Opportunities and challenges facing China’s economic “external circulation”

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Abstract
At present, China’s external circulation is facing opportunities such as the diversification of foreign trade and investment and the opening of a multi-level development pattern with the Regional Comprehensive Economic Partnership. At the same time, challenges brought about by the US Indo-Pacific Economic Framework and the economic trends of Japan and ASEAN are also rising. Therefore, in the face of an increasingly complex international environment and various challenges, China must find new approaches to expand the effective means of China’s external circulation. To accomplish this, China should continue to adjust its relationship with the US and keep the scale of China–US trade relatively stable. In addition, China should actively expand the space for the development of foreign trade.

Keywords External circulation · China–US trade · RCEP · Industrial chain

1 Introduction
At the end of 2020, when China was about to enter its 14th Five-Year Plan, the Chinese government proposed the “promotion of the establishment of a new development paradigm with domestic circulation as the mainstay and domestic and international circulation reinforcing each other.” It clearly pointed out that in terms of the relationship between internal circulation and dual circulation, the former is the foundation and the two comprise a unified body. The international market is an extension of the domestic market, and internal circulation provides a solid foundation for dual circulation. Giving full play to China’s advantages as a massive market will provide broader market opportunities for countries around the world. In addition, China can rely on domestic circulation to attract global commodities and resources. In doing so, China can build new cooperative and competitive international advantages (Liu 2020). However, at the same time, the international political and economic
landscape has undergone profound adjustments in the midst of great changes unseen in a century. Protectionism and populism are rising around the world, and patterns of international trade and investment as well as industrial chains are being impacted. In this context, China’s external circulation is facing both growing opportunities and growing challenges.

As the economic trend of the East’s rise and the West’s decline has become more obvious, the geopolitical strategic focus of the US and the West has also begun to shift to the Asia–Pacific region. From the Obama administration’s pivot to Asia to the Trump administration’s US–China trade war and the Biden government’s Indo-Pacific strategy, the US has greatly elevated the strategic priority of the region, continuing to invest diplomatic, economic, and military resources in it. The US government’s latest Indo-Pacific strategy, issued on February 11, 2022, states that the US “will focus on every corner of the region, from Northeast Asia and Southeast Asia, to South Asia and Oceania, including the Pacific Islands” and “do so at a time when many of our allies and partners, including in Europe, are increasingly turning their own attention to the region”. The document explicitly states that “this intensifying American focus is due in part to the fact that the Indo-Pacific faces mounting challenges, particularly from the PRC” (The White House 2022, 5).

The US’s Indo-Pacific strategy views China as the primary target to guard against and places unprecedented emphasis on economic topics. Since the establishment of China–US diplomatic relations in 1972, more than half a century ago, the gap between the two countries in terms of economic volume has gradually narrowed. According to data, China’s GDP in 1972 was $113.688 billion, which is less than 10% of the equivalent US figure of $1.279 trillion. In 2021, China’s GDP reached $17.73 trillion, approximately, 73% of the US figure of $24.01 trillion (World Bank 2022). This dramatic shift in the balance of power between the two countries will inevitably have a major impact on their bilateral relations and on international relations as a whole. As China’s national strength has continued to grow, the focus of US foreign policy has shifted from building a liberal international order to under-scoring geopolitical competition, and US economic policy has shifted from liberal trade to unilateralism, protectionism, and even decoupling.

Beginning in 2018, the Trump administration imposed sweeping tariffs on China and implemented a decoupling policy in areas including supply chains, imports and exports, technological cooperation, and even the movement of people. Since assuming power, President Biden has not substantively changed the US’s containment strategy against China. Instead, he has made efforts to further unite with allies in an attempt to comprehensively contain China in the fields of security, economics, and science and technology on the grounds of ideology and values. If the Trump administration initiated the decoupling between China and the US, it is the Biden administration that has further polarized the world.

Under the deliberate containment and suppression of the US, China must find new approaches to expand the effective means of its external circulation across multiple levels with broader vision and more diverse perspectives. To accomplish this, China should continue to adjust its relations with the US to avoid further escalation and control the intensity of frictions so as to keep the scale of China–US trade relatively stable. In addition, China should proactively use the Belt and Road Initiative,
the Regional Comprehensive Economic Partnership (RCEP), and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (which it has formally applied to join) to create more space for the development of foreign trade.

2 Opportunities for China’s external circulation

2.1 China’s foreign trade and investment are diversified

2.1.1 The impact of China–US economic and trade frictions on China’s trade and investment

The China–US economic and trade relationship is the most scrutinized such relationship in the world today. It has great influence on not only the two countries’ economies but also the world economy. The economic structures of China and the US are highly complementary, and the two countries are important trading partners for each other. However, trade conflict between the two has intensified in recent years. One of the excuses given to justify the US’s trade war against China is that the US has a huge trade deficit with China. In reality, data show that foreign companies in China, including US companies, account for a considerable share of China’s exports to the US and that US companies’ total sales volume in China is much higher than the amount of US exports to China. In other words, the US–China trade imbalance contains a large number of “reverse imports” from US companies in China. This problem cannot be solved by reducing China’s exports to the US. In fact, China–US trade friction has the trait of “US-US friction” (Guan 2021). Despite this, due to the US policy of restricting the export of high-tech products to China, China’s path to increasing its investment in and imports from the US is full of difficulties.

