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International trade war - Spice Road against Silk Road

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Abstract

Purpose – The purpose of this paper is to analyse the international political economy of Korea and its effects due to geopolitical tension between China and the USA.

Design/methodology/approach – Economic war between China and the USA has prolonged longer than expected. Aftermath of the COVID-19 pandemic, reforming the supply chain has been the centre of economic tension between China and the USA. Quite recently, with the rapid expansion of Chinese e-commerce platforms, distribution channels come upon a new economic tension between the two. And now is the time to pivot its pattern of conflict from competition into cooperation. In this end, economic diplomacy could be a useful means to give a signal of cooperation. From the view of economic diplomacy, this paper tries to analyse the projected transition of economic war between China and the USA with its implication on the trade policy of Korea.

Findings – As an implementation of economic diplomacy, China suggested the Belt and Road Initiative (BRI), enhancing trade logistics among related countries to gain competitiveness. In 2023, the Biden administration suggested the India-Middle East and Europe Economic Corridor as a counter to BRI, which will be a threshold for changing trade policy from economic war into economic diplomacy. As a result, it is expected China and the USA will expand their economic diplomacy in a way to promote economic cooperation among allied states, while the distribution channel war would continue to accelerate the economic tension between China and the USA. Korea has to prepare for and provide measures handling this geopolitical location in its trade policy or economic diplomacy.

Originality/value – This research contributes to the awareness and understanding of trade environments from the perspective of economic diplomacy.

Keywords Korea, Economic war, FTA, BRI, IMEC, Kraljic matrix, Strategic items, Silk Road, Spice Road, Economic corridor, Trade logistics

Paper type Research paper

1. Introduction

The advent of globalisation has led to widespread economic integration, creating global production networks and markets. However, the COVID-19 pandemic has acted as a significant setback to this trend. In the wake of COVID-19, an economic war has arisen between China and the USA, centred on the restructuring of global supply chains following widespread disruptions. International political economy (IPE) examines the power dynamics between states and the structures of influence within regional economies. Consequently, economic diplomacy has gained unprecedented attention. Economic diplomacy focuses on government actions regarding international economic issues, distinct from political diplomacy through its market-oriented approach in foreign policy. Putnam (1988) categorises economic diplomacy into two levels: unilateralism and bilateralism. Unilateral economic diplomacy (or unilateralism) often relies on hard power, involving decisions on trade liberalisation or market protection without negotiation. Bilateral economic diplomacy (or bilateralism) or multilateral economic diplomacy (or multilateralism), by contrast, involves negotiation among trade partners, resulting in agreements such as regional or global free trade agreements (FTAs).

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A vast range of state or non-state actors engage in economic diplomacy, navigating the complex interplay between international and domestic factors. Defining economic diplomacy is extremely challenging, but one useful definition is “the broad concept of economic statecraft, where economic measures are taken in the pursuit of political goals, including punitive actions such as sanctions” (Blanchard and Ripsman, 2008).

To exert influence internationally, ministers and heads of government strive to demonstrate their capacity for national security through two primary approaches, as shown in Figure 1 (above): economic war (or competition) and economic diplomacy (or international cooperation). In the context of global supply chain restructuring, the economic conflict between China and the USA has intensified, marked by threats of supply chain disruptions. This has led to emerging strategies aimed at “crowding out” the USA from global supply chains (去美戰略) or excluding China through alliances such as the Allied Supply Chain and Chip 4.

While economic war is inherently “temporary” due to its painstaking nature, economic diplomacy or international cooperation offer a more “long-term” approach because it is gains-taking. This paper analyses the factors contributing to the prolonged nature of this economic war and explores potential outcomes of the supply chain tensions between China and the USA from the perspectives of IPE or geo-economics. In conclusion, it highlights the importance of preparing for trade policy adjustments and strategic economic diplomacy.

