

ASEAN is reluctant to join the U.S.-led decoupling/de-risking strategy for China

—The IPEF is not working, and Japan may be the key to promote friend-shoring —

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<Summary>

- ◆ The U.S. has positioned major ASEAN countries as key partners for friend-shoring, a process of restructuring supply chains around friendly countries. It has included them in the IPEF, a new framework for economic cooperation. However, ASEAN countries have shown little interest in such moves, and the U.S. strategy may not be working.
- ◆ ASEAN countries generally wish to remain neutral in their relations with the U.S. and China. The reasons behind this are as follows: 1) ASEAN's attitude to security, such as interest in the Taiwan contingency, differs from that of the U.S., 2) the strategy put forth by the U.S., which includes the IPEF, offers no benefits for ASEAN, and 3) ASEAN's economic dependence on China is quite high, so shunning China would not be easy.
- ◆ To push forward with friend-shoring, the U.S. may need the cooperation of Japan, which has a relationship of trust with ASEAN countries. The Japanese government may promote policies such as 1) leading discussions on the evolution of an economic zone based on the TPP, 2) expanding government support for Japanese companies entering ASEAN, and 3) focusing on support for new industries that ASEAN countries are seeking.

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1. Introduction

A U.S.-led restructuring of supply chains is underway, and attention is focused on how ASEAN countries will respond. So far, ASEAN countries have generally been highly committed to maintaining good relations with both the U.S. and China. There is resistance to choosing between the U.S. and Chinese camps, and there are few moves to actively decouple from China¹.

I traveled to Indonesia and Singapore in March 2023 to conduct interviews at think tanks, financial institutions, and media organizations. With these interviews as a base, this paper summarizes local perceptions and discusses what kind of policies Japan may adopt to bring Japan and ASEAN closer together.

2. ASEAN countries have scant interest in the U.S.-led strategy and are reluctant to decouple/de-risk China

In June 2021, the U.S. released a report on strengthening supply chains. It called for a policy of “friend-shoring,” or strengthening supply chains by leveraging not only domestic production but also relationships with allies and friends. Furthermore, the U.S. announced the launch of the Indo-Pacific Economic Framework for Prosperity (IPEF), a new framework for economic cooperation among nations, in May 2022. The framework also includes seven ASEAN countries (Indonesia, Singapore, Thailand, the Philippines, Vietnam, Malaysia, and Brunei). The U.S. has made it clear that it intends to build a strong international cooperative framework in terms of economic security, and has succeeded in including the major ASEAN countries in this framework.

In the ASEAN countries, however, there has been little excitement in discussion about the strategy of supply chain restructuring that the U.S. is pursuing. When I asked experts in Indonesia and Singapore about moves toward supply chain restructuring with a view to decoupling from China, I was struck by the perplexed looks on the faces of many of them. This may be because of the general view there that it is impossible to support the idea of building supply chains in a way that excludes China.

In Malaysia, many foreign semiconductor companies have established operations in the state of Penang, which counts the chip industry as one of its strengths, and the majority of these firms are American. But this does not mean that Malaysia is embittered with China and proactively looking to strengthen its economic ties with the U.S. One expert said that if they were to choose either the U.S. or the Chinese side, there would be only economic disadvantages.

Right from the start, there were comments from ASEAN leaders criticizing the unilateral exclusion of China from the IPEF. Furthermore, the worsening sentiment toward China that is said to be spreading worldwide is not so apparent in Southeast Asia. After China scrapped its zero-COVID policy, several countries tightened border control measures for travelers from China. They were fearful of a resurgence of COVID and thus cautious about accepting Chinese visitors. However, there is hardly any such caution in ASEAN countries, with many welcoming the economic benefits of the increase in Chinese travelers. China is expanding its economic ties with ASEAN countries, including in areas other than tourism, and as such its influence is growing. As discussed

¹ In this paper, the expression “decoupling from China” refers not only to the complete severing of connections with the Chinese economy, but also the correction of excessive reliance on China (i.e. De-risking).

below, Indonesia is increasingly dependent on the Chinese economy as it expands its EV-related mineral resource and battery industries. Locally, few see it as a problem, and the main point of interest is whether dependence on China can grow their own economy.

3. ASEAN cannot actively cooperate with the U.S. for several reasons

There are three possible reasons that ASEAN countries have not been able to align themselves with the U.S. and actively cooperate with it in decoupling from China:

First, there are differences in attitudes to national security. In the ASEAN countries, few are strongly mindful of the risk of a Taiwan contingency. Some ASEAN countries have territorial disputes with China in the South China Sea, but even in those countries, the possibility of armed conflict is not really on people’s radars. Even as China intensifies moves to secure hegemony, there is no indication that ASEAN governments and companies are consciously changing their policies toward China or the direction of business development.

Second, the U.S. strategy lacks consideration for ASEAN. The participating members of the IPEF are mainly ASEAN countries, but the framework does not take ASEAN into consideration. The IPEF does not include a trade agreement. It is a loose, non-legally binding, cooperation-based framework involving countries that have opted to be a part of it, and no concrete measures, such as subsidies for the relocation of companies and infrastructure development, have been announced (Figure 1). Many of the experts from ASEAN countries were more interested in frameworks that include specific trade agreements, such as the RCEP, which entered into force in January 2022, or the TPP, and many of them said that discussions on those frameworks should continue.

