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Geo-economic megatrends in the Indo-Pacific: Integration or (partial) decoupling?

By Ramon Pacheco Pardo | 17 September 2021

Key geo-economic megatrends in the Indo-Pacific in recent decades have been defined and underpinned by a common theme: greater state-led regionalism and market-led regionalisation. In other words, regional integration. This development started in the aftermath of World War II, as Japan and the four Asian tigers of Hong Kong, Singapore, South Korea, and Taiwan strengthened economic links among themselves and, above all, with the US. It continued with China's opening up while the ASEAN-4 of Indonesia, Malaysia, Philippines, and Thailand joined in regional manufacturing and investment networks from the 1980s. This was a time when some European countries, such as France, Germany, and the UK, also became important economic partners for countries in the region. The development continued with the end of the Cold War, which brought Southeast Asian countries in the communist bloc into regional networks – especially Vietnam – and also coincided with Australia, India, and New Zealand strengthening trade and economic links in the region. Meanwhile, the EU in and by itself also started to become more integrated in regional economic networks from the 1990s onwards.

It should be noted, however, that in geo-economic terms regional integration continues to be dominated by the East Asia versus Asia-Pacific divide. Largely, this is because India has voluntarily decided not to participate in the key regional trade agreements and other networks shaping the geo-economics of the region – even though Europe–Asia economic links partially offset this reality, giving the importance of the Indian Ocean to them. In any case, the "Indo" component of the Indo-Pacific concept is weaker than the Pacific and the "Asia landmass" components. Having said that, the realities of the importance of India and the Indian Ocean to the economies of the region; infrastructure and other economic projects with Southeast Asia and South Asia at the centre; and the economic component of the strategies and statements of the EU, EU member states, the Quad, and other countries in relation to the Indo-Pacific show that the geo-economic component of Indo-Pacific strategic discussions is poised to grow in the coming years.

This brief will analyse whether the decades-old trend of growing regional economic integration is poised to continue up to 2030 or not – and whether, in this context, Indo-Pacific economics will be dominated by integration or decoupling. The brief will first look at the areas of trade, foreign direct investment, level playing field, and connectivity and infrastructure.

Our experts survey suggests that these are the areas of most importance for the EU. The second focus is on economic growth, green economy, and sustainable development, also of importance to the EU as per our survey. The brief will then shift its attention to security and diversification of supply chains, which our survey shows also matters to the the EU. A concluding section will summarise the key arguments.

Trade, foreign direct investment, level playing field, connectivity & infrastructure

Economic integration in the Indo-Pacific region began and continues to be dominated by trade and investment regionalisation. This megatrend is likely to continue in the coming decade, mainly because it is driven by market forces that policy-makers can try to control but would find very difficult to stop – never mind reverse. Some of these forces include complementarity among the economies of the region in terms of goods and services offered, savings seeking profitable investment vehicles, or the growing number of middle-class consumers in the region. This matters, since it has been the market rather than politics shaping trade and investment links across the Indo-Pacific. Thus, trade agreements, investment treaties, and other agreements among governments to promote stronger links have usually supported and perhaps accelerated existing megatrends. But they have not created or even unleashed them. This is a crucial difference with the EU, where the conditions for greater economic integration were first set up by policy-makers.

Throughout the decades, two separate political trade and investment groupings have emerged: East Asia and the Asia-Pacific. The crucial difference is whether the US – as well as Canada and selected Latin American countries – is included or not. Thus, the US has been excluded from East Asian economic regionalism such as the ASEAN+3 economic coordination framework launched in 1997 following from the Asian financial crisis. It has also been excluded from the Regional Comprehensive Economic Partnership (RCEP) signed in 2020. In sharp contrast, the US was a founding member of the Asia-Pacific Economic Cooperation forum launched in 1989. Washington was also one of the original signatories of the Trans-Pacific Partnership (TPP) signed in 2016, before it withdrew and the remaining members signed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in 2018. Canada and countries such as Chile, Mexico, and Peru are also part of these initiatives. With CPTPP potentially expanding in the coming years – and perhaps including the US if it changes its recent stance against trade agreement – and RCEP undergoing the necessary approval process to enter into force, it is likely that the Asia-Pacific versus East Asia divide will continue.

