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What Will Become of Globalisation?

Not Replacing, but Complementing

The Emerging ASEAN Countries as Partners in De-risking China

Denis Suarsana

Germany and Europe have to reduce their economic dependence on China. In this context, the emerging economies of the Association of Southeast Asian Nations (ASEAN) afford potential for diversification. Yet, if this potential is to be exploited, the European Union has one particularly urgent task. Free trade negotiations with the emerging countries of Southeast Asia are currently overloaded with non-trade demands; the EU must return the focus to the core issues and bring talks to a swift conclusion.

As part of its China strategy, the German government is striving to de-risk its economy, meaning it seeks to reduce its economic dependence on China. A key part of this project is greater diversification of the German economy – both in view of China's central importance in international supply chains and the marked dependence of many German companies on the Chinese sales market.

In Germany and Europe, at least, there is no longer any talk of wholesale economic de-coupling from China. Instead, the German government aims to "promote the diversification of our economic relations so that we will continue to participate in China's economic development while reducing our dependence in critical sectors". This is because China continues to be "of great importance for many companies owing to its share of the global market, its dynamism and innovativeness".[1]

However, how such de-risking is to be successfully implemented largely remains unclear. The German government understands that, in addition to improving economic conditions in Germany and Europe, it is also important to make "better use of the strong potential of other countries and regions"[2]. But which countries and regions harbour such strong potential? How and where should German and European companies diversify so as to reduce their dependence on China?

These questions are not easy to answer, especially for Germany, which is more economically linked to China than any other country in Europe. The People's Republic is its most important trading partner, with Germany accounting for almost one third of all trade between China and the EU. It is therefore clear that diversification away from China requires tremendous effort – and economic partners with the necessary growth potential to even be considered a serious alternative.

In the search for suitable partners, politicians and businesses often turn to the emerging economies of Southeast Asia. The dynamic growth and relatively large markets of the so-called Emerging ASEAN (Indonesia, Malaysia, Thailand, the Philippines and Vietnam) offer a seemingly promising alternative to their large neighbour, China. However, economic data reveals that the emerging economies of Southeast Asia do not offer unlimited potential for diversification. Having said that, this does not mean that the Emerging ASEAN cannot be attractive for German and European companies. The region offers considerable potential, particularly for companies that (have to) pursue a China+1 strategy, i.e. remain engaged in the People's Republic while also diversifying into other locations and markets to reduce their own dependence on China. The Emerging ASEAN cannot replace China, but they can certainly complement it.

Close Ties with China Become a Problem

China is now the second largest economy worldwide and, even after decades of high growth rates, it continues to be the driving force behind

the global economy. Despite the current economic slowdown, forecasts by the International Monetary Fund (IMF) indicate that the Chinese economy will contribute more than 20 per cent to global economic growth over the next five years – more than any other economy in the world.[3] By contrast, the share of other emerging Asian countries such as India or the Emerging ASEAN lags well behind China. Emerging markets outside Asia only play a subordinate role. Therefore, economically, China will remain eminently important in the coming years; this is particularly true for Germany and the EU, with their economic model based on global trade and open markets.

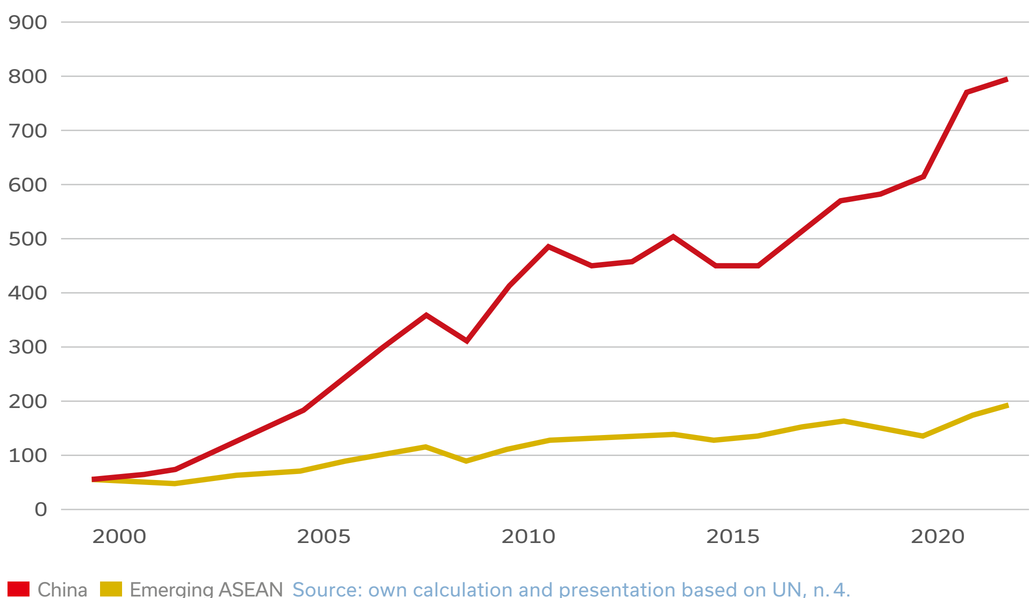
For many European companies, the market environment in China is becoming challenging.

