmaceuticals. The U.S. will also cooperate with Taiwan on critical supply chains through a new **Technology Trade and Investment Collaboration (TTIC)** framework, and it has launched a high-level supply chain dialogue with Singapore.

In addition to these bilateral initiatives, the U.S. has pursued mini-lateral regional cooperation on supply chains. The QUAD announced that it would launch a semiconductor supply chain initiative in September 2021 as part of its work on critical and emerging technologies, and its work on COVID vaccines also emphasizes the importance of **open and secure supply chains**. The 2021 Aotearoa Plan of Action adopted by the Asia-Pacific Economic Cooperation (APEC) forum also set promotion of resilient supply chains as one of its objectives. Although much remains to be revealed about the broader U.S. plan for economic engagement in the Indo-Pacific region, supply chains are expected to feature prominently. Supply chains were mentioned in the recently released Indo-Pacific Strategy as part

Green transition: raw materials in the hands of few

Fundamental materials for the energy transition, market share % by country



Source:
FMI, US Geological Survey



of **the U.S. objective to drive Indo-Pacific prosperity, and supply chains are expected to be one of the pillars of the forthcoming U.S. Indo-Pacific Economic Framework**. It is possible that such minilateral regional agreements have the potential to create a platform for intergovernmental supply chain cooperation.

At the moment, these different lines of effort seem like potentially complementary parts of a broad diversification strategy, and they reflect an impressive whole-of-government effort to map supply chains, identify vulnerabilities, and pursue increased resilience. However, **there is also a potential tension between promoting domestic revitalization and pursuing resilience**, which will also require international cooperation on supply chains. The revitalization and innovation policies that the U.S. plans to adopt are in many ways similar to the industrial policies that the U.S. has criticized in competitor nations, as well as among its allies and partners. As policymakers move toward policy implementation, it will be important to keep the overall aim of increasing supply chain resiliency in mind as they attempt to strike a balance between promoting domestic welfare and international cooperation. The U.S.

is not the only country facing decisions about these tradeoffs, so this is an especially important time for engaging in dialogue with allies and partners to ensure that coordination is achieved where it can be most beneficial. Neither domestic nor international solutions alone can effectively enhance supply chain resilience; an overemphasis on internal revitalization initiatives may lead to inefficiency or protectionism that end up undermining the robustness and adaptability of supply chains.

Moreover, in addition to coordination between national governments, enhancing supply chain resiliency will require consultation and collaboration between the public and private sectors across multiple borders. Most of the government policies being proposed are intended to encourage or constrain the decisions of firms, but **firms remain the principal actors in the process of increasing supply chain resilience**.

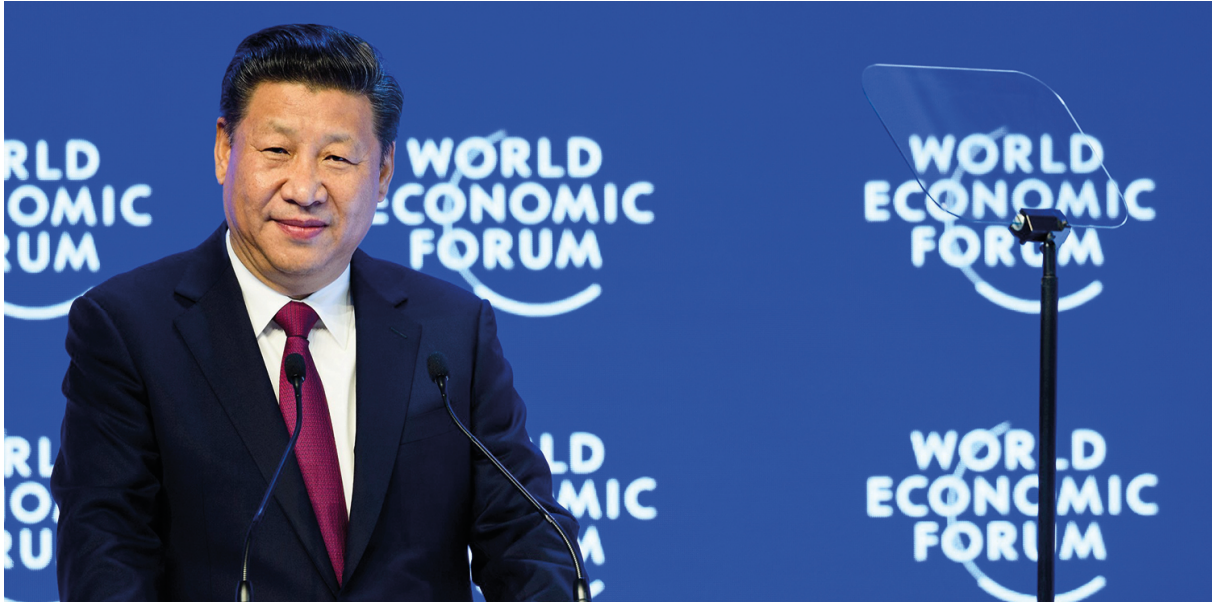
Although government and firms share many common concerns about supply chain vulnerabilities, firms tend to be more narrowly focused on efficiency and profit considerations within specific industries, while governments have a broader view that spans multiple sectors and entire economies. These different perspectives are valuable: by engaging

