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Topics *Moves to restructure supply chains are likely to expand*

U.S. President Donald Trump has announced the enactment of the fourth round of tariffs to be imposed on virtually all goods imported from China. Moves to restructure supply chain in Asia are expected to expand from labor-intensive industries to the electric and electronic industries.

■ The fourth round of tariffs has finally been enacted

On August 1, U.S. President Donald Trump announced the enactment of the fourth round of tariffs by imposing an additional 10% tariff on \$300 billion worth of Chinese goods, which had been excluded from the scope of tariffs, starting from September. While the United States and China agreed to resume trade negotiations between the two countries at the summit meeting at the end of June, the negotiations held in Shanghai at the end of July ended without making significant progress. What lies behind the additional tariffs seems to be the intention of the United States to regain the initiative in the trade negotiations, which had fallen into a state of deadlock, and to win concessions from China.

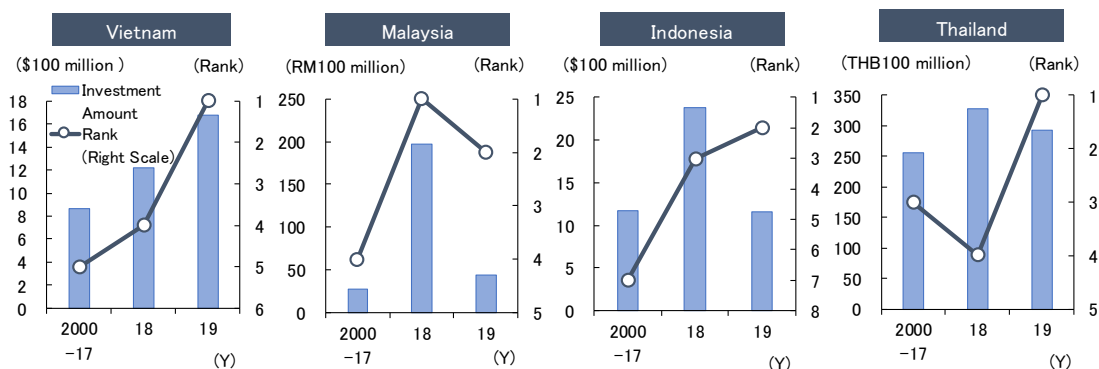
On August 13, the U.S. government announced it would postpone the enactment of tariff hikes on some items including smartphones and notebook PCs until December 15 by taking into account the effects on the Christmas shopping season. However, the U.S. government has maintained a forceful attitude by designating China as a currency manipulator on August 5 because of its alleged intentional devaluation of the yuan, which indicates that there are no signs of any easing of tensions between the two countries.

Slightly over a year has passed since July 2018 when the first round of tariffs on industrial machinery and other goods was enacted. Amid the situation where no clear exit can be seen for the conflict between the United States and China, companies whose final destination for exports to the United States had been urged to exit from China. The fourth round of tariff hikes will likely accelerate this movement. In the next paragraph, we will verify the changes happening for inward foreign direct investment (FDI) and exports to the United States by looking at some ASEAN countries including Vietnam, Malaysia, Indonesia and Thailand, for which the relocation of production bases from China is anticipated.

■ Presence of Chinese companies has been increasing in ASEAN countries

We tend to think that the issue of China exit is a problem faced by Japanese, Korean and Taiwanese companies which have their production bases in China. However, the statistics of inward FDI to each country indicate that Chinese companies are the ones which have been pushing forward with such movement most aggressively. Looking at the trend for 2018 and 2019 (YTD) based on annual average investment amount and rankings by country for the period between 2010 and 2017, China increased investment in all countries either in 2018 or 2019, significantly advancing its ranking. In particular, China's investment in Malaysia increased five times year-on-year to RM19.7 billion in 2018, and China's investment in Vietnam grew five times year-on-year to \$1.68 billion for the January-June 2019 period, both showing drastic growth.

<Trend of China's FDI to Each Country>



Source: The Japan Research Institute, Ltd. based on data from CEIC

Note 1: Investment amount for 2000–2017 indicates annual average investment amount, while the ranks are calculated based on average investment amount.

Note 2: Investment amount for Vietnam indicates new investments on an approval basis, and its results for 2019 cover those for January–June. Investment amount for Malaysia indicates investments in the manufacturing industry on an approval basis, and its results for 2019 cover those for January–March. Investment amount for Indonesia indicate investments on an actual basis, and its results for 2019 cover those for January–March. Investment amount for Thailand indicate investments on an approval basis, and its results for 2019 cover those for January–March.