China is the EU's most important trading partner. In 2022, the total trade volume (imports and exports) between the EU and China exceeded 797 billion US dollars. In contrast, the trade volume with the Emerging ASEAN is just under 189 billion US dollars – even though the figure for China and the Emerging ASEAN in 2000 was almost the same at around 55 billion US dollars (figure 1).

The Chinese economy is of particular importance for Germany. Almost half of all European exports to China are attributed to German companies. Although the volume of foreign trade between Germany and China in 2022 was 229.5 billion US dollars, below the record figure for 2021 (237.7 billion), it still exceeded the pre-COVID level by more than 40 billion US dollars. In contrast, Germany's volume of foreign trade with the Emerging ASEAN was only 47.8 billion US dollars in 2022, even slightly below the pre-pandemic figure.[4]

For many European countries, however, the market environment in China is becoming increasingly challenging. With its "Made in China 2025" strategy, the Chinese government seeks to reduce its technological dependence on other countries and is investing heavily in the competitiveness of Chinese companies within numerous key industries.[5] This means German and European companies will face growing domestic competition on the Chinese market. It

Fig. 1: EU Trade Volume in Billions of US Dollars



China Emerging ASEAN Source: own calculation and presentation based on UN, n. 4.

The air is getting thinner: The market environment in China has deteriorated for European companies, not least due to competition from local companies massively subsidised by the state. The picture shows the plant of a German gearbox manufacturer in Tianjin province. Photo: © Sören Stache, dpa, picture alliance.

has already been felt in mechanical engineering and the automotive industry, where German companies recently lost market share to Chinese companies.[6] In view of the Chinese sales market, diversification is thus not only a question of risk mitigation for European companies, but also an economically necessary strategy to tap into alternative markets with growth potential for their products over the long term.

If the EU is to consider the Emerging ASEAN countries as a real alternative to China in the coming years, they would need to embark on an economic race to catch up and demonstrate far stronger growth momentum than China. Only then could they contribute to a substantial shift in European trade flows away from China and into the region, potentially significantly reducing the enormous gap relative to trade volume between the EU and China. However, a glance at the growth forecasts for China and the five Emerging ASEAN countries gives little reason for such hope.

The IMF predicts a GDP growth rate of 4.2 per cent for China in 2024, placing it roughly on a par with Malaysia (4.3 per cent) and well above Thailand's 3.2 per cent economic growth. While the IMF forecasts that China's growth will lose steam by 2028, the same applies to the economic development of Malaysia and Thailand. For Indonesia, the IMF expects a consistent annual growth rate of five per cent over the next five years. Only for the Philippines and Vietnam, the two economies with the lowest per capita income in the Emerging ASEAN, does the IMF predict a more dynamic development with growth rates of well above six per cent by 2028.[7]

However, even such growth rates are too low for emerging and developing countries striving to catch up with far more developed economies. South Korea, perhaps the most successful of the East Asian tiger economies, achieved double-digit growth rates in the 1980s. And China's economy enjoyed double-digit growth for decades.

