GLOBAL SUPPLY CHAINS (I): RECONFIGURATION OF TRADE AND FOREIGN DIRECT INVESTMENT FLOWS

Sarah CHAN

EAI Background Brief No. 1755

Date of Publication: 1 March 2024

Executive Summary

1. Global supply chains have been under intense pressure since the outbreak of the COVID-19 pandemic and emergence of geopolitical tensions such as the Russia-Ukraine conflict and US-China trade war. This has resulted in some reshuffling or reconfiguration of global economic activities as companies reorganise their production in pursuit of diversification.

2. In view of the strategic importance of semiconductors and the supply chain's vulnerability to shocks, various governments are investing in local semiconductor manufacturing facilities and increasing research funding in the sector. The European Chip Act is an example of localising parts of the supply chain within Europe and reducing reliance on foreign chip supplies.

3. Most notable is a series of bills adopted against the backdrop of rising US-China trade tensions, such as the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act, as well as the Inflation Reduction Act passed by the United States in 2022.

4. US-China trade tensions have significantly affected China-centric supply chains. Over the last five years (2018-2022), there has been a discernible shift from China as a source of US imports across a wide range of traded products, which include electrical equipment and transportation goods.

5. Vietnam is a major beneficiary of trade diversion from China in electronics and peripherals. Similarly, Taiwan and South Korea have benefitted from trade diversion and their competitive strengths in value-added upstream products like semiconductors.

6. Similarly, Mexico has gained from trade diversion, given its proximity to the United States and favourable tariff treatment under the US-Mexico-Canada Agreement. Emblematic of 'friendshoring' or 'nearshoring', Mexico has seen its share of US

imports rise steadily since the 1990s and particularly in the past five to 10 years, from nearly 7% in 1994 to 14% in 2022.

7. While it could be too early to assess the spillover effect from the US-China decoupling or de-risking on capital flows, preliminary data suggests that portfolio inflows into China have started to turn negative and declined by more than US$100 billion in 2022. This could reflect the continued trade tensions between the United States and China, as well as a host of other factors such as a slowing Chinese economy.

8. Research from the Bank for International Settlements reveals that supply chains, particularly those involving Chinese suppliers and American consumers, have lengthened instead of shortened between December 2021 to September 2023. This suggests that despite relocation of intermediate goods production from China to other parts of Asia, China remains integral to global supply chains.