As a matter of fact, the objective demands of the market often precede policy. In recent years, in comparison to the US’s decoupling “wall-building” behavior toward China, the regional integration process driven by the Belt and Road Initiative, RCEP, and the CPTPP has played a role in filling gaps and bridging divisions. The US has attempted to contain China by restricting trade, investment, and capital flows. The specific measures it has taken include export controls, entity lists, foreign investment reviews, import restrictions, investment restrictions and financial sanctions. Chinese enterprises have strived to maintain the import and export markets of developed economies such as those of the US, European countries, and Japan. At the same time, to reduce dependence and risks, they have also made great efforts to explore other import and export markets, especially in emerging countries where China can play a role in the field of technology. By actively developing economic and trade relations with emerging countries, these enterprises are seeking new outlets. Data from recent years show that China’s foreign trade has diversified.

The volume of China–US trade has been on a downward trend after peaking in 2018. In 2020, Chinese direct investment in the US dropped by 64.5% from its peak in 2016. US allies such as Japan and the UK have successively introduced policies aimed at strengthening investment reviews and economic security. In the case of
Japan, the volume of trade between it and China shrank in 2019 due to China–US trade frictions and basically languished in 2020 despite positive growth of 0.8%. The share of China–Japan trade in China’s total foreign trade plummeted from 30.4% in 1985 to 6.8% in 2020.¹ By the end of 2020, China’s cumulative direct investment in Japan was $7.003 billion, accounting for only 1.82% of Japan’s total inward foreign direct investment.

2.1.2 China is expanding the scope of its foreign trade development across a wider range of fields

China’s trade with Belt and Road countries has grown rapidly in recent years, with growth rates generally higher than that of China’s overall foreign trade. From 2013 to September 2021, the trade volume of goods exchanged between China and Belt and Road countries amounted to $10.4 trillion (People’s Daily 2021). In 2020, China’s total imports and exports to Belt and Road countries reached 9.3696 trillion yuan, an increase of 1.0% over the previous year despite the pandemic (National Bureau of Statistics of China 2021b). In 2021, this figure reached 11.6 trillion yuan, an increase of 23.6–2.2% points higher than the overall growth rate of China’s foreign trade during the same period (State Council Information Office 2022).

China–ASEAN economic and trade cooperation is a bright spot. China has always attached great importance to the Association of Southeast Asian Nations (ASEAN). The China–ASEAN Free Trade Agreement (ACFTA), signed in November 2002, is China’s first multilateral free trade agreement and the first free trade agreement negotiated by ASEAN as a whole. In November 2020, the two sides took the 30th anniversary of the establishment of China–ASEAN dialogue relations as an opportunity and greatly upgraded the ACFTA. It, prior to other free trade agreements, relaxed the implementation of origin rules and tariff reductions, lowered thresholds for entering fields such as trade in services and investment, and propelled a 13.2% increase in the trade of agricultural products between China and ASEAN. Drawing on this successful experience, RCEP has significantly increased the proportion of selective rules of origin criteria to 65.8%, improving the convenience and flexibility of rules of origin. In 2020, the economic and trade exchanges between China and ASEAN grew continuously, and the total import and export volume between the two sides reached 4.74 trillion yuan (China-ASEAN Business Council 2021). For the first time, the two sides became each other’s largest trading partner. In 2021, China’s imports from and exports to ASEAN reached 5.67 trillion yuan, a year-on-year increase of 19.7%. This sum accounted for 14.5% of China’s total foreign trade value (China-ASEAN Business Council 2022) (see Fig. 1).

China is actively building a network of free trade areas along the Belt and Road. Most of the countries and regions that China has signed or will sign free trade agreements (FTAs) with are those participating in the construction of the Belt and Road. The most noteworthy of these agreements are the upgrading of the China–ASEAN

¹ Calculations based on statistics from the 1986 and 2021 editions of the China Statistical Yearbook (National Bureau of Statistics of China 1986, 353; National Bureau of Statistics of China 2021a, 566).
Free Trade Agreement and the signing and entry into force of RCEP. According to statistics from the General Administration of Customs of China, China’s import and export volume with the other 14 RCEP member countries reached 10.22 trillion yuan in 2020, accounting for 31.7% of China’s total foreign trade value (General Administration of Customs of the People’s Republic of China 2020). In 2021, these figures were 12.07 trillion yuan and 30.9%, respectively (General Administration of Customs of the People’s Republic of China 2021). There is still great potential for the further development of trade between China and Belt and Road countries. Compared with developed countries, most countries along the Belt and Road are developing states with large populations and room for further economic and social development. Their demand for Chinese products will continue to expand. This trend provides an important direction for China to promote the diversification of its export markets moving forward.

2.1.3 China’s outbound investment is diversifying

In 2020, China’s outbound investment flows ranked first in the world for the first time, accounting for more than 20% of the world’s total (Chinese Ministry of Commerce 2021b, 6–7). The World Investment Report 2021 released by the United Nations Conference on Trade and Development (UNCTAD) shows the global foreign direct investment in 2020 was $1 trillion, a year-on-year decrease of 35% due to the impact of the COVID-19 pandemic. This drop is mainly due to a 56% decrease in outward foreign direct investment from developed countries and regions to $347 billion, which reduced their share of the world’s total to 47%. In contrast, outward foreign direct investment from developing countries and regions fell by 7% to $387 billion. Due to this small decline, their share in the world’s total outward foreign direct investment rose to 53%. Among these countries and regions, China had $133

![Graph showing countries' share in ASEAN's total trade](image-url)
billion in outward foreign direct investment flows, ranking first in the world for the first time (United Nations Conference on Trade and Development 2021, 1–5).

