

Exit Strategies for ASEAN and East Asia: A Huge Demand Shock Will Come

Fukunari Kimura

Professor, Faculty of Economics, Keio University

Chief Economist, Economic Research Institute for ASEAN and East Asia (ERIA)

Synopsis

- To maintain and further enhance our Factory Asia, ASEAN and East Asian countries must plan and implement effective exit strategies from COVID-19 pandemic with three policy phases: emergency responses, exit policies, and policies for the new normal.
- Macroeconomic policy must be designed in three phases: mitigation as emergency responses, stimulus as exit policies, and regaining fiscal health as policies for the new normal.
- As for global value chains (GVCs) or international production networks (IPNs) in ASEAN and East Asia, the production system has still been largely intact. However, we must prepare for possible prolonged negative demand shocks.
- To catch up with the worldwide digital transformation accelerated by COVID-19, developing Asia must promote the introduction of information technology (IT) and communications technology (CT) as a core part of its development strategies.
- ASEAN's initiative is crucial. Our Factory Asia must be even more strengthened through this difficult time.

The damage of COVID-19 on our health and the economy has been relatively light compared with other parts of the world. However, ASEAN and East Asia should plan and implement proper exit strategies for maintaining and even strengthening our "Factory Asia." Health policy, macroeconomic policy, policies for international production networks (IPNs), and policies for the digital economy must be well designed and coordinated in three different policy phases: emergency responses, exit policies, and policies for the new normal (Table 1; Kimura 2020).

Table 1: Policy framework for overcoming COVID-19 by ASEAN and East Asia

	Emergency responses	Exit policies	Policies for the new normal
Health policy	<ul style="list-style-type: none"> • Conduct social distancing • Provide testing • Keep medical treatments within capacity 	<ul style="list-style-type: none"> • Carefully remove social distancing • Set medical services back to normal • Develop international collaboration to exit (medical supply, vaccines, quarantine) 	<ul style="list-style-type: none"> • Establish long-term healthcare system • Disseminate health insurance • Develop International cooperation for future pandemic prevention
Macroeconomic policy	<ul style="list-style-type: none"> • Stabilize exchange rates and avoid a collapse of asset markets • Provide mitigation to help businesses and people at risk 	<ul style="list-style-type: none"> • Provide macroeconomic stimulus (monetary, fiscal) • Develop international macro policy coordination 	<ul style="list-style-type: none"> • Resume fiscal health and address inclusiveness and sustainability • Develop macro policy coordination framework
Policies for IPNs	<ul style="list-style-type: none"> • Keep IPNs and related industries (logistics, transportation, SMEs, local firms) alive with social distancing 	<ul style="list-style-type: none"> • Keep IPNs and related industries alive with worldwide recession and some restriction on people's movements • Strengthen location advantages and reduce service link costs (connectivity, trade and investment liberalization/facilitation) 	<ul style="list-style-type: none"> • Better positioning in IPNs with competitive location advantages (human capital, infrastructure, institutions) and reduced service link costs • Make Asia-Pacific as a competitive region to attract innovative IPNs
Policies for digital economy	<ul style="list-style-type: none"> • Remove bottlenecks for teleworking and other digital connectivity 	<ul style="list-style-type: none"> • Utilise IT and CT to strengthen international competitiveness in IPNs • Apply IT and CT in traditional industries and government services • Encourage digital-related businesses • Establish domestic and international policy discipline for the free flow of data and data-related businesses 	<ul style="list-style-type: none"> • Effectively utilize IT and CT for econ/social development • Develop innovation hubs to promote the application of IT and CT • Establish a secure policy environment for free flow of data • Further develop the ASEAN Digital Integration Framework, E-commerce Agreement, and other initiatives
Economic situation	<ul style="list-style-type: none"> • Forced halting of economic activities for social distancing 	<ul style="list-style-type: none"> • Prolonged recession in the world • Slow recovery of the cross-border movement of people 	<ul style="list-style-type: none"> • The new normal • More efficient/thick value-added PNs • More penetration of digital technology

COVID-19 = coronavirus disease, IPN = international production networks, IT = information technology, CT = communications technology. Items in red font are international initiatives for Asia-Pacific. Source: Kimura (2020).

1

Health policy must be prioritized at the stage of emergency responses (Kimura, Thangavelu, Narjoko, and Findlay 2020). Without containing pandemic within the capacity of healthcare services, the economy cannot revive. Still some countries in the region are struggling with calming down the pandemic while others are worrying about the second and third waves of the pandemic. In the transition from emergency responses to exit policies, restrictions on the movement of people, domestic and cross-border, can be removed only with great care. It is likely to take considerable time to resume the mobility of people as before.

Although the current macroeconomic downturn has been unprecedented, a serious financial crisis or a collapse of asset markets has not come yet. Figures for GDP and international trade seem to bottom out in May 2020 for most of the countries in the region. However, our region may still face prolonged negative demand shocks coming from all over the world from now on. Mitigation policy in emergency responses, macroeconomic stimulus as exit policies, and resuming fiscal health for the new normal will be focal points for macroeconomic policies (Zen and Kimura 2020).

COVID-19 has generated three kinds of shocks on global value chains: negative supply shocks such as an interruption of imports from China in February 2020, positive demand shocks for medical-related goods and goods for teleworking and staying home, and negative demand shocks due to the overall slowdown of the world economy. Fortunately, the production system in ASEAN and East Asia is almost intact so far. As proved at the occasions of past crises such as the Global Financial Crisis and the East Japan Earthquake, IPNs are robust and resilient against temporary shocks (Ando and Kimura 2012). However, prolonged demand slumps in the world may hurt our IPNs.

The China factor would generate further uncertainty. In the COVID-19 pandemic, the US-China confrontation has been aggravated, and a partial "decoupling" seems to proceed, particularly industries and commodities related to potentially military-used technologies and

high tech in general. ASEAN and East Asian economies other than China would like to keep good economic relationships with both the US and China and thus avoid a situation of being forced to choose just one of them though it may not be easy to maneuver complicated geopolitics. Private firms will try to enhance the resilience of their IPNs, which will generate chances for countries to attract more production blocks and upgrade their position in IPNs. It is crucial to maintain the rule-based trading regime and provide better investment climate.

The usage of digital technology is being accelerated by COVID-19 in both developed and developing countries. To catch up with the worldwide digital transformation, developing Asia must incorporate the introduction of information technology (IT) and communications technology (CT) in its development strategies for the following three fronts. The first is to make traditional industries such as agriculture, cottage industry, transportation, and tourism more productive by IT and CT. The second is to position better in manufacturing IPNs by introducing IT such as industrial robots and upgrading CT to further reduce service link costs (Obashi and Kimura 2020). The third is to develop new service industries led by CT, which include e-commerce, matching businesses, service outsourcing, e-payments, and fintech. Particularly for the third front, it is crucial to overcome possible digital divide, construct innovation hubs for applications, and establish a policy environment for the flow of data and data-related businesses with trust (Chen, et al. 2019).

ASEAN and East Asia can be a model case for the recovery and play a more proactive role in global governance. It is imperative to activate ASEAN's initiatives for exit strategies. A crucial test will come with huge worldwide demand shocks and prolonged social distancing.

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