

# Asian supply chain pact takes aim at China



A move by India, Japan and Australia last month to collectively boost supply chain resilience could eventually squeeze China out of the trios' supply chains for sectors such as semiconductors, batteries and rare earths, experts say.

The Indian, Japanese and Australian trade ministers announced the Supply Chain Resilience Initiative (SCRI) following a video call on April 27, indicating the three governments intend to use broad policy levers such as greater adoption of digital technology "and supporting trade and investment diversification".

The initiative will begin with attempts to match exporters and importers in each country and through "sharing of best practices on supply chain resilience". "The SCRI aims to create a virtuous cycle of enhancing supply chain resilience with a view to eventually attaining strong, sustainable, balanced and inclusive growth in the region," the announcement said.

The ministers said supply chains "have been left vulnerable due to a range of factors", but observers say the initiative mainly stems from a challenge the three

countries have in common: testy political relationships with China.

India and China are locked in a simmering dispute over part of their border in the Himalayas, while China has banned or slapped tariffs on a number of major Australian exports after Canberra called for an investigation into the origins of the coronavirus, which angered Beijing. Japan's relationship with its giant neighbour has long been fraught by trade hiccups and historical resentments over the early 20th century occupation of China.

"This Supply Chain Resilience Initiative is being viewed in China as an anti-China move - because it is an anti-China move," says Jeffrey Wilson, research director at the US Asia Centre think tank in Perth, Australia.

China's foreign ministry reacted coldly to the ministers' announcement, saying "the formation and development of global industrial and supply chains are determined by market forces and companies' choices".

"Artificial industrial 'transfer' is an unrealistic approach that goes against the economic laws and can neither solve domestic problems nor do anything good to the stability of the global industrial and supply chains, or to the stable recovery of the world economy," foreign ministry spokesperson Zhao Lijian said following the trade ministers' announcement.

China is by a long way the top trading partner of Japan and Australia, and India's second biggest after the US.

"They've all realised we've got a political relationship with China that's deteriorating; it may deteriorate further and many of our critical goods value chains depend on Chinese inputs or outputs," says Wilson, who specialises in Indo-Pacific trade. "They [China] have a habit of cutting them off during disputes; they may do it again. So we need we need a plan B. And that's where this initiative comes from."

Wilson cites the example of China unofficially choking off Japan's supply of rare earth materials, which are critical in a wide range of industries, during a 2010 spat between the two countries. China dominates the global supply for rare earths and Wilson says boosting output from India and Australia could be one of the first forays of the new initiative.

Carter McNabb, managing director for strategy and consulting at Accenture in Australia, agrees the supply chain pact may make inroads on rare earths supply.

“The production of essential assets like semiconductors, and significantly, the supply of rare earths... is not going to transition easily away from China, and will depend on the success of this new supply chain pact between India, Australia and Japan,” he tells **GTR**.

“However, with India and Australia both being equipped to mine rare earth minerals, and Japan already manufacturing semiconductors locally, there is certainly potential for an extended regional supply chain network for other goods and services in the future.”

Lithium batteries, widely used in electric vehicle and solar manufacturing, are also a candidate for a supply chain shake-up through co-operation between India, Japan and Australia, Wilson suggests.

Much of the lithium dug up in Australia for use in electric cars manufactured in Japan undergoes processing in China, he says. One of the concrete moves of the initiative could be to incentivise businesses to move some of that processing to India.

### **Supply chains awry**

While supply chain weaknesses caused or exposed by the pandemic have rattled the entire region, businesses in Japan and Australia have responded most strongly, according to research from law firm Baker McKenzie published earlier this month.

Some 45% of respondents in Japan and 38% in Australia said they “are currently transforming our production, sourcing and supply chain” in response to rising trade tensions and protectionist measures.

“Many companies believe the diversification of their supply chains is a viable option for them as part of mitigating trade tension uncertainty,” Kana Itabashi, an international commercial and trade lawyer at Baker McKenzie in Tokyo, tells **GTR**.

Japanese government subsidies for businesses that move supply chains into Southeast Asia are also likely contributing to willingness to shake up how

businesses source goods, she adds.

India's *Economic Times* newspaper reported last year, when news of the possible trade initiative surfaced, that Tokyo first proposed co-operating on supply chains and pressed on the Indian government the "urgency" needed to progress it.

At the same time in Canberra, difficulties sourcing personal protective equipment during the height of the pandemic and a worsening trade row with China saw the government begin its own supply chain resilience initiative focused on securing access to critical supplies.

In the wake of supply chain havoc caused by the coronavirus pandemic, the government tasked the Productivity Commission, an influential official advisory body, to study imports and exports that could be threatened by trade wars, natural disasters or a financial meltdown.

Its interim report found that one in 20 imports are considered vulnerable due to being available only from one source, with two-thirds of those vulnerable imports coming from China. But it said that only a few of those are considered "essential", concluding: "the analysis offers suggestive - but not conclusive - evidence that many essential goods and services do not depend critically on vulnerable imported inputs".

## **Made in India**

In India, Prime Minister Narendra Modi has pitched the country as an alternative to China in manufacturing supply chains. "They should also be based on trust along with affordability," he told a virtual forum last November, according to news reports. "Companies are also now looking for reliability and policy stability. India has all of these qualities."

The government has also introduced measures such as a scheme that offers financial incentives to major manufacturing sectors such as electronics, carmakers and food processing, in an effort to spur local production.

But Accenture's McNabb says China is still significantly better placed to serve supply chains of developed markets like Japan and Australia.

"While the potential for India to become a leading export factory is certainly there, it would require a number of structural and regulatory reforms, such as tax

and land-use reforms, modernizing labour laws, and improving infrastructure and safety conditions for workers, in order for Indian suppliers to be ready to take on Australian and Japanese markets,” he says.

Baker McKenzie’s Itabashi agrees: “While these initiatives might provide Australian and Japanese businesses with opportunities to build supply chain resilience through including more Indian inputs into their supply chains, for many businesses, relocating their supply chains outside of China will be no easy task because of the geographic differences, existing infrastructures, and technical capabilities differences between the two countries.”

The announcement of the initiative suggested it could also be expanded. A likely contender is the US, which is also grappling with supply chain concerns over essential imports.

Wilson says Washington joining in would make the supply chain effort the first economic plank of the security dialogue dubbed “the quad”, in which it takes part alongside Japan, Australia, and India.

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