Since entering the twenty-first century, China has actively implemented its “going out” strategy. Driven by the Belt and Road Initiative in particular, China’s outward foreign direct investment has continued to rise, reaching a record high of $196.15 billion in 2016—a year-on-year increase of 34.65% (National Bureau of Statistics of China 2021a, 344). However, after 2017, China’s foreign direct investment declined each year. This is mainly because the US, European countries, Japan, and other Western countries have successively introduced economic security policies that target China, including enhanced review and restrictions on foreign investment. In October 2017, Japan began implementing a revised Foreign Exchange and Foreign Trade Act that allows it to compel foreign investors associated with so-called national security concerns to sell their shares. In August 2018, the US passed the Foreign Investment Risk Review Modernization Act (FIRRMA), which strengthened the review authority of the Committee on Foreign Investment in the United States (CFIUS). In 2020, China’s outward foreign direct investment saw its first year-on-year growth since 2016, rising 12.27% to $153.71 billion. Among its outward foreign direct investment, China’s investment in the US grew by 58.11% to $6.019 billion. However, this growth was just a rebound after a sharp drop of 49.09% in 2019 and still represented a 64.56% drop from a peak of $16.981 billion in 2016 (National Bureau of Statistics of China 2017, 372; 2021a, 344, 377).

By the end of 2020, the cumulative total of China’s foreign direct investment in Japan was $7.003 billion. This accounted for only 1.6% of China’s total investment in developed countries and 1.82% of Japan’s total inward foreign direct investment. This figure is quite unbalanced, especially given that Japan’s total cumulative direct investment in China stood at $143.450 billion (Japan External Trade Organization n.d.). In terms of import restrictions, Japan followed the US’s lead in excluding Chinese companies such as Huawei in fields such as information and communication equipment. In the context of the escalation of China–US trade frictions and a long-term China–US competition, Japan’s direct investment in China in 2020 was $11.043 billion, a year-on-year decrease of 8.1%. This amount is about 81.9% of the peak of $13.479 billion in 2012. In particular, investment in China’s manufacturing industry fell by 31.0% year-on-year and plummeted by 73.3% year-on-year in the first half of 2021 (Japan External Trade Organization n.d.). Some Japanese enterprises in China have begun to transfer their production bases to Southeast Asia to avoid the risks caused by China–US economic and trade frictions.

While China has been forced to reduce its investment in developed countries, its outward direct investments in countries along the Belt and Road have, in sharp contrast, maintained robust growth. In 2020, China’s direct investment in countries along the Belt and Road increased by 20.6% to $22.5 billion, accounting for a record high of 14.7% of China’s total outbound investment. Among these countries, Singapore, Indonesia, Thailand, Vietnam, the United Arab Emirates, Laos, Malaysia, Cambodia, Pakistan, and Russia have become the main investment destinations. China’s investment in ASEAN is particularly dynamic. In 2020, China’s industry-wide direct investment in ASEAN reached $14.36 billion, a year-on-year increase of 52.1% (Chinese Ministry of Commerce 2021a). From January to
September 2021, China’s direct investment in ASEAN hit $10.59 billion (Chinese Ministry of Commerce 2021c). As can be seen, because the US and the West have targeted China and tightened restrictions on foreign investment, China is shifting more of its outward foreign direct investment to countries along the Belt and Road.

In particular, emerging market countries that have a need to cooperate with China in the field of technology welcome Chinese investment. Many ASEAN countries are willing to cooperate with Chinese companies such as Huawei in the construction of highly visible communication infrastructure such as 5G. Compared with European and American companies, Chinese companies have both technical strength and lower service costs. In fact, ASEAN countries’ governments and the private sector have signed technology development memorandums with Huawei, and ASEAN operators have adopted Huawei as their 5G equipment supplier. Chinese IT companies such as Tencent are also intensifying their efforts to expand their ASEAN-facing projects due to the suppression and restrictions of the US. The Philippines’ largest state-run telecommunications company, the Philippine Long Distance Telephone Company (PLDT), and its second-largest mobile operator, Globe Telecom, have both launched 5G pilot services using Huawei equipment. In 2020, Huawei invested 475 million baht (about 102 million RMB) to establish a 5G ecosystem innovation center at the headquarters of Thailand’s Digital Economy Promotion Agency (Bangkok Post 2020). ASEAN’s digital economy has huge potential and is expected to drive the regional economy past US $1 trillion in 2025 (Huawei 2020).

2.2 RCEP: an effective way to expand China’s external circulation at multiple levels

As the largest free trade agreement in the world so far, the signing and entry into force of RCEP is one of the biggest achievements of East Asian integration after the Cold War. In the context of trade protectionism and the ongoing impact of the COVID-19 pandemic on the international economic and trade system, globalization and regional integration are at a low ebb. The signing of RCEP goes against this trend, and its significance extends beyond the economic field to the political and even strategic domains. The signing is closely related to the current strategic contest among great powers and the trend of the reconstruction of the international order in reality.

The total population, economic output, and export volume of the fifteen RCEP member countries account for about 30% of the global total. Once RCEP comes into full effect, it will drive nearly one-third of the world’s economy to form a large, unified market and enhance the stability of regional economic and trade policies. China’s Ministry of Commerce has pointed out that after RCEP comes into effect, it will gradually eliminate 90% of tariffs on trade in goods and eventually realize zero tariffs (China News Service 2021). In addition, it will form rules for trade issues such as investment, intellectual property rights, and e-commerce. These measures are expected to increase the intra-regional trade by about $42 billion (The Nikkei 2021). Based on the GDP of its member countries, RCEP will become the largest
RCEP not only accelerates economic and trade cooperation among countries in the region, but also helps attract the investment of foreign companies in member countries. The entire Asia–Pacific region will benefit from tariff reductions under RCEP, and trade barriers between most countries will be greatly reduced. This encourages the further development of Asia–Pacific regional economic integration, promotes regional economic recovery and growth, and enables countries to jointly address the instability of the world economy. In addition, RCEP reflects the determination of member states to jointly promote free trade and multilateral cooperation and contribute to the global economy. East Asian economies will continue to play a leading role in global economic growth.