Meanwhile, such extreme movement as from China has not been seen for Japan, Korea and Taiwan. Looking at the investment in Vietnam, Malaysia, Indonesia and Thailand in 2018 and 2019 (YTD) based on the annual average investment amount for the period between 2010 and 2017, a significant increase was witnessed only for Japan's investment in Vietnam in 2018 (increased 3.1 times year-on-year to \$4.82 billion). Most other investment either remained flat or decreased on a year-on-year basis. These results indicate that Japan, which has supply chains in ASEAN countries of a size comparable to that of China, has been reviewing production systems by utilizing its supply chains and that Korea and Taiwan have been relocating their production bases back to their own homes for the time being, in an effort to avoid the effects of the tariffs.

■ Movement for restructuring has shifted from the labor-intensive industries to the electric and electronic industries

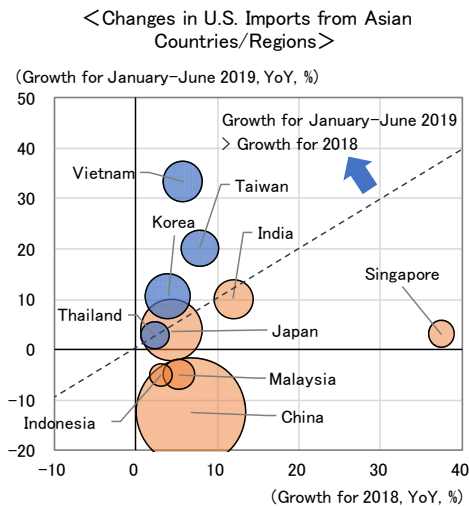
If some of China's production bases are transferred, exports from the transfer destinations to the United States should increase. According to U.S. import statistics, U.S. imports from China were strong in 2018, up 6.8% year-on-year to \$539.7 billion. As the effects of the tariffs have emerged since the beginning of 2019, U.S. imports from China decreased 12.4% year-on-year to \$219.0 billion for the January-June 2019 period. U.S. imports from China declined more than 10% year-on-year for the first time since 2009 when they plunged 12.3% year-on-year due to the impact of the collapse of Lehman Brothers.

So, what countries are replacing China's exports to the United States? In fact, there are not many countries with considerable increases in the U.S. import statistics for the January-June 2019 period. If we plot Asian countries on a chart with the growth of imports for 2018 on the horizontal axis and the growth of imports for January-June 2019 on the vertical axis, the results indicate that the latter exceeds the former only for Vietnam, Taiwan, Korea and Thailand. Out of these countries, it became most apparent that for Vietnam an increase in investment from China resulted in an increase in exports to the United States.

On the other hand, while investment from China has increased to Malaysia and Indonesia, we cannot say that exports to the United States from these two countries have grown significantly. Against this background, there is the fact that the breakdown of China's investment in these countries includes infrastructure investment related to the One Belt One Road (OBOR) initiative. In addition, it seems that differences in industrial structure have affected the situation. Since personnel expenses are lower and the scale of the labor-intensive industries is larger in Vietnam compared to other ASEAN countries, Chinese companies rushed to Vietnam quickly and its exports to the United States increased consequently. U.S. imports from Vietnam of labor-intensive products (SITC82-85) such as clothes and shoes for the January-June 2019 period increased 15.7% year-on-year to \$11.7 billion, which is nearly three times as large as imports from Indonesia, eight times as large as imports from Malaysia, and 13 times as large as imports from Thailand.

However, the plot shown in the diagram on the right may change significantly in the future. This is because the restructuring of supply chains is anticipated to get into full swing also in the electric and electronic industries as a result of the enactment of the fourth round of tariffs. The electric and electronic industries that produce smartphones and other products, for which the enactment of tariff hikes had been postponed in December 2018, have much a broader scope of businesses compared with the labor-intensive industries. U.S. imports of electric and electronic products (SITC75-77) for the January-June 2019 period amounted to \$440.9 billion, which is nearly 2.5 times as large as U.S. imports of labor-intensive products. If even some of production bases in China, which account for 40% of the entire production thereof, are transferred, it will have impact that can change exports from the transferred destinations and industrial structures. How will the supply chains for the electric and electronics industries change in the future given the announcement on the enactment of the fourth round of tariffs? Close attention must continue to be paid to the trends of inward FDI and exports to the United States of each country.