2. International trade war and strategic items

2.1 Supply chain

The supply chain encompasses a network of interconnected suppliers involved in each stage of production, from raw materials and components to the finished goods or services. This network can include vendors, warehouses, retailers, freight stations and distribution centres. Effective supply chain management is a “crucial process because an optimised supply chain results in lower costs and a more efficient production cycle” [1]. Within the supply chain, a leading company typically holds governance power, enabling it to coordinate scheduling and exercise control across the interconnected suppliers, resulting in reduced costs and shorter production times (Gereffi *et al.*, 2005) [2]. Since the 2000s, forward and backward integration have been key strategies for managing time, cost and uncertainty in supply chains. For example, Toyota’s Just-In-Time (JIT) system demonstrated the efficiency of locally concentrated supply chains until disruptions from the 2011 East Japan Earthquake and the

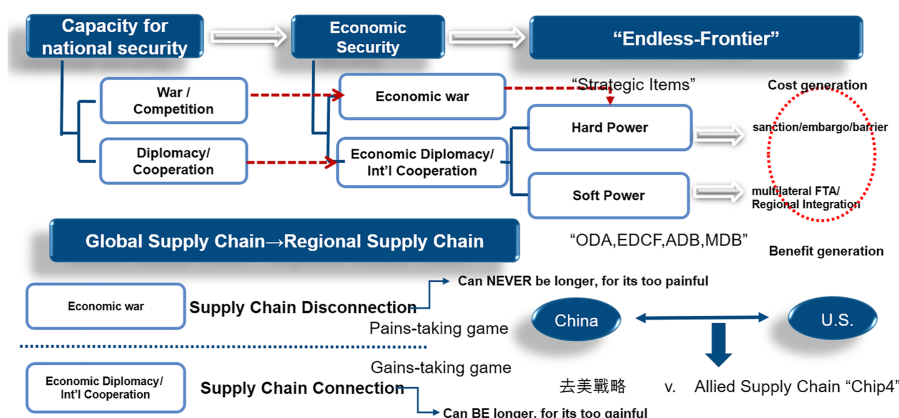


Figure 1. Recent trend of economic diplomacy

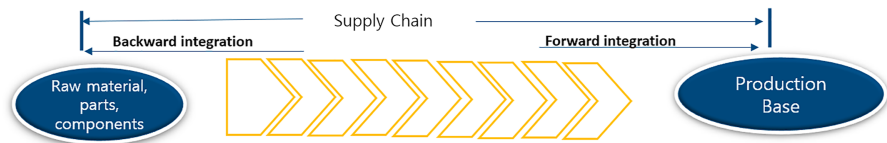
Thailand flood. Following supply chain shutdowns in 2020, many businesses shifted from local to global supply chains, utilising advancements of the information technology (IT) and transportation technologies to geographically diversify operations. As the need for a systematically functioning global supply chain has grown, a leading nation, much like a leading company, often assumes governance power in international trade and investment, as illustrated in Figure 2 (below), by aligning with the leadership of a dominant market competitiveness, which makes this leadership valuable.

The COVID-19 pandemic dealt a severe blow to the global supply chain, causing sudden lockdowns that led to widespread supply chain disruptions. To mitigate the risks of future global disruptions, supply chains have begun restructuring to operate on a more regionally segmented basis. In this shift toward regional supply chains, China and the USA are at the centre, drawing allied countries within their spheres of influence. This alignment helps explain why the economic war between China and the USA has lasted longer than anticipated.

2.2 Strategic items

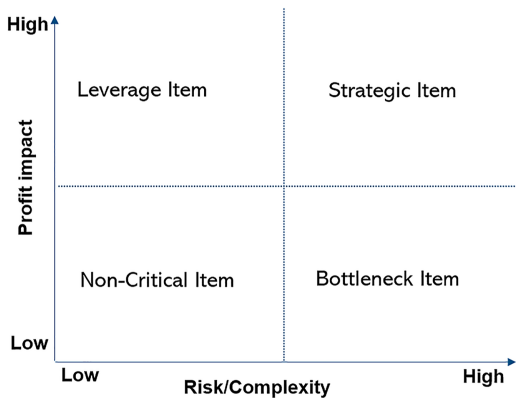
China has restricted exports of two rare metals, gallium and germanium, which are critical to semiconductor production. Kraljic (1983) highlighted the importance of managing “strategic items” within the framework of supply chain management, as shown in Figure 3. Kraljic emphasises the need to strengthen and diversify critical items. The Kraljic matrix provides a valuable tool for identifying essential items that require focused management within the supply chain.