RCEP has also brought closer economic relations between China, Japan, and South Korea, three important Northeast Asian countries. Due to various complicated factors such as history, reality, politics, and security, no FTA has been signed between China and Japan or between Japan and South Korea, and trilateral free trade negotiations among the three countries have been unsuccessful for a long time. Now RCEP connects the three countries through a multilateral FTA, and on this basis, the negotiation of a China–Japan–Korea FTA has become more possible. This is a crucial step not only economically, but also politically. Japan, due to its concerns about China’s growing influence in the Asia–Pacific region, initially insisted on bringing India into the group, which delayed the RCEP negotiation process. In the end, the Japanese government decided to sign RCEP, highlighting its consideration of its interests. According to the calculations released by UNCTAD, among the 15 countries participating in RCEP, Japan will benefit the most from the reduction of tariffs. Of the expected increase of $42 billion in intra-regional trade, 48%, or about $20 billion, will benefit Japan. The economic effect of RCEP will exceed that of all trade agreements that Japan has signed so far and will be of great practical significance for Japan’s economic recovery.

Since the Meiji Restoration, Japanese society has reached a cultural consensus of “leaving Asia and entering Europe” and has fully taken in Western civilization. Today, Japan still boasts about being a member of the Western camp, and China also regards it as a developed Western country. Although Japan still follows the US and the West in geopolitics, it has increasingly tied itself to Asia, especially East Asia, in terms of economic and trade relations by signing RCEP and leading the CPTPP.

In the face of an increasingly complicated international environment and various challenges, China must, with broader vision and more diverse perspectives, develop effective ways to expand its external circulation at multiple levels. After

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2 The Japanese government’s report on the economic effects of RCEP also shows that after RCEP comes into effect, Japan will be the member that benefits the most, as the agreement is expected to increase its GDP by 2.7%. The CPTPP, which came into effect in 2018, is expected to increase Japan’s GDP by 1.5%, or about 7.8 trillion yen. The economic benefits of RCEP promise to be nearly twice that of the CPTPP, mainly because RCEP member countries include China and South Korea, which are Japan’s main export targets. The tariff rates of RCEP member states are higher than those of CPTPP member states, and the corresponding reductions will be larger (Kiuchi 2022).
the implementation of RCEP, China will not only establish free trade relations with Japan for the first time, which will increase the number of China’s free trade partners to 26, but also increase the rate of free trade coverage in its foreign trade to 35%. This means that in the future, more than one-third of China’s import and export trade will be safeguarded by rules, and the political and economic risks of foreign intervention will also be reduced. Through RCEP, China can reduce its dependence on the US and European markets and balance the excessive concentration of China’s foreign trade market in developed economic markets such as those of the US, Europe and Japan, which cause its products to often have low added value and profit margins and face high risk of foreign trade barriers.

In addition to its economic scale, RCEP also has geographical and historical continuity. Chinese trade with Northeast Asian and ASEAN countries has a strong historical and cultural tradition. These are important factors that cannot be ignored. On the basis of geographical proximity and cultural affinity, member states should strive to build a modern and high-standard free trade area network and promote the high-level and high-quality development of RCEP. RCEP is an important attempt by China and other East Asian member states to participate in a regional trade and investment cooperation mechanism. It will help formulate rules in emerging fields and promote the continuous improvement of the global economic governance system.

3 Challenges to China’s external circulation

3.1 The US plans to launch the Indo-Pacific Economic Framework

The official entry into force of RCEP has brought economic and trade relations in the Asia–Pacific region closer. The agreement integrates the previously fragmented free trade areas of ASEAN–China, ASEAN–Japan, ASEAN–South Korea, and ASEAN–Australia–New Zealand and builds a mega-FTA that covers the major economies in the Asia–Pacific region. China is the largest economy among the 15 member countries of RCEP and the US government believes that it will play a leading role. Japanese media has pointed out that “the US will not sit back and watch RCEP bring about the growth of free trade and economies in the Asia–Pacific, especially given the resulting rise of China’s regional dominance, and will inevitably fight to maintain its influence in the region” (Reference News 2022).

Although the Biden administration has overturned many of the Trump administration’s policies, it has further strengthened the US’s geopolitical strategy against China. Its Indo-Pacific strategy has given rise to AUKUS, an Australia–UK–US military and security partnership; the Quadrilateral Security Dialogue, a US–Japan–India–Australia informal strategic dialogue mechanism also known as the Quad; and the Five Eyes, a US–UK–Canada–Australia–New Zealand intelligence alliance. The US government has also frequently issued national security reports that define the China–US relationship as a strategic competition, and the US Senate and House of Representatives have competed to introduce various bills to counter China. In June 2021, the US Senate passed the United States Innovation
and Competition Act of 2021, and at the beginning of 2022, the US House of Representatives passed the America COMPETES Act of 2022. These pieces of legislation, which aim to improve US competitiveness, include not only strengthening ties between the US and Taiwan and enhancing the Quad mechanism, but also imposing additional sanctions on China over so-called “human rights issues” in Xinjiang. US President Biden has said that by passing these bills, the US has an opportunity to show China and the rest of the world that “the twenty-first century will be an American century” (Beijing Daily 2022).

The purpose of this series of security mechanisms and bills is to contain China. However, China is the largest trading partner of many Indo-Pacific countries, which has led the US to feel the need to, in addition to its military and political power, strengthen its economic influence in the region. Recently, the US economic community has pointed out that the weakness of US diplomacy in Asia lies in its absence of economic cooperation (Reference News 2021). The American Enterprise Institute has bluntly stated that the lack of a regional trade agenda is a shortcoming of the US’s Asia strategy (Global Times 2022). According to Jeffery Schott (2021), China’s CPTPP bid puts Biden on the spot.