in close dialogue, the public and private sectors can help to make sure that private capital is mobilized in an efficient yet coordinated manner and that government is focusing its support in the correct areas. The creation of so many new mechanisms and dialogues for supply chain resilience presents opportunities, but care must also be taken to avoid the proliferation of so many dialogues that it confuses industry or hinders the progress of meaningful collaboration. Moving forward, improving supply chain resilience will require a balanced, multi-faceted approach that weighs tradeoffs between domestic and foreign policy initiatives and leverages the respective strengths of the public and private sectors.

10. SUPPLY CHAIN RESILIENCE CALLS FOR NEW GEO-ECONOMIC RISK DEFINITION AND ASSESSMENT

by **Alessia Amighini**

ASIA & EUROPE INITIATIVE STABILITY AND SECURITY IN THE INDO-PACIFIC



Countries are now realizing the risks deriving from the weaponization of interdependence and are devising strategies to minimize supply chain risks, especially in the Indo-Pacific.

Global economic interdependence – usually known simply as **globalisation** – has radically changed its role in **international relations** over the past two decades. It was actively pursued by major world economic powers between the 1980s and the Great Financial Crisis, as an instrument to secure good, widespread economic relations, with a view to preventing the rise of geopolitical frictions. The same sense inspired China's accession to the WTO back in 2001, until it became clear that the widespread expansion of supply chains across long distances and the massive role of China in many of them was becoming increasingly "weaponised".

The Trump administration's trade war against China, followed by the current post-Covid-19 crisis and recent severe disruptions to international economic exchanges caused by the war in Ukraine, have made it clear that building complex cross-border supplier networks in search of ever greater efficiency based on streamlining production costs (the process of international offshoring that started back in the 1980s), contains many hidden vulnerabilities that may arise due to disruption in some part of the production chain or in the transport linkages between the different actors in the chains. A lively debate started at the



beginning of 2020 on the desirability – from a policy perspective at national and possibly European level – of hedging against such vulnerabilities by securing production of crucial inputs, within home or EU borders where possible, i.e. by reshoring (or onshoring) production.

At the same time, in view of the assertive stance towards **technology leadership** officially embraced by the Chinese government since 2015, geopolitical competition and **rivalry between China and the US has intensified**, making the Indo-Pacific Region the main concern for both the Trump and Biden administrations. As a result, the traditional arena of contest has progressively extended beyond the strategic realm to encompass economic competition, since many **regional actors promoted several trade agreements** such as TPP, CPTPP and RCEP which will most likely reinforce existing production linkages between signatory countries within even deeper economic relations.

As critical and emerging technologies such as 5G, semiconductors and biotechnology have become the centre of the ongoing wave of technological revolution – digital transformation – and many vital parts of those high tech production activities are located in some of the most important signatory countries, maintaining good economic

relations with the Indo-Pacific region has become a central point in foreign policy strategies, both within the framework of QUAD and in the EU. Since 2018, when France adopted its Indo-Pacific strategy – followed by Germany and the Netherlands in 2020 – **EU Member States' interest in the region started converging into a common policy, which led to the formulation of EU Indo-Pacific policy guidelines in April 2021.**

Economic security concerns have finally found their place, alongside, military security strategies in the EU foreign policy agenda.

