Plugging into the Global Grid

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World trade and production is increasingly being structured around "global value chains" (GVCs). A value chain identifies the full range of activities that firms undertake to bring a product or a service from its conception to its end use by final consumers. Technological progress, cost, access to resources and markets and trade policy reforms have facilitated the geographical fragmentation of production processes across the globe according to the comparative advantage of the locations. This international fragmentation of production greatly increases efficiency and firm competitiveness. Currently, more than half of world-manufactured imports are intermediate goods (primary goods, parts and components, and semi-finished products), and more than 70 percent of world services imports are intermediate services.

The emergence of GVCs during the last two decades has implications for the impact of trade and investment barriers both on the country implementing the measures and on the global economy. There are a growing number of case studies on the globally integrated value chain at the product level. Likewise, more aggregate evidence has also been developed in order to get a more comprehensive picture of GVCs.

In the recently released World Investment Report (WIR) 2013, by United Nations Conference on Trade and Development (UNCTAD), it was noted that the Malaysian manufacturing sector is indeed making a transition from labor-intensive investments to high-technology investments. While other ASEAN countries had investments in the infrastructure, services and primary sectors, Malaysia's inbound FDI were largely in the manufacturing sector.

Are we moving from low value added economy with high participation to a high value added economy? Is Malaysia still a low cost manufacturing center and a parking space for capital & technology? Is our investment-driven growth strategy, sustainable & inclusive? Is there a trade-off between the environment and economic growth? Do we have a skill shortage that will impede us from becoming be a significant value enhancer?

It is no surprise that policy makers everywhere are looking for more and better policy evidence to examine the position of countries within international production networks. A number of indicators have been developed to help policy makers assess the role of their country in these GVCs. For example, trade policy instruments such as import tariffs, rules of origin and anti-dumping may directly hurt the competitiveness of domestic industries. A better understanding of whether countries are positioned upstream or downstream in the GVC will definitely help determine the actual costs of specific trade policies as well as assess the sensitivity of national economies to protectionist measures.

Another issue is that of national competitiveness and growth, because of the growing interdependencies within GVCs, countries no longer rely exclusively on domestic resources to produce goods and services. National competitiveness not only reflect the technological capabilities and relative endowments that constitute a country's domestic production activities, but also the technological and factor endowments of countries from which the country in question imports intermediate goods. This would inevitably lead to moving up the value chain and innovation. Most of the value is thought to be created in activities upstream (examples include innovation, R&D, design) and downstream (examples include marketing, branding, logistics). On the other hand, it is hypothesized that only limited value is created in the pure manufacturing/assembly stages.

It should be noted that with marked improvements in global interconnectedness, the effects of global systemic risks also become more pronounced. For example the earthquake/tsunami that hit Japan in March 2011 highlights the potential disruption/risks of value chains when key and upstream producers of inputs stop producing. As were with the flooding that occurred later in Thailand, which resulted in major disruptions in the automotive and electronics industries. Therefore mapping GVCs clearly illustrate the interconnectedness between economies and highlights the transmission of macro-economic shocks along global value chains. The vulnerability of individual countries to global shocks is directly determined by their participation and position in GVCs.

A Tale of Two Trade Agreements –RCEP & TPP

In the realm of international strategy and diplomacy, competition is usually a negative paradigm. Whether jostling over territory, contesting freedom of navigation or an arms race, strategic competition tends to be risky and counterproductive. In other domains, however, competition should be welcomed. For example, in a market economy, competition leads to innovation and efficiency. Therefore, what should be avoided between China and the United States is to be encouraged between Apple and Samsung.

Whereas in other areas, competition is neither wholly good nor bad, but is instead a delicate scenario to be managed. Asian trade diplomacy is one such area, where there are competing agendas for trade liberalization, as manifested by the emergence of a “noodle bowl” of free trade agreements in East Asia.

From the United States under the umbrella of APEC, we have the proposed Trans-Pacific Partnership (TPP). From the East Asia Summit (EAS), with ASEAN in the lead, we have the proposed Regional Comprehensive Economic Partnership (RCEP). The RCEP involves ASEAN member states, and nations with which ASEAN has formed free trade agreements (FTAs). In other words China, South Korea, Japan, India, Australia and New Zealand could participate in the RCEP. The TPP, on the other hand, has as its members a more diverse and unrelated group of countries that include New Zealand, Chile, Brunei, Singapore, the US, Canada, Australia, Peru, Vietnam, Mexico and Malaysia.

It is very interesting to note that the TPP does not include China, and the RCEP does not include the US. Not only do the two proposals involve different sets of countries. They also take very different approaches. The TPP aims to be a high quality preferential trade agreement with few exemptions and extensive regulatory alignment is in areas such as labour law, environmental protection and intellectual property rights. The RCEP, on the other hand, sets the bar low and accepts that countries will reduce trade barriers at different rates—especially among less developed members—and also makes limited demands for regulatory harmonisation.

The TPP is open to new entrants already, as will the RCEP be in the future. More importantly, neither agreement restricts participants from joining other trade groupings. Nevertheless, it is hard to ignore the fact that the China-supported RCEP does not presently involve the United States and the US-led TPP negotiations don’t presently include China. And while China is not excluded from the TPP in principle, the regulatory emphasis of the arrangement makes them less likely to join.

The two agendas are not mutually exclusive and there is undeniable geopolitical competition between the ASEAN and US proposals. The RCEP was a compromise between China’s narrow view of regionalism based on ASEAN+3 (ASEAN & China, Japan and Korea) and Japan’s wider vision based on ASEAN+6 (10 ASEAN nations and China, South Korea, Japan, India, Australia and New Zealand). The TPP, on the other hand, is being promoted heavily by the United States as part of its 'pivot' to Asia, which is undeniably a response to China's rise.

We have to thank Japan for being the counterbalance between the rising dragon China & the USA who does not want to be knocked off her perch. There is no reprieve for Malaysia, sooner or later would have to decide to join either RCEP or TPP or both, or be a hermit nation and join neither grouping.

In the final analysis, against the backdrop of an unfolding global landscape, change is inevitable, unrelenting and overarching. Like the smart proverbial mousedeer (*kancil*), an open economy like Malaysia must learn to dance along with the behemoths of the international trading system, while making the required structural transformation in government and economy. In this context, the proverbial Malay *sang kancil* or mousedeer is known for its agility and wit. Strategy and timing is of essence, as we dance along the goliaths, we must be careful not get trampled by them. Instead we ought to play according to the accepted rules and reap the maximum amount of benefits.

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