The Biden administration has no intention of rejoining the CPTPP at present. One factor is the strong domestic opposition to the CPTPP in the US, which includes accusations that the agreement would threaten the employment of American workers and hit the manufacturing industry. The Biden administration has had to come up with another set of economic mechanisms to counteract Chinese influence. Recently, the US government announced its plan to launch the Indo-Pacific Economic Framework, claiming that it will use multilateral platforms such as the Asia–Pacific Economic Cooperation forum, ASEAN, the Quad, and the Indo-Pacific Business Forum to develop common rules with regional allies on areas including trade facilitation, the digital economy and technological standards, supply chain resilience, decarbonization and clean energy, infrastructure, and labor standards. US Secretary of Commerce Gina Raimondo said at the Bloomberg New Economy Forum that the US will seek to establish an economic cooperation framework with regional allies that goes beyond the CPTPP. US Trade Representative Katherine Tai has said that the Indo-Pacific Economic Framework is an arrangement independent of China and that she hopes that developed countries and emerging market economies in the region will join (Global Times 2022).

The Indo-Pacific Economic Framework’s approach to excluding China still consists of the “high standards” touted by the US and the West. The Biden administration seeks to use these “high standards” to win over domestic opposition and to serve as an important means to enhance regional economic competitiveness and influence. Looking back at the launch of the Trans-Pacific Partnership (TPP), the Obama administration also proposed the formulation of new “high standard” and “high quality” trade rules in the Asia–Pacific region. After China proposed the Belt and Road Initiative in 2013, Japan’s Abe administration immediately proposed “high-quality infrastructure construction” in an attempt to counter China’s influence. To Japan’s dismay, China quickly incorporated “high quality” into the Belt and Road Initiative. In his keynote speech at the April 2019 Second Belt and Road Forum for International Cooperation, President Xi Jinping emphasized the need to make
continuous progress toward high-quality development, adopt widely accepted rules and standards, and ensure the commercial and fiscal sustainability of all projects (China Daily 2019).

Both the Trump administration’s withdrawal from the TPP and the Biden administration’s current refusal to rejoin the CPTPP are the result of “America First” unilateralism. When applying to join the CPTPP, the Chinese government stated that the agreement is a necessary path toward promoting the integration of the Asia–Pacific economy and that China is willing to work with other economies to jointly make the vision of an Asia–Pacific free trade area a reality. Regarding the high threshold and high standards set by the CPTPP, China’s statement is more sincere, as joining a higher level of free trade agreement will promote the reform of current Chinese policies and practices that do not conform to international conventions. This in turn will help China achieve a higher level of opening up, trigger deeper reforms, and realize high-level economic development.

Through the Indo-Pacific Economic Framework, the US is trying to establish an economic cooperation framework with regional allies that exceeds the CPTPP. Its purpose is very clearly expressed in the Indo-Pacific Strategy of the United States: “American interests can only be advanced if we firmly anchor the United States in the Indo-Pacific and strengthen the region itself, alongside our closest allies and partners,” and “The prosperity of everyday Americans is linked to the Indo-Pacific. We will put forward an innovative new framework to equip our economies for this moment” (The White House 2022, 11). The Biden administration prioritizes the US’s own interests. To gain domestic support, it intends to first attract manufacturing, capital, and technology back to the US rather than allowing so-called like-minded trading partners to enter the US market. In addition, the Biden administration will not offer Southeast Asian countries tariff cuts or other market-opening tools to give ASEAN agricultural and manufactured goods greater access to the US market. Although the US is eager to establish “common goals” for economic cooperation with countries in the Indo-Pacific region in early 2022, it will be difficult to achieve any of them without the vision to jointly advance.

3.2 Japan will use economic security policies and RCEP rules to reconstruct its Asian industrial chain

As the US joins with so-called like-minded countries to build technology and supply chain alliances that exclude China, Japan has begun to implement economic security policies, tighten its cooperation policies with China in high-tech fields, and adjust its supply chains that are overly dependent on China. In April 2021, Biden and then Japanese prime minister Yoshihide Suga held a summit meeting and issued a US–Japan Joint Leaders’ Statement. In the statement, they declared that the two countries will deepen research and development cooperation in the fields of life science and biotechnology, artificial intelligence, quantum science, and civil space and strengthen cooperation on sensitive supply chains, including those involving semiconductors. The two countries also announced the Competitiveness and Resilience (CoRe) Partnership and plan to jointly develop secure and open 5G networks and
next-generation mobile networks. On May 24 of the same year, Japan’s Ministry of Economy, Trade and Industry proposed adjustments to its economic security policies, emphasizing the need to strengthen supply chain cooperation with friendly countries such as the US while limiting cooperation with China to non-sensitive industries within the framework of relevant legal systems. That June, Japan’s Ministry of Economy, Trade and Industry released the 2021 edition of its *White Paper on International Economy and Trade*. The document pointed out that as Japan faces new challenges in upgrading its value chain, it should avoid old problems such as the excessive concentration of production bases and pay attention to issues such as the environment, human rights, and the offensive and defensive aspects of economic security. On January 21, 2022, the leaders of the US and Japan agreed to establish a “2 + 2” consultation framework involving the US secretary of state and secretary of commerce and the Japanese minister of foreign affairs and minister of economy, trade and industry to strengthen cooperation on economic security and climate change issues. The new mechanism will focus on security in areas such as technology and supply chains. One of the key elements of the economic security policy-related bills promoted by the Kishida government in the Japanese parliament is the readjustment of Japan’s industrial chain system to strengthen domestic production and cease excessive reliance on abroad. Its main goal is to reduce excessive dependence on Chinese products.