> **China is now by far the most important economic partner for the countries in the region.**

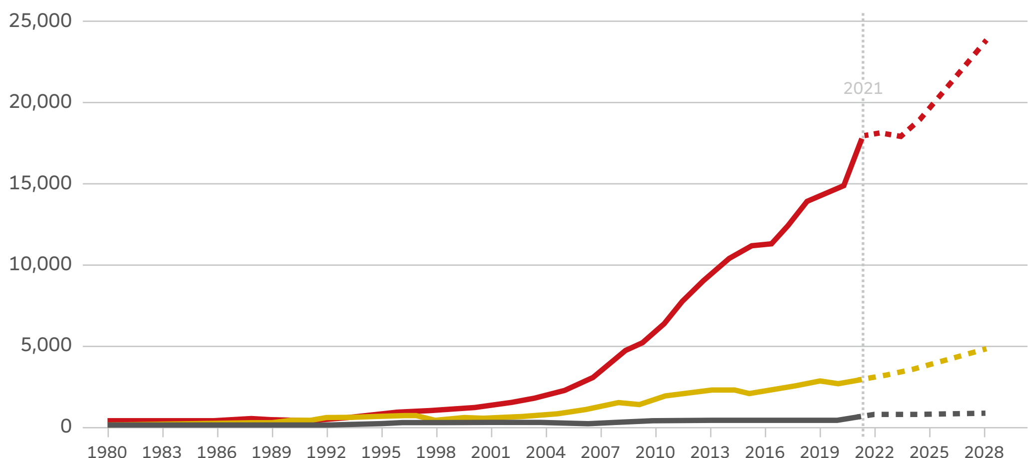
In terms of overall economic performance, the growth rates of the Emerging ASEAN, which are rather moderate when put in a historical perspective, mean that these countries will be unable to narrow the large gap with China. If anything, China will actually expand its lead in the coming years. China is expected to increase its GDP from the current 17.7 trillion US dollars (2023) to 23.61 trillion by 2028, while the Emerging ASEAN will only increase from 3.23 trillion US dollars (2023) to 4.73 trillion (figure 2). In other words, the Chinese economy will grow by more in the next five years than the entire projected economic output of the Emerging ASEAN in 2028 – China's economy will have grown by an entire ASEAN by 2028.

The Dangers of Pseudo-Diversification

In addition to the – by historical standards – moderate growth rates of the Emerging ASEAN, another factor complicates the diversification of German and European economic relations from China to the region. Despite all the aforementioned data, ASEAN is one of the most dynamic economic regions in the world, so it is also attracting other economic powers. Japan, South Korea, Australia, the US and many others are expanding their economic ties with the economies of Southeast Asia. Having said that, the EU's fiercest economic competitor in the region is China itself.

In recent years, China has gained tremendous economic importance, not only for the EU, but also for the countries of Southeast Asia. China benefits from the ASEAN-China Free Trade Area (ACFTA) and from being a member, together with the ASEAN countries, of the Regional Comprehensive Economic Partnership (RCEP), the largest free trade zone in the world – unlike the EU, whose trade negotiations with

Fig. 2: Gross Domestic Product in Billions of US Dollars



Years 2021 to 2028 as forecast. China Emerging ASEAN Other ASEAN countries
Source: own illustration based on IMF 2024, n. 3.

the Emerging ASEAN countries have stalled since the successful conclusion of negotiations with Vietnam in 2019.

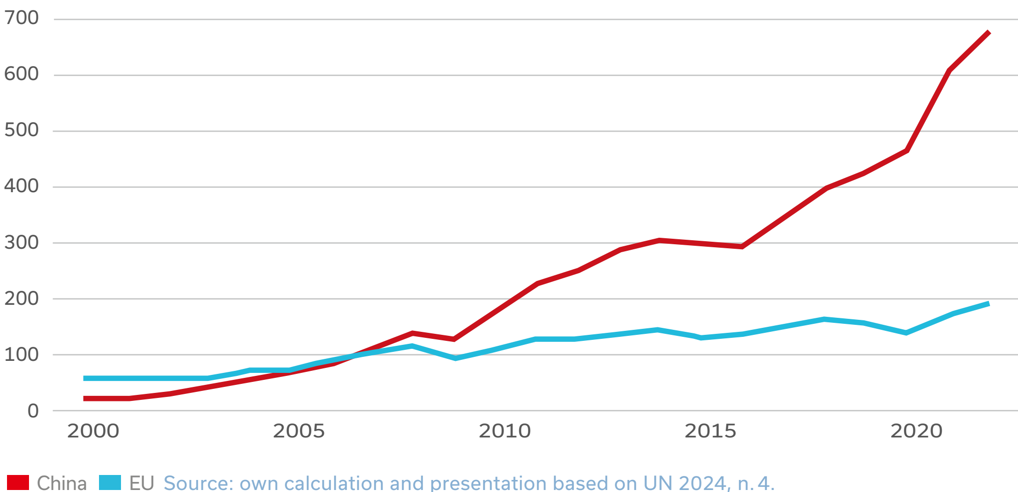
China is now by far the most important economic partner for the countries in the region. While the volume of trade between the EU and the Emerging ASEAN has grown relatively slowly in recent years, the volume between China and the Emerging ASEAN has almost doubled over the past five years (figure 3).