(Yuji Miura)



Source: The Japan Research Institute, Ltd. based on data from CEIC
 Note: The size of the circles indicates the amount of imports for January-June 2019.

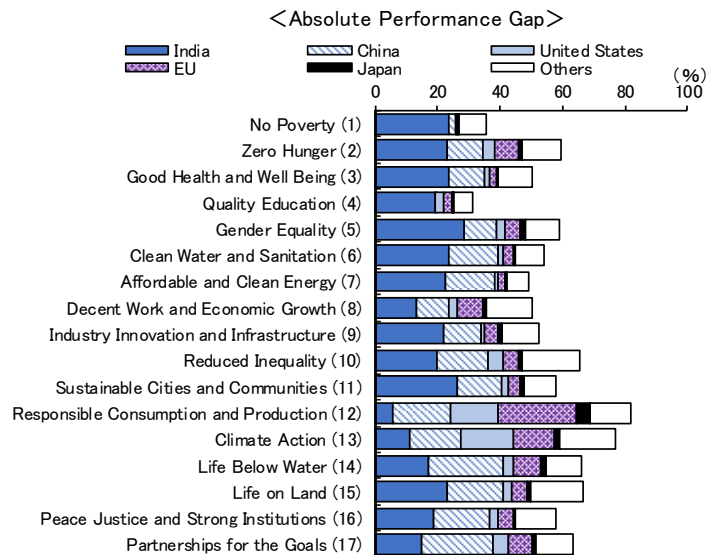
Topics SDGs (Sustainable Development Goals) in India

India has an extremely important role in achieving the SDGs set by the United Nations.

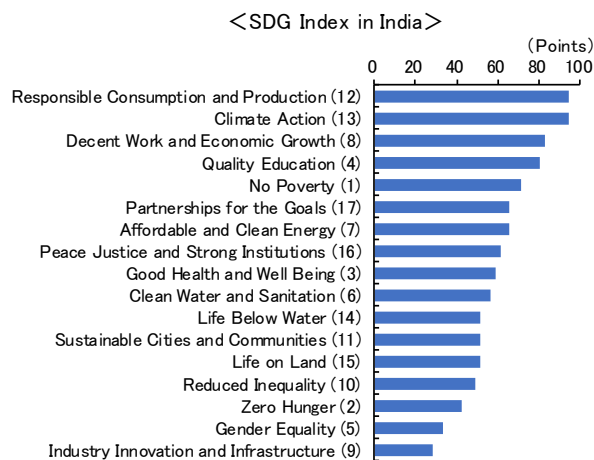
■ What is the significance of India in the SDGs?

In September 2015, the Sustainable Development Goals (SDGs), a collection of 169 targets in 17 fields including the elimination of poverty and enhancement of education, and gender equality, to be achieved by 2030, were adopted by the United Nations. As about four years have passed since then, the recognition of the SDGs in Japan has been gradually increasing. Companies have also shown great interest in incorporating the perspective of the SDGs into their business plans along with ESG (Environment, Social and Governance) that reflect the Principles for Responsible Investment (PRI) advocated by the United Nations in 2006.

The G20, which accounts for the majority of the world population, GDP and emissions of environmental pollutants, play an extremely important role in achieving the SDGs. Taking into account the economic and social situations of each country, however, India has a particularly important role among G20. India, which has population exceeding 1.3 billion, is expected to become the world's largest country in terms of population in the near future, overtaking China. On the other hand, on the economic front, India's nominal GDP per capita is approximately \$2,000, which is the lowest among G20. India is also faced by a number of challenges including the elimination of poverty and the development of infrastructures. In the report on qualitative assessment of the SDG achievement status of each country released at the end of June by an international organization that supports the achievement of the SDGs, India ranked 115th out of 162 countries, which was the lowest ranking among G20 and indicated that there is still significant room for improvement. In terms of the contribution rate of G20 and regions to the gap between the achievement targets and the reality as revealed by the same report, India's contribution rate was higher in many fields. Meanwhile, in the fields of "production and consumption" and "climate change" whose targets include the reduction of emissions of environmental pollutants associated with economic activities, the majority of the gap between targets and the reality are contributed by the EU, China and the United States, and India's contribution rate turned out to be lower. However, this reflected India's current low per-capita income and consumption level. In fact, environment-oriented, efficient production and consumption systems have not been established in India yet. Since it is anticipated that India's per-capita



Source: United Nations Sustainable Development Solutions Network "SDG Index and Dashboards Report 2019"
 Note: Figure in parenthesis shows SDGs' target number.