In reality, Japan has been continually adjusting its industrial chain. The Japanese government did not propose moving away from dependence on a single country—i.e., China—only after the China–US trade war or the outbreak of the COVID-19 pandemic. Whenever there is major turmoil in China–Japan political relations, the Japanese government and Japanese industry propose a “China + 1” strategy to diversify the economic risks brought about by the deterioration of political relations. After Donald Trump took office, the China–US trade war intensified, especially with the disruption of global industrial chains and supply chains caused by the COVID-19 pandemic. This led the Japanese government to intensify its efforts to promote its restructuring policy involving the localization, diversification, and decentralization of its industrial chain. Judging from the current situation, Japan’s high-tech enterprises will gradually “localize,” and enterprises whose production bases are too concentrated in China will gradually build a diversified supply system in ASEAN countries.

As mentioned above, China has achieved a strategic buffer against China–US trade frictions through trade diversification, and RCEP is an important platform that embodies the above strategies. The implementation of RCEP will not only bring about a reduction in tariffs, but also is expected to reduce trade barriers within the Asian region, promote trade and investment, restructure supply chains, and improve supply chain efficiency. However, opening up is also a double-edged sword, as one of the major functions of tariffs is to protect domestic enterprises and industrial chains. Once RCEP comes into effect, its regional rules of origin system will be implemented, which can promote the free flow of production factors within the region. Under this system, even if products are processed and assembled across multiple member states, they can still enjoy preferential tariff treatment as long as they remain within the region. For example, once tariffs are totally lifted, automobile
parts imported from China, assembled in Thailand, and exported to Australia will all be exempted from taxation. The fifteen member countries are at different stages of development, with Japan at the high end of the industrial chain and ASEAN at the low end. After the elimination of tariffs, Japan will consider rebuilding its supply chain by selecting the most suitable countries in RCEP for processing and assembly to lower prices and increase the real added value of products. ASEAN is an important base for the production of automobiles and parts, but its raw material industry has not been well developed. Therefore, with RCEP coming into effect, Japanese companies may choose to restructure their supply chains in the future by purchasing essential materials from China and processing and assembling them in ASEAN countries.

With the flow of low-end industrial chains such as processing and assembly to ASEAN countries, some of China’s domestic low-end industries, and especially small- and medium-sized Chinese enterprises, will face challenges in terms of survival and employment. If China fails to further accelerate its economic restructuring and establish high-end industrial chains in a timely manner, it will lose its competitive edge as labor costs continue to rise. Manufacturers from various countries, including Japanese companies, are shifting their labor-intensive industries from China to lower-income countries. Chinese companies will also move to ASEAN countries as labor costs increase.

### 3.3 ASEAN will become an important platform for other countries’ direct investment and industrial chain restructuring

#### 3.3.1 ASEAN hopes to maintain a balance between China and the US

Due to its location at the intersection of the Pacific and Indian Oceans and its political neutrality, ASEAN has become the preferred platform to help the US, China, Japan, and other countries to carry out their trade transitions and adjust their production arrangements. The regional integration promoted by RCEP has made ASEAN’s status and role increasingly important.

According to the Indo-Pacific Strategy of the United States, the US “endorses ASEAN centrality and will deepen long-standing cooperation with ASEAN,” and it “will work with ASEAN to build its resilience as a leading regional institution and will explore opportunities for the Quad to work with ASEAN” (The White House 2022, 9). This strategic document again emphasizes that the US will work with allies and partners to promote the construction of an Indo-Pacific economic framework. However, in terms of content, it is still a mere scrap of paper.

Taking infrastructure construction as an example. ASEAN has a strong demand for infrastructure investment. The Asian Development Bank forecasts that from 2016 to 2030, ASEAN will need a total of $2.3–2.8 trillion in infrastructure investment, i.e., an annual demand of $184–210 billion (Global Times 2017). Can the US fill this huge gap? According to the Indo-Pacific Strategy of the United States, “the US will help Indo-Pacific allies and partners close the region’s infrastructure gap. Through its Build Back Better World initiative with G7 partners, the US will equip
the emerging economies of the region with the high-standards infrastructure that will enable them to grow and prosper” (The White House 2022, 11–12). In the field of free trade, the US once boasted about establishing a high-standard free trade system, such as the US-led TPP and the CPTPP led by Japan after Washington gave up on the former agreement. In reality, this system imposed discriminatory regulations on the integration of global value chains and imposed unfair costs on most ASEAN countries. Now, can the US, which is hesitant to even join the CPTPP, further increase its trade volume by signing a free trade agreement with ASEAN? Washington avoids addressing this point in the Indo-Pacific Strategy of the United States.

ASEAN countries want to maintain a balance between China and the US. However, to what extent are ASEAN countries willing to cooperate with the US in containing China’s development if Washington’s geopolitical strategy in East Asia is designed only to contain China and not to establish genuine cooperation among countries in the region? As put by Singapore Prime Minister Lee Hsien Loong in a March 2021 interview, “It is not possible for us to choose one or the other, because we have very intense and extensive ties with both the US and with China, economic as well as in other areas” (China Central Television 2021).