Kraljic identified the importance of managing “bottleneck items” in strategic supply chain management – items that present high supply risk but have relatively low business value. Due



Source(s): Figure by the author

Figure 2. Supply chain



Source(s): Figure by author’s own drawing based on Kraligic(1983)

Figure 3. Kraljic matrix

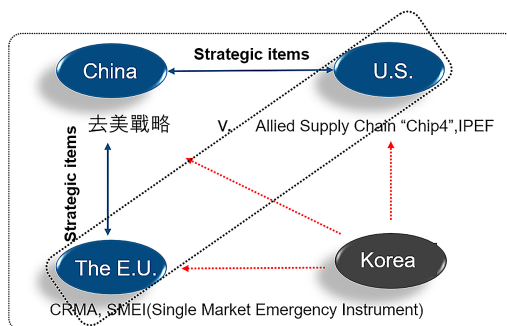
to the potential costs associated with non-delivery or compromised quality of strategic items, these must be closely monitored and controlled. From a risk management perspective, establishing medium-term business relationships and collaboration with suppliers is essential. For example, South Korea imports over 90% of its urea for agricultural and industrial purposes from China [3]. Heavily dependent on China for urea supplies due to pricing factors, Korea faced challenges when China imposed export controls on urea, underscoring Korea's vulnerability within China's sphere of influence. The European Union (EU) also faces challenges with critical raw materials (CRMs). China remains the EU's sole supplier of processed rare earth elements, while Chile supplies 79% of its lithium. In response, the EU introduced the CRM Act (CRMA) to support projects aimed at increasing "the EU's capacity to extract, process, and recycle strategic raw materials and diversify supplies from the third countries" [4].

2.3 Resilient supply chain alliance

In contrast to China's approach of leveraging supply disruptions to strengthen its influence, the Biden administration in the USA has adopted a cooperative approach focused on building resilient supply chains (Pillar 2) through the Indo-Pacific Economic Framework (IPEF), which includes 14 member countries [5]. The need for resilient supply chains has been further underscored by the Russia-Ukraine crisis. The IPEF aims to address supply chain vulnerabilities by fostering global efforts to reduce risks associated with concentrated, fragile supply chains [6].

In Figure 4, the EU Commission presented the Single Market Emergency Instrument (SMEI) in September 2022, a crisis governance framework designed to ensure the availability of essential goods and services during future emergencies. The SMEI operates on three levels: contingency planning, vigilance and emergency. The contingency planning phase focuses on collaboration among member states to mitigate supply chain disruption and monitor incidents. The vigilance phase can be activated when a significant disruption is anticipated, enabling specific measures such as mapping and monitoring supply chains and production capacities. Finally, the emergency phase is activated in cases of severe disruption to the functioning of the single market [7].

Establishing a resilient supply chain through international cooperation may be appealing, yet the reality often falls short of the ambition. In South Korea, the IPEF took effect on 17 April 2024, after an extended negotiation process, marking the first multilateral agreement on supply chains. As a result, during non-crisis periods, the 14 member countries will collaborate to strengthen international trade, investment and trade logistics. In times of crisis, member countries will activate a "crisis response network".



Source(s): Figure by the author

Figure 4. Resilient supply chain alliance

Conversely, opportunities for negotiation with China, South Korea's largest trading partner, are essential for building supply chain resilience [8]. China has pursued an industrial policy focused on enhancing its supply chain management capabilities. In the semiconductor sector, the decoupling between China and the USA has become increasingly evident. Contrary to expectations, China has adopted a policy of internalising its supply chains, returning to the integration strategies of the 2000s rather than furthering globalisation. A promising opportunity for transformation between the two countries has emerged recently. Since 2015, China and South Korea have maintained bilateral FTA, and with the second phase of FTA negotiations currently underway, there is an opportunity to strengthen trade and investment ties, fostering positive progress through international cooperation.

