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Supply Chain Resilience in the Indo-Pacific: Building Mutual Beneficial Dependency

by Stephen Nagy

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POLICY PERSPECTIVE

SUPPLY CHAIN RESILIENCE IN THE INDO-PACIFIC: BUILDING MUTUAL BENEFICIAL DEPENDENCY

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Building mutual beneficial dependency into supply chain resilience in the Indo-Pacific has become an increasingly important topic among like-minded countries. Canada, Japan, the United States, Australia, India and many more are looking to supply chain resilience as an important part of their economic security and a critical tool to negotiate the challenges of U.S.-China strategic competition across the Indo-Pacific.

Critical Junctures

There have been three critical junctures in terms of thinking about supply chain resilience in the Indo-Pacific. First, the ongoing COVID-19 pandemic exposed the dilemma of over-concentrating our supply chains in one country or one region. With the initial outbreak centred in Wuhan, China, the home to semiconductor, pharmaceutical, automobile and other manufacturers, the initial regionwide lockdown negatively affected the supply chains of a variety of sectors with global ramifications.[1] Consequences included bottlenecks in the supply of personal protective equipment, semiconductors, automobile parts and more.

Second, we've seen the weaponization of supply chains following Australia's calls for an investigation into the Chinese origin of COVID-19.[2] The economic coercion that Canberra faced after it called for an international investigation into COVID-19 was an explicit attempt by Beijing to shape Canberra's domestic politics and choices in voicing its concerns about transparency, clarity and importantly, finding the origin of this pandemic to prevent future ones.

Canada faced economic coercion as well in retaliation for the arrest of Huawei executive Meng Wanzhou. Canola, beef and other products faced increased scrutiny as Beijing attempted to pressure the Trudeau government's position on Meng's extradition.[3]

A third critical juncture is based on the potential for any country to shut off or close off technology supply chains that can affect trade and economy. Critical minerals and rare earths fall within this category.

In 2010, following the Japanese coast guard's arrest of a Chinese fisherman, we saw China engage in an informal embargo of rare earth materials.[4] Rare earth materials are vital for the electronics

[1] Takahashi Kawakami, "Wuhan Lockdown Strikes at Heart of 'Made in China 2025,'" *Nikkei Asia*, February 3, 2020. Accessed January 25, 2022, https://asia.nikkei.com/Spotlight/Coronavirus/Wuhan-lockdown-strikes-at-heart-of-Made-in-China-2025.
[2] Bonnie Glaser, "How China Uses Economic Coercion to Silence Critics and Achieve its Political Aims Globally," Statement before the Congressional-Executive Commission on China, December 7, 2021. Accessed January 3, 2022, https://www.cecc.gov/sites/chinacommission.house.gov/files/documents/CECC%20Hearing%20Testimony%20-%20Bonnie%20Glaser.pdf.
[3] Duanjie Chen, "Countering China's Economic Coercion No Fear but Resolve, No Illusion but Diversification," Macdonald-Laurier Institute, August 27, 2019. Accessed January 15, 2022, https://macdonaldlaurier.ca/files/pdf/20190827_China_Economic_Coercion_Chen_PAPER_FWeb.pdf.
[4] Stephen R. Nagy, "Territorial Disputes, Trade and Diplomacy: Examining the Repercussions of the Sino-Japanese Territorial Dispute on Bilateral Trade," *China Perspectives*, April 2013, http://journals.openedition.org/., DOI: 10.4000/chinaperspectives.6321.

of many of Japan's signature industrial products. Honda, Toyota, Suzuki and other important Japanese automobile manufacturers were negatively affected.

Japan responded to the informal rare earth embargo by engaging in a recycling campaign of digital devices such as phones and computers for their rare earth materials. Japan also sought out new partnerships in Mongolia, Myanmar and south-central Asian states to get a steady supply of rare earth materials.[5]

Responses to Weaponization, Monopolization and Black Swan Events

Clearly, rare earth materials and critical minerals are now subject to either weaponization or monopolization by China (and other countries as well) because of political differences between states. As a result of these three critical junctures, countries such as Japan have adopted new budgets to promote reshoring of their businesses,[6] but there has also been a selective diversification of supply chains throughout Southeast Asia and South Asia.