3.3.2 Japan increasingly attaches importance to economic and trade ties with ASEAN

Japan, by contrast, has actively taken sides in the US’s geopolitical strategy and is now seen as being at the forefront of the US’s so-called “like-minded nations.” However, as a member of East Asia, should Japan—so as to “stand in line” economically—adopt policies that deviate from market rules and bring losses to its own economy? Japan seemingly has not yet made up its mind. First, based on its export-oriented economy, Japan has taken a completely different stance from the US in maintaining an open world economy, supporting multilateralism, and actively promoting regional and cross-regional free trade strategies. Instead, Japan shares common ground with China, which is an important reason for the signing and implementation of RCEP. In addition, due to its deep economic integration with China, Japan has selectively participated in Washington’s efforts to build a variety of technology and supply chain-centered alliances that aim to exclude China.

Japan’s economy is highly dependent on foreign markets. Its domestic economy has already entered a mature stage and does not have the conditions for domestic circulation like China’s. The issues of aging and low birth rates further limit Japan’s domestic demand. Since the beginning of the twenty-first century, Japan has actively expanded its foreign trade. This was especially the case after Shinzo Abe returned to office in 2012, when Japan became the most active country in promoting mega-FTAs and achieved remarkable results. In 2017, the Trump administration withdrew from the TPP and suspended negotiations on the Transatlantic Trade and Investment Partnership. Against the backdrop of unilateralism and protectionism pursued by the US, Japan became eager to move to the core of the industrial chain in trade, investment, logistics, information, and other fields. According to the December 5, 2017 issue of the *Nihon Keizai Shimbun*, Japan’s trade policies have entered “an era of countries in different regions forming mega-FTAs. Japan should keep pace with the
times and become a leader in this new era. It should continue to be the standard-bearer of free trade and promote a new twenty-first century economic order based on free and fair rules to the world” (The Nikkei 2017). The Abe administration also put forward a series of foreign policies such as “diplomacy that spans the globe” and the “free and open Indo-Pacific” concept to support Tokyo’s strategic ambitions for free trade.

As of December 2021, Japan has signed and implemented economic partnership agreements with 16 countries and 3 regions. The RCEP has also taken effect since January 2022. Japan is in an unprecedented advantageous position and demonstrates a leading attitude in the process of international economic and trade institutionalization as well as cross-regional integration. It is clear from the above agreements that Japan attaches great importance to its economic relations with ASEAN countries.

Japan has been deeply engaged with Southeast Asia for many years, starting from its construction of a car factory in Thailand in the 1960s. Tokyo now has manufacturing bases in all ASEAN countries and more than 14,000 Japanese enterprises there. The Japanese government has also supported the construction of infrastructure such as roads, railways, and industrial parks in the region through its Official Development Assistance. In the past 10 years, Japan has continually increased its investment in ASEAN. According to the statistics of the Bank of Japan, Japan’s investment in ASEAN reached 18.9 trillion yen in 2014 and 27.6 trillion yen in 2020. Over the same period, Japanese investment in China remained stagnant at 12.4 trillion yen and 14.4 trillion yen, respectively (Bank of Japan 2022a) (see Fig. 2).

Japan’s overseas investment is influenced by political factors. According to the Bank of Japan, from January to June 2021, the total amount of Japan’s outward

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Fig. 2 Proportion of major countries and regions in Japan’s outward direct investment [calculated by the author with data from the Bank of Japan (2022b)]

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3 The 16 countries are Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, the Philippines, Switzerland, Vietnam, India, Peru, Australia, Mongolia, the US, and the UK. The three regions are ASEAN, the Pacific Rim (10 countries) and the EU.
direct investment was 9.4852 trillion yen, of which 34.6% went to North America and 22.6% to Europe. This represented a year-on-year increase of 37.4%. Its investment in ASEAN rose 67.1% to 2.2 trillion yen, while its investment in China fell 29.8% to 478.1 billion yen. Japan invested more than four times as much in ASEAN as it did in China. However, compared to the return on Japan’s investment in China, which increased by 17.8% year-on-year to 1.187 trillion yen in the first half of 2021, the return on investment in ASEAN decreased by 6.9% to 1.221 trillion yen over the same period (see above). In fact, China has always provided the highest rate of return on Japan’s overseas direct investment. As Nobuhiko Sasaki (2020), Chairman of the Japan External Trade Organization, bluntly put it, “China underpins Japan’s overseas direct investment earnings.” Although the rate of return on Tokyo’s direct investment in China has been steadily expanding year by year, its investment volume has been shrinking.

After the implementation of RCEP, Japan will further strengthen its infrastructure investment in ASEAN. At the beginning of 2022, Japan’s Ministry of Economy, Trade and Industry released the *Next Chapter of ASEAN and Japan Economic Cooperation in the Post-pandemic Era*. Looking ahead, Japan will increase its investment in ASEAN in the following three areas: first, it will help ASEAN enhance its attractiveness as a global supply chain hub. Japan believes that ASEAN values free trade and multilateralism and enjoys high regional security and stability. Building a supply chain in ASEAN has relatively high value and is of great significance for improving the resilience of Japan’s economy. Second, it will help ASEAN enhance its innovation capacity and sustainable development. Third, it will help ASEAN accelerate its energy transition. By providing subsidies to Japanese companies, the Japanese government will vigorously promote investment and cooperation with ASEAN in supply chains, connectivity, digital innovation, human resources, and green decarbonization.

Despite recurring COVID-19 outbreaks and the slowing recovery of the global economy, trade between China and ASEAN increased to record highs in 2020 and 2021. However, it should be noted that in some key product areas, such as automobile parts and semiconductors, the degree of trade integration between China and ASEAN is not as high as between ASEAN and Japan. In 2020, the degree of ASEAN’s intra-regional integration in its import and export of automobile parts reached 8.1, which was about eight times closer than the degree of integration between ASEAN and countries outside the region. In terms of countries, ASEAN’s degree of trade integration with Japan, India, and China was 4.5, 2.5, and 1.2, respectively, which shows ASEAN and China are not closely integrated in terms of trade in automobile parts (Ikebe 2022).