The economic dimension as a pillar of EU engagement in the Indo-Pacific is evident from the **EU Strategy for cooperation in the Indo-Pacific**, which reflects a desire to create "a strong basis for a mutually beneficial relationship". This starts with building more resilient value chains and completing trade agreements with several regional partners. All the actors involved – namely the EU, Europe, Japan, India and the US, among others – are busy conceiving **new frameworks to figure out their own role in the region and to structure bilateral and regional relationships**, with the aim of responding to China's massive rise in the region, matched by its rising ambitions of economic and technological independence.

This is the context where new concepts have developed – “Decoupling”, “Competitive interdependence” and “Strategic autonomy” – to shape the industrial dimension of the renewed competition between China and Western and Indo-Pacific powers. Industrial policies and initiatives to bolster supply chain security are being promoted across the globe: examples include the “Dual circulation strategy” in China; the “Strategy for semiconductors and the digital industry” in Japan; the “The Supply Chain Resilience Initiative” by India, Japan and Australia; the “New Industrial Strategy” and its update in the EU; and Biden’s “Executive Order on America’s Supply Chains”. **There are currently various national and international initiatives to secure supply chains between Indo-Pacific countries in order to minimise dependencies in critical sectors.**

However, the possibility of designing and implementing policies aimed at securing supply chains must face the harsh reality of the fundamental motivations that lie at the very origins of supply chain development. Supply chain management decisions do *not* (and in principle even should not) consider the **social or collective objective of making value chains more resilient in order to secure production of or access to vital**

or critical items or goods. Supply chain risk management (SCRM) is the process of taking strategic steps to identify, assess and mitigate the risk in end-to-end supply chains. The standard approach to SCRM involves the management of all types of *measurable* risk, for all tiers of supply and for all risk objects (suppliers, locations, ports and more). The concept of supply chain risk has been operationalised without really considering geo-economic risks, which usually fall into the broader category of **“political risk” or “country risk”**. Such types of risks are undergoing substantial changes and need to be largely reassessed. The category of political risk is not in itself new. In the pre-9/11 bipolar world and pre-digital revolution, it was included within the more general concept of country risk, i.e. all those analyses that served (and still serve) to determine the potential economic and commercial damage arising from the opportunity to invest in a foreign country. Political risk was and still is simply one of the possible factors examined, and is included as a parameter, i.e. as the result of a set of hypothesis not necessarily linked to the effective probability of disruptions.