It is important to diversify supply chains so that a black swan event such as COVID-19, or the weaponization of supply chains due to political differences or monopolies in critical materials or rare earths, will have less of an impact on industrial Japan or any country.

Since 2019, we've seen several unilateral and multilateral initiatives emerge. For example, the Resilient Supply Chain Initiative (RSCI)[7] between Australia, Japan and India is meant to overcome some of the challenges associated with the pandemic. We've also seen Japan work with Quadrilateral Security Dialogue (Quad) partners to strengthen supply chains within the region and commit significant funds to ensure that supply chains continue to diversify.[8] Initiatives included developing shared technical standards, 5G diversification and deployment, horizon scanning and technology supply chains.

Selective diversification of supply chains to build mutually beneficial dependency among like-minded countries does not mean decoupling from China. Research has shown that China continues to have comparative advantages in terms of a seasonal labour force. Its logistic capabilities, human capital and skilled labourers can deliver the materials and goods that countries need in a timely and sizable fashion during times of instability.[9]

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[5] Kristin Vekasi, "Politics, Markets, and Rare Commodities: Responses to Chinese Rare Earth Policy," *Japanese Journal of Political Science* 20, no. 1 (2019): 2–20.
[6] Japan's Ministry of Finance, "Overview of the Supplementary Budget for FY2020," April 20, 2020. Accessed January 16, 2022, https://www.mof.go.jp/english/policy/budget/budget/fy2020/02.pdf.
[7] Japan's Ministry of Economy, Trade and Industry, "Joint Statement on the Supply Chain Resilience Initiative by Australian, Indian and Japanese Trade Ministers," April 27, 2021. Accessed January 12, 2022, https://www.meti.go.jp/press/2021/04/20210427004/20210427004-1.pdf.
[8] Japan's Ministry of Foreign Affairs, "Fact Sheet: Quad Leaders' Summit," September 24, 2021. Accessed January 14, 2022, https://www.mofa.go.jp/mofaj/files/100238181.pdf.
[9] Stephen R. Nagy and Hanh Nguyen, "Asymmetric Interdependence and the Selective Diversification of Supply Chains," *Journal of Contemporary Eastern Asia* 20, no. 2 (December 31, 2021): 237–58, doi:10.17477/JCEA.2021.20.2.237.

However, there has been a shift in thinking in many capitals as China continues to pursue a zero-COVID-19 strategy.[10] As China shuts down large cities, such as Xi'an in December 2021, or Tianjin in January 2022, we've seen a massive disruption in supply chains making China a less reliable destination point for the export of global goods. This suggests that until China adopts a coexistence strategy with COVID-19 in which cases of the disease are not associated with shutdowns[11] of ports, manufacturing cities and key supply chain hubs, countries will continue to try to find alternative supply chains that are stable, efficient and economically viable.

In line with this thinking, we're also seeing the economy as one of the key drivers behind the selective diversification of supply chains. Geopolitics and over-concentration of supply chains in China, as well as weaponization and monopolization of particular supply chains, have changed the thinking in manufacturing superpowers such as Japan.

The importance of diversifying production networks means that manufacturing powerhouses such as Japan need to create alternative hubs close to centres of consumption. In effect, there will be several production networks centred in China, in Southeast Asia and South Asia to produce and export goods to a particular region rather than a global export.

Last, technology – in particular, semiconductors – continues to be a critical area of discussion for supply chain diversification. The Taiwan Semiconductor Manufacturing Company (TSMC), which is primarily based in Taiwan, has a monopoly on the top-tier semiconductors that go into our iPhones, cars, jet fighters and other such technologies.

These semiconductors can be used in both military and civilian technologies and there is a concern that they could be weaponized through an attack on Taiwan. This would seriously affect the global supply of semiconductors, which is already facing a bottleneck.