European companies are at a major disadvantage due to the lack of free trade agreements.

China also dominates the industrial supply chains in the Emerging ASEAN with an enormously high share of all primary product imports. More than one third of all imported primary products in Indonesia originate from China. In Vietnam, the share is 29.5 per cent, in Thailand 28 per cent, in the Philippines 26.9 per cent and even in Malaysia it lies at an impressive 17.4 per cent. In comparison, the share of Chinese primary product imports in Germany, which is particularly criticised for its strong dependence on China in terms of industrial integration, is just 12.4 per cent.[8] The high proportion of Chinese primary product imports in the Emerging ASEAN makes it clear that establishing a production site in the region would only reduce dependence on China to a limited extent. German and European companies would probably still rely on a high proportion of Chinese primary products in their factories in Southeast Asia. In this case, a China+1 strategy would ultimately be little more than pseudo-diversification – diversification in terms of geography, but not in terms of supply and value chains.

What is more, protectionist rules in countries such as Indonesia and the Philippines make access to these potentially huge markets costly or, in some cases, virtually impossible. This represents a major disadvantage for European companies due to the lack of free trade agreements. Countries such as Australia, Japan, South Korea and India threaten to outpace Europe thanks to free trade agreements and regional trade zones such as RCEP and CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership). This is especially true for China, which, thanks to ACFTA and RCEP, has become the most important country of origin for ASEAN imports within just a few years. Between 2017 and 2022 alone, Chinese exports to ASEAN grew

Fig. 3: Emerging ASEAN Trade Volume in Billions of US Dollars



Source: own calculation and presentation based on UN 2024, n. 4.

by 70 per cent. This means that China accounts for almost 25 per cent of all imports in the region. 80 per cent of imports from China are industrial goods – primarily electronics, machinery and machine parts as well as chemical products.[9] Hence, these are products with which Chinese manufacturers compete directly with German and European industrial companies on the global market and in the Emerging ASEAN.

Only in Thailand and Vietnam German direct investment stocks recently increased.

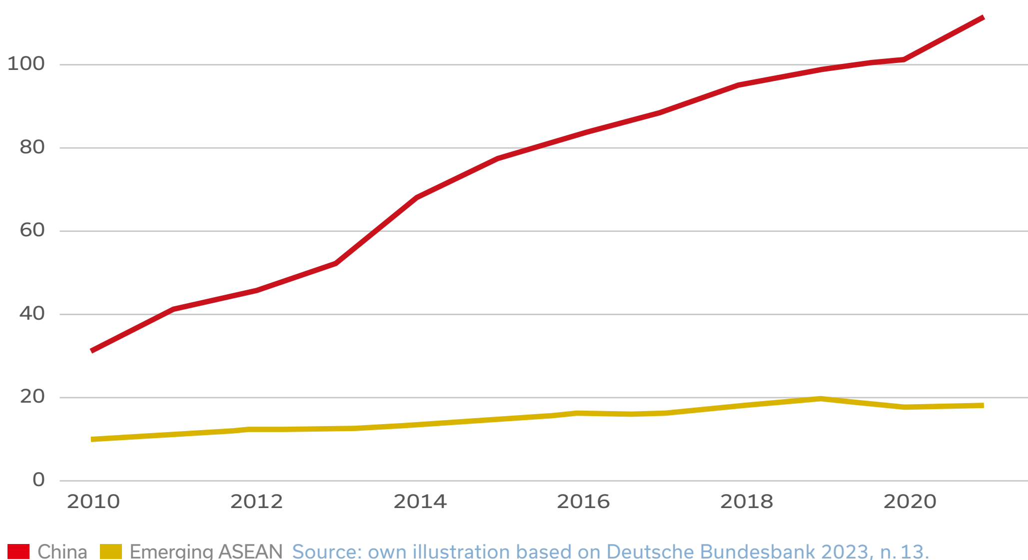
Diversification of the German Economy Remains Sluggish