2.4 China manufacturing exodus

During the COVID-19 pandemic, China imposed sudden lockdowns without prior notice or preparation, halting production and logistics cycles. This "zero COVID" policy may have triggered a shift towards "de-risking" China from supply chain disruptions. Although China still offers significant advantages as "the factory of the world," with vast market potential, prolonged trade tensions with the USA, intensified during the Trump administration, have prompted global manufacturers with substantial USA market bases to relocate operations amid rising geopolitical uncertainties. For example, Nike and Adidas have shifted much of their footwear manufacturing to Vietnam, Apple has begun iPhone production at a Foxconn in Chennai, India, and AstraZeneca has contracted production with India's Serum Institute.

In the pre-globalised era, defining the Rule of Origin (ROO) was straightforward, as a product's components were usually manufactured and assembled within a single country. However, with the complexity of global supply chains, particularly since 2012, determining ROO has become a time-consuming and subjective process. ROO are classified as either non-preferential or preferential. The USA applies non-preferential ROO to restrict imports from countries like Cuba, Iran and North Korea, while offering trade preference programmes for others. Preferential ROO are used to determine duty-free eligibility for imports from approved countries [9], whereas non-preferential ROO play a crucial role in "country of origin labelling, government procurement, enforcement of trade remedy actions, compilation of trade statistics, supply chain security issues." [10]

China manufacturing exodus may negatively impact capital inflows into Hong Kong, traditionally seen as the Gateway to China. In 2023, Hong Kong's initial public offering volume fell to a 20-year low of \$5.9bn [11]. While China-oriented business remains in Hong Kong, which returns fully to Chinese control in 2047, non-China-oriented businesses have migrated to Singapore. As the certainty of contract and ownership rights forms the foundation of capitalism, this capital flight from Hong Kong is likely to persist.

3. Trade logistics and economic corridors

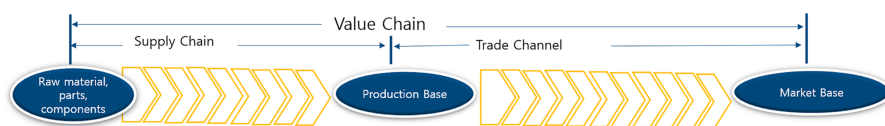
Globalisation has allowed supply chains to leverage interdependence and interconnectedness, maximising efficiency. However, while these efficiencies have been beneficial, they have also created a fertile ground for friction between trade partners due to a "survival of the fittest" mindset and the principle of "winner takes all." This interdependence has also highlighted vulnerabilities; the global supply chain struggled to manage the disruptions caused by COVID-19, prompting a shift towards regional integration initiatives, such as Association of Southeast Asian Nations, Regional Comprehensive Economic Partnership, United States–Mexico–Canada Agreement and Comprehensive and Progressive Agreement for Trans-Pacific Partnership. As the global economy seeks stability, collaboration over competition has become increasingly essential, with economic diplomacy emerging as a priority. The prolonged economic war between China and the USA arguably needs to shift towards economic diplomacy.

The global supply chain is restructuring into regional supply chains, building resilience by operating in regional segments that can withstand crises. Michael Porter introduced the concept of value chain as “a set of activities that a firm performs to deliver a valuable product or service to the market.” [12] Complex finished goods often depend on global value chains, traversing multiple countries. As shown in Figure 5, the value chain consists of supply chain and trade channel components. While the focus has traditionally been on which country holds lead status within a regional supply chain, the emphasis is now shifting to how these regional segments can be interconnected and relayed. In this context, the supply chain competition may evolve into a “channel war” in international trade, where trade logistics will centre on the internal flow of goods, standardising channel processes and establishing authority over these channels.