There is also concern that China could create a semiconductor monopoly by a quick reunification of Taiwan and use these critical technologies to leapfrog its own industrial development. China could also monopolize semiconductor production, grinding economies and military powers to a halt because they can't produce those semiconductors themselves.

Supply chain resilience in the Indo-Pacific is going to be about building mutual beneficial dependency in several key areas including critical materials, rare earth materials and pharmaceuticals as well as other technologies, such as semiconductors. The goal will be to ensure that monopolization and/or weaponization of these critical technologies will not hamper economic growth or stability.

Canada needs to use its comparative advantages to maximize its contributions to supply chain resilience and stability in the Indo-Pacific, but also to maximize the benefits this can bring to Canada. This may include having stable and open access to critical materials, rare earth materials

[10] Smriti Mallapaty, "China's Zero-COVID Strategy: What Happens Next?" *Nature*, January 27, 2022. Accessed January 29, 2022, https://www.nature.com/articles/d41586-022-00191-7.
[11] Arendes Huld, "Are China Port Closures to Blame for Continued Supply Chain Disruption?," *China Briefing,* January 25, 2022. Accessed January 29, 2022, https://www.china-briefing.com/news/china-port-closures-to-blame-for-continued-supply-chain-disruption/.

and energy security, as well as other resources necessary for manufacturing within the region. Canada will need to work with like-minded countries such as Japan, the United States, Australia, India and others to find ways to co-ordinate their supply chain policies and match their comparative advantages so that they can maximize their influence within the region, along with the benefits.

About the Author

Stephen R. Nagy *(nagy@icu.ac.jp) is a senior associate professor at the International Christian University in Tokyo, a senior fellow at the Macdonald-Laurier Institute, a fellow at the Canadian Global Affairs Institute (CGAI) and a visiting fellow with the Japan Institute for International Affairs (JIIA). He is the director of policy studies for the Yokosuka Council on Asia-Pacific Studies (YCAPS). He is working on middle-power approaches to great-power competition in the Indo-Pacific.*

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His consulting work related to the Indo-Pacific includes projects on: CPTPP membership and expansion, on-line extremism in Japan, Sino-Japanese politico-economic relations, and US-Japan-China relations.

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He has published widely in peer-reviewed international journals such as China Perspectives, East Asia, the Journal of Asian Politics and History and the International Studies Review on topics related to trade, nationalism and China-Japan relations. He has also published in think tank and commercial outlets such as the China Economic Quarterly on trade and political risk. In addition to writing in media and policy forms outlets in Japanese and English such as Diamond OnLine, SCMP, the East Asian Forum and Policy-net on issues facing the region. He is a frequent political/ economic and security commentator on Japan-China-Korea-US relations in Japanese and international media outlet such as the New York Times, BBC, CNN, SCMP, WSJ, The Japan Times, The National Post, cNBC, Al Jazeera, Channel News Asia, Australian Broadcasting Corporation, etc.

His latest publications include:

- *With Hanh Nguyen, "Asymmetric Interdependence and the Selective Diversification of Supply Chains," Journal of Contemporary Eastern Asia. vol. 20, no. 2, DOI: 10.17477/jcea.2021.20.2.0 ISSN 2383-9449;*
- *"Indo-Pacific Resilience, Prosperity and Stability: Canada's Capabilities-led Approach to Strategic Free and Open Indo-Pacific Engagement," in Canadian and Japanese FOIP Visions, Policy Perspectives, Canadian Global Affairs Institute, March 3, 2021;*

- *"Sino-Japanese Reactive Diplomacy as Seen Through the Interplay of the Belt and Road Initiative (BRI) and the Free and Open Indo-Pacific Vision (FOIP)," China Report, 1–15, 2021;*
- *"Quad-Plus? Carving out Canada's Middle Power Role," Journal of Indo-Pacific Affairs, Special Issue, Quad Plus: Form versus Substance, vol. 3, no. 5: 179–195, 2020.*

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