Despite all political appeals, there has been little sign of the German economy diversifying away from China. Movement towards de-risking on the part of German companies can only be observed to a very limited extent.[10] For example, in a study conducted by consulting firm PwC, only one per cent of the companies surveyed indicated their intention to give up their operations in China.[11] Other company surveys also demonstrate that a majority of the German companies that rely on inputs from China do not plan to take steps to reduce their dependence on China or even seek to expand their procurement and investments in China.[12]

German direct investments in China have also increased massively in recent years. The stock of all German direct investments in China is currently around six times higher than the value in the Emerging ASEAN (figure 4). In fact, the direct investment portfolios of German companies in the Emerging ASEAN have largely stagnated over recent years. Only Thailand and Vietnam have experienced a significant increase in German direct investment in recent years, while overall investment in Vietnam remains relatively low.[13] In China, on the other hand, German direct investment flows reached a new record high of 11.9 billion euros in 2023.[14]

For many German and European companies, China is currently irreplaceable both as a production location and as a huge sales market. There is a paucity of genuine alternatives to the Chinese economy. Nevertheless, many companies need to geographically diversify their own markets, manufacturing locations and supply chains in addition to their business in China in order to

Fig. 4: German Foreign Direct Investment Stocks in Billions of Euros



Source: own illustration based on Deutsche Bundesbank 2023, n. 13.

avoid a one-sided focus and thus dependence on the Chinese economy. In addition to the political aspects, this kind of China+1 strategy seems particularly urgent in light of the deteriorating market environment in China itself. German and European companies are increasingly called on to look for new markets outside of China so as to generate additional growth. The Emerging ASEAN could play a key role here.

The Potential of the Emerging ASEAN for Production Locations and Markets

The Emerging ASEAN is geographically located on some of the world's most important trade routes and in close proximity to major markets in the Asia-Pacific region such as Australia and Japan. In addition to the RCEP, the countries are also members of a number of other regional and bilateral free trade agreements. This could make these countries ideal for companies as regional production centres from which to serve regional markets outside China. What is more, with a population of around 596 million people[15] and a growing consumer-oriented middle class, the Emerging ASEAN itself is becoming increasingly important as a sales market. A closer look at the economic data of the five countries[16] shows that a China+1 strategy focusing on the Emerging ASEAN could provide many opportunities for German and European companies, while also presenting major challenges.

Malaysia stands out as the best performer across all categories in the regional comparison, and usually by a wide margin. Wages in Malaysia are almost one third lower than in China in the manufacturing sector, yet Malaysian workers have a higher annual productivity level per worker at 24,861 US Dollars.[17] Malaysia's economy is well developed, with a technologically advanced industry, a relatively well-educated and productive workforce, and, by regional standards, solid framework conditions for foreign companies and investors. Malaysia is also an attractive sales market due to its relatively high income level. Although the country is comparatively small with a population of around 34 million, it probably has the most potential in the short term with regard to the diversification efforts of primarily high-tech European companies.

In the long term, however, **Vietnam** could become the country with the greatest diversification potential. Although Vietnam currently ranks at the bottom in most categories of regional rankings such as productivity, per-capita income and infrastructure quality, it has made great strides in almost all areas in recent years and even partially outpaced countries such as Indonesia and the Philippines. A major advantage for Vietnam is its cheap yet well-educated workforce, coupled with rapidly improving industrial competitiveness. Moreover, Vietnam's 2019 free trade agreement with the EU makes it particularly attractive for European companies compared to its Southeast Asian neighbours without such agreements.

Indonesia and the Philippines can boast dynamic economic growth.

Thailand is still performing relatively well in most categories compared with the other Emerging ASEAN countries, yet a closer look at the data suggests that the Thai economy is increasingly living off its capital. At around three per cent, economic growth is too low for an emerging country, and key economic indicators such as productivity, industrial competitiveness and income are stagnating at a low level. General conditions for investors, such as the high level of corruption, also pose a challenge. Thailand's population is already ageing and shrinking. Thailand is therefore at risk of becoming a "grows old before it gets rich" country.

Indonesia and the **Philippines** can boast dynamic economic growth and a large and growing labour pool due to demographic change. Despite labour costs in both countries being very low by regional standards, unlike in Vietnam, the workforce is relatively poorly educated and therefore not very productive. In rankings such as PISA or the World Bank's Human Capital Index,

Indonesia and the Philippines fare worst in the regional rankings. However, with a population of more than 275 million and a rapidly growing middle class owing to rising incomes, Indonesia has a huge sales market that makes the country attractive as a regional production hub for foreign companies. Indonesia is also one of the largest producers of raw materials such as nickel, cobalt and copper, which are crucial in the context of the global energy and mobility transition. However, both countries exhibit relatively challenging regulatory environments, and their high levels of legal uncertainty and corruption could deter foreign investors. The Philippines and Indonesia in particular also have extensive protectionist rules and measures, such as high tariffs, non-tariff trade barriers and complex import regulations and procedures.