3.1 Trade logistics

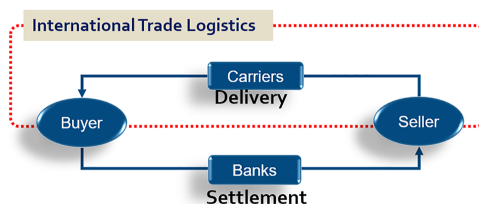
It is natural for governments to seek environments that enhance competitiveness within in their countries. In terms of trade, effective trade logistics are essential for maintaining competitive advantage. As a prerequisite, a strong IT management infrastructure is indispensable. As shown in Figure 6, trade logistics encompass the internal flow of goods to market, integrating physical infrastructure with operating software – such as transport hubs, warehouses, highways, ports, terminals, trains and shipping vessels. Key areas of conflict in trade logistics involve the standardisation of channel processes and determining who holds governance over operation of these logistics systems. This is equally relevant within the digital economy. Recently, Chinese e-commerce – often referred to as C-commerce – has aggressively sought to gain control over digital distribution channels, interconnected delivery networks and trade logistics via digital platforms. Chinese platforms such as Taobao, Temu and AliExpress are actively working to increase their monthly active users (MAUs), positing themselves as counterweights to USA-based platforms such as Amazon and eBay in digital trade [13].

When the agenda of establishing international trade logistics is introduced to relevant trade members across various countries, initial progress and effective responses are often achieved. However, efforts soon encounter obstacles related to standardising logistics processes and establishing operational governance. Greater reliance on international institutions could help resolve these issues (Bayne, 2017). Yet governments frequently prioritise domestic interests,



Source(s): Figure by the author

Figure 5. Supply chain v. trade channel



Source(s): Figure by the author

Figure 6. Trade logistics

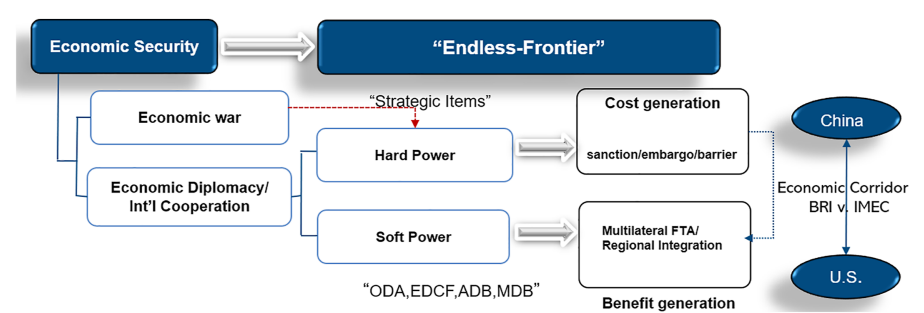
and after prolonged negotiations, the risk of international agreements failing increases. Amid the economic war between China and the USA, China launched a trade logistics initiative known as the Belt and Road Initiative (BRI), or One Belt One Road, in 2013. Often referred to as the New Silk Road, the BRI aims to establish economic corridors for trade logistics. The World Bank estimates that the BRI could boost trade flows by 4.1% and reduce trade costs by 1.1% [14].

In response, the Biden administration proposed the India-Middle East and Europe Economic Corridor (IMEC) in September 2023 to strengthen transport and communication links between Europe and Asia as a countermeasure to China’s BRI. IMEC has been well received by participating countries, with expectations of fostering economic growth, enhancing connectivity and potentially rebalancing trade and economic relations between the EU and China [15]. Both BRI and IMEC are ambitious projects aimed at boosting international trade through substantial investments in trade logistics infrastructure. Each seeks to assert governance over international trade channels, signalling that the supply chain war may soon evolve into a trade channel war between China and the USA.