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emissions of environment pollutants will significantly increase in line with economic growth in the future, India's initiatives in this field will likely significantly influence SDG achievement status on a global scale.

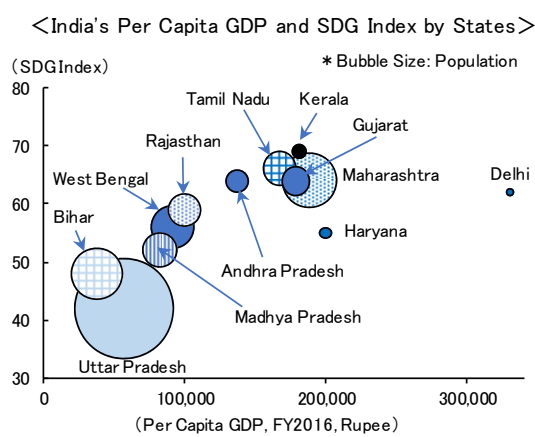
On the other hand, as Japan is ranked 15th in the world in terms of SDG achievement, there is little room for improvement compared with the case of India. For this reason, in order for Japan to make contributions to SDG achievement on a global scale, it is important not only to improve the situation in Japan but also to expand positive effects to emerging countries including India through international cooperation and overseas business development.

■ What is the SDG achievement status in India based on SDG indicators?

Looking at India's achievement status of the SDGs based on the SDG indicators which assess the achievement status in each field using indicators between 0 and 100, the scores for the "innovation" and "gender" fields are particularly low. For the reason behind the low score for the innovation field, we can point out the facts that R&D expenses represent a small portion of the GDP, there is a limited number of researchers in comparison with population, which limits the creation of innovation, and economic infrastructures indispensable for industrial development have not been established. In addition, in the gender field, shorter school education and a lower labor participation rate among women are the reason behind the low scores.

Even in the fields with relatively higher scores, it is possible that the challenges faced by India have not been captured appropriately due to the assessment methods and statistical restrictions. For example, SDG indicators in the "production and consumption" and "climate change" fields have been prepared based on per-capita emissions of environmental pollutants in each country. Although per-capita emissions are lower in India, emissions for the entire country are rather significant due to its large population. Therefore, the elimination of environmental issues including the problem of air pollution has been an imminent challenge. In addition, with regard to the "growth and employment" field for which India also scored high, the delay in job creation has been criticised by various sources as one of the biggest failures of the Modi administration. Since India's working age population has increased at a pace exceeding 10 million each year, unemployment has been a significant social problem despite an average real GDP growth rate exceeding 7% for the past five years. While the unemployment situation has been considered when preparing the SDG indicator for this field, the unemployment rate originally estimated by the International Labour Organization (ILO) has been used as large-scale labor force surveys are conducted only once in five years in India. The unemployment rate has remained stable at slightly below 3% for the past five years. However, since there has been a significant gap from the current unemployment rate exceeding 7% which is originally estimated by a local private think tank, the unemployment rate provided by the ILO may not accurately reflect the reality.

Based on the foregoing, it is necessary for India to vigorously push forward with initiatives for achieving the targets not only in the fields with lower SDG indicators but also in all fields. Japan is expected to be further involved in economic and social development in India through infrastructure development in both software and hardware aspects by means of Official Development Assistance (ODA) as well as business development in India by the private sector, thus contributing to the achievement of the SDGs on a global level. Amid the improvement of the business environment under the Modi administration among other factors, the number of Japanese companies conducting business in India has been on a steady rise during the past five years. However, most Japanese companies have businesses in the high-income regions such as Delhi, Maharashtra and Haryana whose the SDG indicators are already high. Japanese companies' business presence has been limited in the low-income regions such as Uttar Pradesh and Bihar which are expected to play significant roles in achieving the SDGs in the future. For such reason, when Japanese companies incorporate SDG perspectives into their business plans in India, they should be mindful of the ripple effects on these regions.



(Shotaro Kumagai)