In the semiconductor industry, ASEAN had the highest degree of integration with Taiwan (3.7) in 2020, followed by Japan (1.8), the US (1.7), and the EU (1.7). Although ASEAN is geographically close to China, the degree of integration between the two in terms of semiconductor trade was just 0.6. In this respect, ASEAN was more closely integrated with the US and the EU, which are geographically distant. Among the semiconductor manufacturers located in ASEAN, many are European and American. Moreover, as semiconductors are light in weight and valuable, the cost of transporting them via air is not significantly affected by distance.
Therefore, compared with automobile parts’ manufacturers, which must gather near consumption areas, the semiconductor industry allows for an international division of labor on a large scale (Ikebe 2022).

To summarize, ASEAN countries, which have experienced rapid economic development in recent years and have large advantages in productive factors such as labor and land, have become the first choice for Japan to decentralize its supply chains and build a diversified supply chain system. Combined with ASEAN’s geographical proximity and increasingly improved infrastructure, the implementation of RCEP will not interrupt Japan’s supply chain restructuring policies, but may accelerate the relocation of Japanese companies in China to Southeast Asia. Certain tariff cuts may also sharply decrease the incentive for Japanese companies to invest in China. In terms of changes in Japan’s direct investment in China, manufacturing investment declined by 31.0% year-on-year in 2020 and 73.3% year-on-year in the first half of 2021 (Japan External Trade Organization n.d.). With RCEP taking effect and Japan’s full implementation of its economic security policy, there may be a large-scale withdrawal of Japanese companies from China in the future, whether they return to their homeland or move to ASEAN countries. In this regard, China must make preparations.

4 Conclusion

In conclusion, in the face of the decoupling policy adopted by the US government, China has taken the initiative to seek changes and diversify its foreign trade. After several years of competition, the US has also realized that it is not in its interest to cut off its economic ties with China. The rebound in bilateral trade between the two countries in 2020 and 2021 shows that China and the US may “recouple” in some areas. Despite this, due to the containment policies of the US and the West, China has become more committed to deepening its cooperation with other economies around the world and to focusing more on its economic relations with countries along the Belt and Road. By the end of 2021, China had become the largest trading partner of 124 countries and regions in the world, with foreign trade in excess of $6 trillion and an increase in both its imports and exports of around 30% (State Council Information Office 2022).

From the perspective of investment, China still attracts a massive influx of foreign investment and that hit and will hit record highs in 2020 and 2022, despite the tense global economic and financial situation caused by the COVID-19 pandemic and the US’s unification of so-called “like-minded countries” to build technology and supply chain alliances that exclude China and to greatly reduce direct investment in China. In terms of China’s outbound foreign direct investment, due to the economic security policies adopted by Washington and the West, Chinese investment in developed countries has been forced to decline. However, China’s foreign direct investment in countries along the Belt and Road has maintained a strong growth, and China’s economic ties with the world have become closer than ever before.

China is also committed to strengthening regional and multilateral cooperation. The economic and trade cliques built by the US and its allies have forced China to
speed up its process of negotiating and signing FTAs and to actively promote the signing and implementation of RCEP. Through RCEP, China can reduce its dependence on the US market and the risk of foreign trade barriers caused by overconcentration in developed economic markets such as the US, Europe, and Japan and effectively enhance the resilience of the Chinese economy’s external circulation.

Of course, this external circulation will face many challenges in the future. Trade frictions between China and the US will be prolonged, and the areas of US containment against China will continue to expand. While China should continue to adjust its relations with the US to avoid further intensification of the conflict, it should also confront challenges by focusing on the following areas:

First, China should strengthen mutual political trust and deepen opening up to the outside world. It should firmly uphold multilateralism, consolidate mutual political trust in surrounding regions, give full play to the role of multilateral governance platforms, and strive for more time and space. At the same time, China must unwaveringly promote a high-level of opening up to the outside world and reduce its trade and investment costs through continuous opening up, so that it becomes an attractive place for global trade and production.

Second, China should create China-centered regional economic circulation. By promoting the implementation of RCEP and applying to join the CPTPP, China has contributed to regional economic integration as well as the process of trade and investment liberalization and facilitation. This not only opens up broader international space for China’s economic development, but also adds new impetus to the recovery and growth of the world economy. China should continue to advance joint construction of the Belt and Road, create economic circulation that is deeply integrated with countries along the Belt and Road, and build a relatively stable system of “two markets, two resources” at home and abroad.

Third, China should strive to build more innovative, higher value-added, and more resilient industrial and supply chains. In response to US attempts to form technology and supply chain alliances that exclude China, it has become critical for China’s technological innovation and high-tech manufacturing to move to the middle and high ends. At present, the US and Japan clearly intend to use ASEAN to “de-Sinicize” the East Asian industrial chain and have clearly proposed making ASEAN the hub of high-quality industrial chains in East Asia. China’s current labor costs cannot compete with those of some low-income ASEAN countries, and its technological value added to goods cannot compete with those of developed countries such as the US and Japan. High technology requires long-term accumulation; breakthroughs do not happen overnight. With the signing of RCEP, there is not much time left for the transformation of China’s economic structure. China must encourage enterprises to become more involved in the international division of labor, enhance their ability to allocate global resources, and climb up to the high end of value chain. It should strive to build more innovative, higher value-added, and more resilient industrial and supply chains. China and ASEAN countries along the Belt and Road should explore cooperation in innovation and sustainable development; strengthen innovative cooperation in the digital economy, e-commerce, smart cities, big data, 5G, and other areas; and build scientific and technological innovation and digital cooperation partnerships.
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