3.2 Economic corridors

Economic corridors are transport networks designed to support and facilitate the movement of goods, services, people and information. These corridors often include integrated infrastructure, such as highways, railways and ports, linking cities or even countries (Octaviano and Trishia, 2014). They are typically established to connect manufacturing hubs, high-supply and high-demand areas, and producers of value-added goods. Economic corridors comprise both hard infrastructure – such as trade facilities – and soft infrastructure, including trade facilitation and capacity-building measures. The Asian Development Bank introduced the term “economic corridor” in 1998 to describe networks connecting various economic agents within a region [16].

Economic corridors are integrated trade logistics networks, providing essential infrastructure for connecting regional segments of supply chains. As supply chains increasingly operate in regional “chunks,” linking these segments becomes ever more important. Economic corridors typically include a network of transport infrastructure, such as highways, railways, terminals and ports. Initiatives like the BRI and IMEC use economic corridors as instruments of economic diplomacy, shifting strategies from hard power to soft power, as shown in Figure 7. Because less-developed or developing countries often lack sufficient funding to invest in trade logistics, they tend to welcome these initiatives from developed countries, which offer international collaboration and support. However, these initiatives usually come with the condition that participating countries must accept standardised trade processes and governance led by the sponsoring developed country.



Source(s): Figure by the author

Figure 7. Economic corridor initiatives as economic diplomacy

To succeed, economic corridors must meet three key conditions [17]. First, government intervention is essential, as economic corridor initiatives primarily involve public infrastructure investments beyond the scope of the private sector. In realising these projects, governments must reconcile three tensions to ensure their policies are mutually supportive: tensions between politics and economics, between international and domestic pressures and between governments and other stakeholders. Second, intermediate outcomes should be measured and demonstrated as results of economic corridors, allowing participants to experience tangible benefits throughout these longer-term projects. Finally, economic corridors should deliver broader benefits. Participants need incentives to utilise the infrastructure sustainably. These benefits may extend beyond economic welfare, such as wages and income, to include social inclusion, equity and environmental gains, which support the long-term viability of the infrastructure.

4. BRI vs IMEC

4.1 Belt and Road Initiative (BRI) - Silk Road

The BRI can be a modern-day realisation of the Silk Road concept, connecting Europe as a market base with China as a production base. Unlike the ancient Silk Road, which connected trade routes across Eurasia, the BRI poses potential challenges due to its extensive connectivity. Firstly, there are social and environmental externalities, such as increased congestion and accidents from concentrating traffic flows through limited links and nodes within trade networks. Secondly, while the connectivity may benefit the production and market bases at either end, regions situated between these hubs, through which highways and railways pass, may gain minimal advantage. Thirdly, there is often a mismatch between where costs and benefits are realised. Transit regions that facilitate network traffic often see fewer direct benefits compared to high-density nodes within the network.

4.2 India-Middle East and Europe Economic Corridor (IMEC) - The Spice Road

The ancient Spice Roads once connected the Middle East and Northeast Africa with Europe, facilitating the exchange of goods such as cinnamon, ginger, pepper and cassia, which, like silk, served as a form of currency. The IMEC proposes a modern route from India to Europe through the United Arab Emirates (UAE), Saudi Arabia, Israel and Greece. Since its announcement in September 2023, some regional experts have expressed reservations about its feasibility, particularly regarding the connection between the Middle East and Israel. The project has faced delays due to the Israel–Hamas war. Despite these challenges, IMEC holds potential to drive economic growth and strengthen connectivity, especially as countries like Vietnam and India emerge as alternative manufacturing bases for companies relocating from China. For Saudi Arabia and the UAE, IMEC is not viewed as a challenge to China but rather as an opportunity to diversify their economies and solidify their roles within the Middle East region [18].

5. Conclusion

A new trade war between China and the USA has begun, with the Biden Administration's introduction of IMEC as a counter to China's BRI. This shift could soon transform the nature of economic war from a focus on supply chains to one on trade channels. The China manufacturing exodus was further accelerated by supply disruptions during the COVID-19 pandemic.