Having said that, it should be noted that countries in the Indo-Pacific region understand that the East Asia and Asia-Pacific groupings are complementary. The “noodle bowl” of agreements in the region is not exclusionary. Take the case of the RCEP and the CPTPP. Seven countries including Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam have signed both agreements. Meanwhile, RCEP signatories China, Indonesia, South Korea, Philippines, and Thailand have announced their interest in joining the CPTPP. And most of the countries across the region have signed other bilateral or multilateral trade and investment agreements, and a few also have deals with the EU and the US. This noodle bowl is very likely to continue to expand over the decade, with new countries joining existing agreements and new agreements being signed. Coupled with the already-mentioned existing market forces, this is going to drive further trade and investment integration, and could strengthen Indo-Pacific integration, as opposed to Asia-Pacific or East Asian.

At the same time, one megatrend that is more recent, the push for a level playing field, is likely to accelerate in the coming decade, and will affect trade and investment integration. The EU, the US, and Asian Indo-Pacific countries including Japan and South Korea consider the establishment of a level playing field an essential part of their foreign economic policy. Whether implicitly or explicitly, their target includes China and – admittedly to a lesser extent – India. Regional and bilateral free trade agreements and investment treaties in theory guarantee a level playing field for all businesses. However, the reality across the Indo-Pacific is that this has not been the case so far. European and US firms continue to be discriminated against, whether openly or de facto. And other large investors in the region such as Japan, South Korea, and Taiwan also complain about discrimination – often privately, but sometimes in public. With CPTPP in place and RCEP due to enter into force in the coming years, there should be more of a level playing field for most countries in the region. But CPTPP is more comprehensive in terms of the issue-areas covered, which could accelerate integration among its members while reducing economic links with non-members that do not have their own, separate agreements. As for the EU and the US, their existing and suggested bilateral trade and investment deals should also support this megatrend. Yet, these deals lack effective enforcement mechanisms, which means that governments will still be able to tilt the playing field in their favour if so they wish and without major consequences.

Greater connectivity and infrastructure integration is another megatrend that should continue in the coming decade. In this case, the role of governments matters more. Policy-makers in the EU, the US, and Asian countries in the Indo-Pacific are pushing for connectivity in areas such as digital, transport infrastructure, and energy. Projects such as China's Belt and Road Initiative (BRI), Japan's Partnership for Quality Infrastructure, South Korea's New Southern Policy Plus, the EU's Connecting Europe & Asia strategy, or the recently announced Build Back Better World agreed by the G7 show the commitment of different governments and groups to support infrastructure development in the Indo-Pacific in years to come. Having said that, BRI lacks some of the qualitiative markers of the other initiatives: sustainability, transparency, resilience, or openness. This could affect economic links between China and other countries in the region, thus somehow eroding regional integration. The role of governments is supplemented by that of development banks. The Asian Development Bank, the Asian Infrastructure Investment Bank, and the World Bank provide their capital and expertise to build infrastructure in the region. Furthermore, market forces are again a crucial driver in a geo-economic megatrend in the Indo-Pacific. After all, it is private firms that provide much of the capital and expertise to build infrastructure and connect the region – as well as helping to run the infrastructure once it is completed.

Economic growth, green economy, and sustainable development

A high rate of economic growth has been a quintessential megatrend of the Indo-Pacific region that is very likely to continue over the next decade. In fact, China, India, Indonesia, Japan, and South Korea – in this order – should be among the 10 biggest economies in the world by 2030. To this we need to add the US, the biggest economy in the world today and which should remain one of the three biggest in 2030. Not even the Asian financial crisis of 1997-98, the global financial crisis (GFC) of 2008, or the COVID-19 pandemic that hit the world economy in 2020 have stopped the Indo-Pacific region from registering high rates of economic growth. Whereas developed economies such as Japan, South Korea, and Taiwan have seen their growth decline in recent years, emerging and developing countries such as China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam will continue to drive growth in the region. Indeed, countries across the region in general took a smaller economic hit from the GFC and COVID-19 pandemics compared to Europe, North America, and other parts of the world.