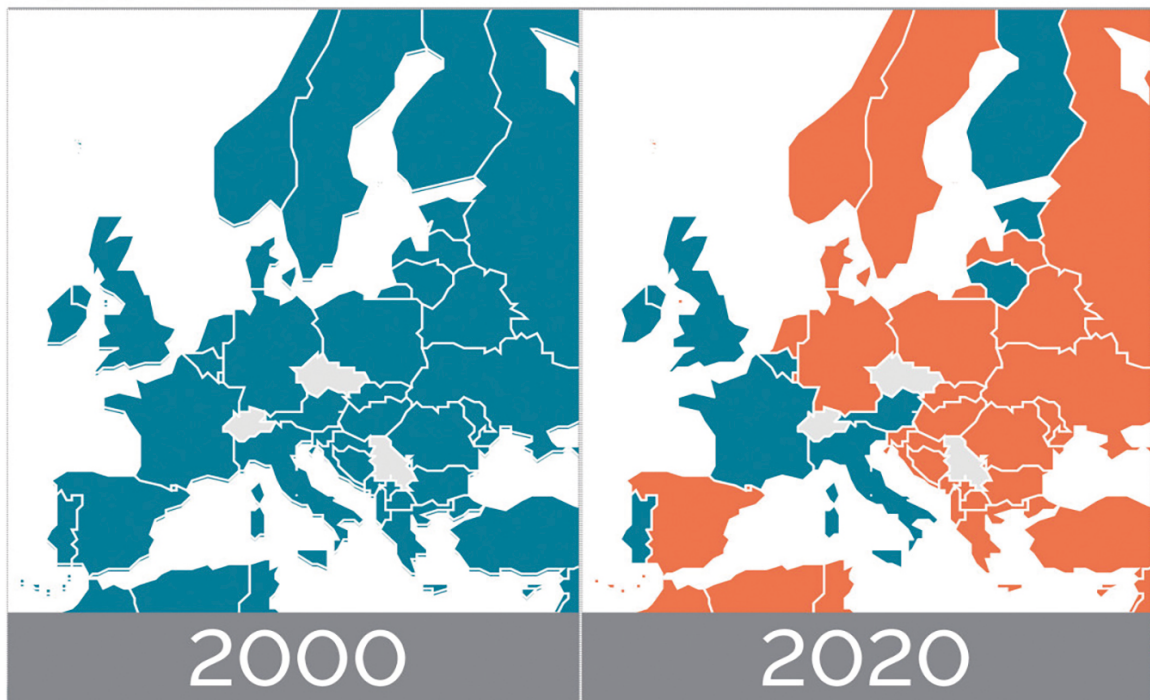
Today, it is becoming increasingly clear that the category of **political risk analysis**, as it has always been conceived, is taking on a



China's rise as leading trade partner

China or Us as relative top partner

● USA ● China



Source:
Knoema, Eurostat

ISPI

special dignity, since it is no longer limited **to monitoring the stability of a third country.**

To put it bluntly, it could be said that in normal times, analysts tended to focus on dictators with their changing orientation, or colonels threatening coups d'état. The worst nightmare to predict and monitor was the nationalisation of foreign companies.

In order to effectively secure supply chains against geo-economic disruptions, policies should consider the possibility of substantially reassessing the concept of political risk, as well as measuring.

A further issue in the current debate is how far should and could regulating authorities and governments go in trying to regulate cross-border production in favour of resilience. **The current juncture in Europe, at least, is such that the scope for policy measures seems to have enlarged, given the widespread failure of the business sector to secure their own resilience.**

Besides Covid-19, shocks that affect global production are growing more frequent and more severe. These range from natural disasters to geopolitical uncertainties and cyberattacks on firms' digital infrastructures, and the financial toll associated with the most extreme events has been climbing. In fact, even before Covid-19 certain sectors started to revise the international organisation of production in favour of higher shares

of domestic input. **Other sectors, meanwhile, have not significantly modified their supply linkages despite the ongoing trends towards reshaping the geographic scope of suppliers for security reasons.**

A McKinsey study from May 2016 entitled "Geostrategic risks on the rise" confirmed that only a quarter of executives of large companies have a formal process for analysing and managing political risk, admitting (in 43% of cases) that they only address the issue once the "case" has broken out. This solution, which is still widely used, is considered valid by only 29% of respondents. The same study also indicates that reports purchased from external think tanks are widely used (40% of the sample used them), but that even in this case the percentage of respondents who believe that this measure is really effective does not exceed 30%. Only 18% of the sample stated that they had implemented "Comprehensive scenario methodologies, integrated in the strategic planning process", admitting in 52% of cases, the effectiveness of this approach. This is still largely valid today, despite the growing uncertainty that characterises the international scenario. A novel concept of **"gloeconomic risk"** is therefore needed to identify the many areas of possible disruptions, with a view to making the various factors involved measurable.

CONCLUSIONS

The **war in Ukraine** entered a geopolitical environment that was already in turmoil after **two years of Covid-19** pandemic and four years of a Trade War launched only few days after the conclusion of a centralisation process in China that strengthened Xi Jinping's role in China's politics. This means that **different reactions in Asia** to the Russian invasion will affect a geopolitical landscape already experiencing a deep transformation taking place around the concept of the Indo-Pacific.