Amidst the economic tensions between China and the USA, the restructuring of global supply chains into regional networks has made significant progress. With China maintaining its stance on export controls for strategic items, South Korea must prepare for resilient supply chain management. In relation to China–Korea FTA, which is currently undergoing its second phase of negotiation, South Korea should seek clarity on the transparency of China's strategic

item controls. The Committee on Foreign Investment in the United States (CFIUS) plays a key role in monitoring the quality of inbound investments; similarly, South Korea is experiencing increased inbound investment due to the manufacturing shift from China and should apply similar standards to evaluate investment quality.

This emerging economic war between China and the USA is now marked by the competing initiatives of the BRI and IMEC. The BRI can be viewed as a modern Silk Road, linking China with Europe, while the IMEC seeks to establish a trade logistics corridor connecting Saudi Arabia, the UAE, Israel and Greece. The South Korean Government should take proactive steps to prepare for the evolving dynamics of the trade war between China and the USA.

Notes

1. <https://www.investopedia.com/terms/s/supplychain.asp>
2. According to Gary Gereffi et al, 5 governance types of a lead company could be categorised as market, modular, relational, captive and hierarchy.
3. Korea imports urea from 12 countries including Qatar, Vietnam, Indonesia and Saudi Arabia, in addition to China.
4. https://single-market-economy.ec.europa.eu/sectors/raw-materials/areas-specific-interest/critical-raw-materials/strategic-projects-under-crma_en
5. IPEF was launched on May 23, 2022 at Tokyo. 14 member countries are Australia, Brunei, Fiji, India, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, Vietnam and the USA. 4 Pillar of IPEF are Trade (Pillar 1), Supply Chain (Pillar 2), Clean Economy (Pillar 3) and Fair Economy (Pillar 4).
6. Critics say “lack of substantive actions and binding commitments, instead focusing on process-driven framework building.” <https://www.piie.com/blogs/realtime-economics/its-time-ipef-countries-take-action-supply-chain-resilience>
7. https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5443
8. As of 2023, the first-largest trade partner of Korea is China (Trade volume of \$267.66bn), the second is the US (\$186.96bn) and the third is Vietnam (\$79.43bn)
9. As preferential ROO contain the labour value content requirement in the USMCA, it could increase compliance costs for importers. <https://crsreports.congress.gov/product/pdf/RL/RL34524>
10. **USITC(1996)**, Country of Origin Marking: Review of Laws, Regulations and Practices, USITC Publication 2975, July, pp. 2–4
11. <https://www.barrons.com/articles/hong-kong-financial-center-china-46ba5d36>
12. Porter identifies a value chain broken in five primary activities: inbound logistics, operations, outbound logistics, marketing and sales and post-sale services. https://www.usitc.gov/publications/332/journals/concepts_approaches_in_gvc_research_final_april_18.pdf
13. MAU is a metric commonly used to identify the number of unique users who engage with apps and website. MAU is an important measurement to the level of platform competitiveness in the digital trade logistics or e-commerce industry.
14. <https://home.kpmg/xx/en/home/insights/2019/12/china-belt-and-road-initiative-and-the-global-chemical-industry.html>
15. <https://www.bradley.com/insights/publications/2023/10/the-india-middle-east-europe-economic-corridor-prospects-and-challenges-for-us-businesses>
16. The Asian Development Bank (ADB), which first used the term in 1998, defines economic corridors as important networks or connections between economic agents along a defined geography, which link the supply and demand sides of markets. <http://research.bworldonline.com/popular-economics/story.php?id=350&title=Economic-corridors-boost-markets,-living-conditions>
17. Legovini *et al.* (2020) comments traditional cross border agreements of transport investment focuses only on a narrow set of direct benefits and cost. However, economic corridors can entail much wider

economic benefits and costs such as trade and economic activity, structural change, poverty reduction, pollution and deforestation.

18. Arab Centre Washington D.C. <https://arabcenterdc.org/resource/the-geopolitics-of-the-india-middle-east-europe-economic-corridor/>

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