A move towards green economy models is likely to drive economic growth over the next decade. Following from the COVID-19 pandemic, an increasing number of countries are rethinking their economic growth models. China, Japan, South Korea, and the US are among the Indo-Pacific countries that have announced green growth plans, based on the principle of sustainability. These plans build on years-long plans resulting from concerns about climate change and domestic pressure across many Indo-Pacific countries to improve environmental conditions. These plans have led to an increase in the use of renewable energies as part of the energy mix, the building of sustainable infrastructure, or the development of circular economy systems. In other words, the green economy seems to have moved from the talk shop to the world of policy-making. Having said that, the green economy continues to be secondary to economic growth per se for the least developed countries in the region. For these countries, their objective continues to be to lift people out of poverty and increase the ranks of their middle classes. Therefore, it is safe to say that economic growth will continue to be a bigger priority than green growth for most developing and emerging economies up to 2030. In the case of China, it remains to be seen what the balance will be.

Closely related, sustainable development is a megatrend that is very likely to pick up over the coming decade. Developed countries across the region such as Japan, South Korea, and Taiwan have been shifting their thinking away from economic growth at all costs and towards sustainable development – or growth – for some years. This line of thought is only accelerating as a result of the COVID-19 pandemic. Meanwhile, less-developed countries in the Indo-Pacific are among the strongest adopters of sustainable development principles among emerging and developing countries worldwide. Many governments across the region indeed support and try to achieve sustainable development goals such as no poverty, zero hunger, good health and well-being, and quality education. But it should be noted that the Indo-Pacific region lags behind in areas such as gender equality and sustainable cities and communities. And similarly to the case of green growth, many countries across the Indo-Pacific are likely to continue to prioritise "traditional" economic growth policies over sustainable development if need be. Thus, over the next decade and up to 2030 it is likely that economic growth will remain a priority above sustainable development for emerging and developing countries in the Indo-Pacific. Again, whether this will be the case for China as well or not is still unclear.

Security and diversification of supply chains

In recent decades and especially since China opened up and then joined the World Trade Organization, another megatrend has been that supply chains across the Indo-Pacific are becoming more integrated. The security and diversification of supply chains, however, had already started to become a concern prior to the COVID-19 pandemic – only to arguably become the top concern as a result of it. There was no Indo-Pacific supply chain before the pandemic. Instead, there was a Sino-centric supply chain pulling together countries across East Asia and, increasingly, globally. In fact, China's share of global manufacturing output by value reached a new record during the pandemic, accounting for almost 30% of the total. Other Indo-Pacific countries in the top 10 include the US, Japan, India, South Korea, and Indonesia, in this order. The increasing reliance on China as "the factory of the world" was and is the main driver behind calls for the diversification of supply chains. Additionally, the political push by the US and, to an extent, the EU to diversify supply chains away from China – arguably supported by Japan to a certain extent as well – could result in diversification. But it should be noted that market forces drove the integration of supply chains, and it remains to be seen whether government efforts at diversification bear fruit. Were supply chain diversification to take hold, however, there could be a partial economic decoupling between China and other economies in the Indo-Pacific. This is due to the importance of supply chain integration in driving trade and foreign direct investment across the region, and especially towards China.

Conclusion: Integration vs. decoupling

The geo-economics of the Indo-Pacific region have been dominated by the megatrend of deeper integration in recent decades. The main driver behind this integration has been the market, with the state playing an important yet secondary role. This explains why integration is likely to continue to dominate the geo-economics of the region in the coming decade, especially since emerging and developing countries in the region are probably going to continue to focus on economic growth as their top goal, above others such as green economy or sustainability. Integration would support this goal, but decoupling could threaten it.

Having said that, different approaches to connectivity and infrastructure or ongoing discussions about supply chain security and diversification could bring about partial decoupling over the next decade. This would have knock-on effects on regional integration, given the centrality of these supply chains to trade and foreign direct investment links in the region. Yet, full decoupling seems unrealistic. There is no appetite in the Indo-Pacific region to completely exclude China from regional economic networks. And even if there was political appetite to do so, market forces point in the direction of further integration.

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