Indeed, **China's economic rise and its active posture in the East and South China Sea induced regional actors to find a common answer to deal with Beijing**. Initially, Japan, India, the US and Australia put their efforts primarily into redefining the **regional security architecture**, but later the Trade War and the effects of the pandemic highlighted the need to focus on the economic dimension of regional security. Therefore, securitising supply chains in critical sectors has become a priority that can no longer be delayed. Since the war in Ukraine is not only fought on the ground, but also through **economic sanctions** and through the **weaponisation of oil and gas supply and demand**, the new reality of a strategic dimension of economic interdependence has gained new relevance.

The European Union has recently realised that the **world's centre of gravity in the coming decades will shift towards Asia**, and it has developed a coherent strategy to have a seat at the table where regional dynamics will be decided. However, it will have to balance its desire to take its fair share of the world's fastest growing market with its effective capacity to be a serious player in the security interplay of the region.

The findings compiled in this work show that there is still much work to be done regarding the **security dimension**. The contrast between China's and other actors' positions on key regional issues is deep and is set to be a source of confrontation in the coming years. The need to address global challenges like **climate change** might be a starting common point to ease tensions, but it is probably not enough to find regional stability. However, even among the like-minded countries that are promoting Indo-Pacific policies there is room for a more profound cooperation. The dispute that arose between France and Australia over nuclear submarines after the launch of AUKUS has not been settled yet and it might negatively affect the **relationship between Australia and the EU**, especially considering that France is leading the EU's policy towards



the region. In addition, India's choice not to review its long-term relationship with Russia after the invasion of Ukraine and not to align with those countries condemning **Moscow's aggression might impact cooperation within QUAD**. The war in Ukraine might also divert the EU's interest in the short term but there is consensus on the fact that the Indo-Pacific will still be among its priorities. A stable framework for EU participation in regional dynamics is yet to be found, but the minilateralism mechanism that emerged in the last few years is proving to be an effective way of engagement, at least initially. Given the strong European focus on the economic pillar, the easiest way to involve Europe might be through common policies regarding the securitisation of the supply chains that are increasingly regarded as a strategic issue. Indeed, perspectives on global value chains are shifting from a positive development for global economic growth to a source of vulnerability.

Considering the above and the contributions of the authors to this initiative, the following options remain critical to finding stability and security in the Indo-Pacific successfully:

a) On EU pivot to Asia: **the EU needs to carefully understand what effective capability it has to provide security**

in the region. European comparative advantage still falls mainly into the economic domain, something that can also be said about Japan. The flexible framework of the QUAD might be well suitable for increasing cooperation with EU, especially since the QUAD itself is already changing its nature from a hard-security dialogue towards a more economic-focused one. In this case, the EU might leverage its strength as a leading trade partner, investor, and donor to the region. **The shift towards cooperation in the economic dimension might be instrumental to improve ties with Asean countries.** In this regard, Japan as well might play a significant role as the second biggest economy in the region.

b) On security: **the underlying risk when talking about Indo-Pacific policies and their security architecture is to have unrealistic expectations.** Sharing a common view on the adoption of the Indo-Pacific as an interpretative lens does not mean fully agreeing on contentious issues. Indeed, the geopolitical landscape is shaped by the actors' relationship with China, and while **some emphasise the role of China as the biggest political threat to the EU, US, Japan and the liberal order, others see the Indo-Pacific concept as an inclusive and flexible**

framework that might also represent a chance for cooperation with Beijing. In addition, even traditional allies like the US and the EU should be considered as competitors and rivals, with very different priorities and concerns on some specific issues, as the AUKUS affair demonstrates. This implies that it is useful to work on specific tasks through minilateral dialogues that can help to sort policies and reduce misunderstandings.

c) On securing supply chains: **supply chain resilience has become an essential element of national economic security for many countries, given that interdependence might be easily weaponised.** Once again, the “elephant

in the room” is China, as reforming global chains entails restructuring global chains away from China and repositioning them in countries without security threats. However, individual national policies aimed at securing supply chains might fail due to competing interests between governments and companies. While the latter would prefer **global value chains based on economic efficiency**, the former are increasingly pushing for **security based global value chains**. To successfully restructure them, it is crucial to build broad international networks that will reduce the cost of diversification for the companies.

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