The Emerging ASEAN can and must play a key role in the China+1 strategies of German and European companies. After all, the Emerging ASEAN has the world's most dynamic growth rates and a growing, young and increasingly affluent population. Compared to other emerging countries and economic regions, it still offers the best potential for diversification of production and sales markets away from China, despite all the challenges.

The Emerging ASEAN are increasingly willing and able to let the negotiations fail.

The EU's Trade Negotiations with the Emerging ASEAN

The EU must finally conclude its trade negotiations in the region so that European companies can truly harness the potential for diversification in the Emerging ASEAN. While the EU signed a free trade agreement with Vietnam in 2019, negotiations with Indonesia, Malaysia, Thailand and the Philippines, some of which have been ongoing for years, have made little progress. The main obstacle to successfully concluding negotiations is the EU's efforts to impose non-trade

More of this, please! In 2019, Vietnam and the EU signed a free trade agreement. Although agreements with the other Emerging ASEAN states are urgently needed in view of European diversification efforts, Europe has so far overloaded the talks with non-trade issues. Photo: © AP, picture alliance.

demands, such as extensive labour and environmental standards, as part of the negotiations. Countries such as Indonesia reject this approach and accuse the EU of protectionism under the guise of climate protection and human rights.

The countries of Southeast Asia themselves have a strong interest in closer political and economic cooperation with the EU, particularly when it comes to counteracting their own growing dependence on China. According to the annual "The State of Southeast Asia" survey[18] of around 2,000 experts and decision-makers in the region, the EU is still viewed as the favoured partner with a view to hedging the rivalry between the US and China. However, the survey also shows that Europe's influence in the region is markedly declining and that the role of countries like Japan, Australia and South Korea is gaining importance alongside the two major powers. Economically, the importance of countries such as India, Qatar and the United Arab Emirates is also on the rise.

In light of growing global economic interest in the region and the current stagnant trade with the EU, the Emerging ASEAN countries are increasingly willing and able to walk away from trade negotiations with the EU.[19] For the EU, this would be a significant setback both in terms of Europe's diversification efforts and its already declining geopolitical influence in the region. The EU needs the ASEAN states to achieve its ambitious goals in areas such as global climate protection, the reform of multilateral trade rules or the protection of free and open trade routes.

The EU should no longer overload trade negotiations with non-trade demands and instead decouple such issues, where they are not directly trade-related, from trade policy issues. The EU has other instruments for supporting social development or climate protection in the Emerging ASEAN countries. The main instrument is undoubtedly the Global Gateway Initiative, within the scope of which the EU plans to invest ten billion euros in green transformation and sustainable connectivity in the ASEAN countries over the next few years.[20]

It is also essential for the European Commission and the German government to ramp up their support to European companies striving towards diversification in Southeast Asia. The German government's introduction of favourable conditions for taking over investment guarantees in countries with high diversification potential in October 2023 was a step in the right direction. Moreover, political support for the engagement of European companies in the Emerging ASEAN should be expanded. The number of high-level political visits from the EU to ASEAN countries could still be significantly increased. As with similar visits to China or India, high-level political delegations to the region should also be accompanied by high-level business delegations.

The Emerging ASEAN is becoming more confident given its dynamic economic development and the increasing global interest in the region. The ASEAN countries expect the EU to pursue a genuine partnership-based policy. For them, Europe is now just one option among many, and in the region's capitals, patience with an EU perceived as morally arrogant is wearing thin. Europe needs the emerging economies of Southeast Asia if it is to reduce its economic dependence on China. This is why the EU should adopt a more pragmatic approach. Europe will not be successful in ASEAN by wagging its finger and insisting on European standards. Countries like China and the US, but also Australia, Japan, South Korea and India are queuing up to work with the Emerging ASEAN countries – and Europe increasingly risks being left behind.

– translated from German –

This article is based on the author's May 2024 study published by the Konrad-Adenauer-Stiftung: De-risking, but where to? The Emerging ASEAN countries as an alternative to China, accessible at https://ogy.de/tbik.

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