The media describes the IPEF as “a framework established by countries that share democracy to counter tyranny,” so there is an implicit intention on the part of the U.S. to demand democracy from participants. From

Figure 1. Four Pillars of the IPEF

Trade	Build high-standard, inclusive, free, and fair trade commitments
	Cooperation in the digital economy
Supply Chain	Improving transparency, diversity, security, and sustainability in our supply chains
	Ensuring access to key raw and processed materials, semiconductors, critical minerals, and clean energy technology
Clean Energy, Decarbonization, and Infrastructure	Accelerate the development and deployment of clean energy technologies
	Deepening cooperation on technologies, on mobilizing finance, including concessional finance, and on seeking ways to improve competitiveness and enhance connectivity by supporting the development of sustainable and durable infrastructure and by providing technical assistance.
Tax and Anti-Corruption	Enacting and enforcing effective and robust tax, anti-money laundering, and anti-bribery regimes
14 countries: the U.S., Australia, Brunei, Fiji, India, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, Korea, Thailand, and Vietnam. (as of September 2022)	

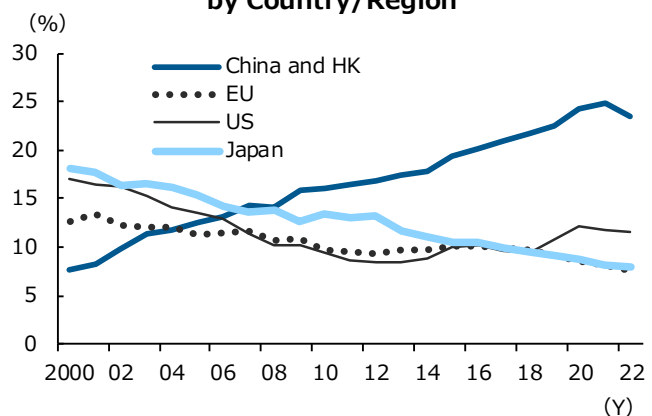
Source: Ministry of Foreign Affairs of Japan

ASEAN, only Indonesia, Malaysia, and the Philippines were invited to participate in the U.S.-hosted Summit for Democracy in December 2021 and March 2023. Although the IPEF ministerial statements do not include a definition of democracy, some ASEAN countries have political systems that cannot really be described as democratic. The IPEF is no more than a framework drawn up from the unique U.S. perspective of keeping China in check, and there do not seem to be any components that can draw ASEAN in and make the framework work in practice.

Third, ASEAN's economic dependence on China is already quite high. If ASEAN countries move to decouple from China, their economies could suffer serious damage. In particular, ASEAN countries have become increasingly dependent on China for trade in recent years. China's share of total trade transactions (exports plus imports) by ASEAN countries was 23.4% in 2022 (Figure 2). Of this total, China's share of exports is 19.8%, lower than the 34.3% share of Japan, the U.S., and Europe combined, while China's share of imports is 27.2%, much higher than the 18.8% share of Japan, the U.S., and Europe combined. This reflects the structure of assembly and processing in China and ASEAN, with the finished products finally exported to developed countries. Although Japan, the U.S., and Europe are important to ASEAN countries as final demand destinations, they have lost the ability to supply the materials and parts necessary for assembly and processing, and ASEAN has fallen into a situation where it is impossible for its supply chains to function without China.

In addition to trade, the region is increasingly dependent on China in financial terms as well, with money from China playing a major role in the growth of the ASEAN economies in recent years. In 2021, the Foreign Direct Investment (FDI) stocks by China in ASEAN countries expanded sharply by 2.3 times from 2018, with the size of the stock reaching \$52 billion and surpassing the \$51.2 billion in U.S. investment in ASEAN (Figure 3). While investment by the U.S. has been dominated by spending on upgrading facilities, China has been rapidly increasing new capital investment, making it a highly attractive source of investment capital for ASEAN countries that want to focus on developing new industries. Locally, many say

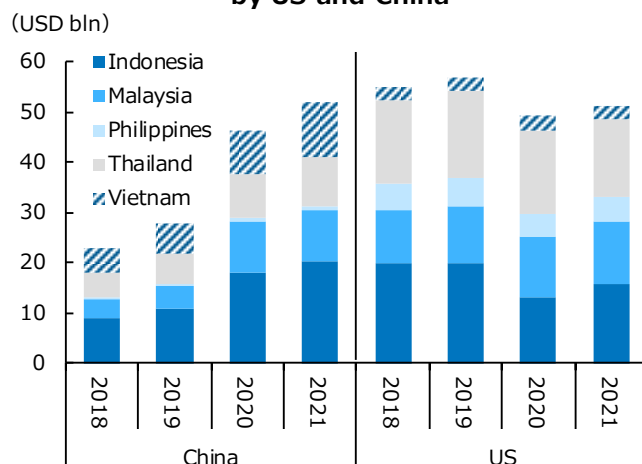
Figure 2. Share of Total trade in ASEAN by Country/Region



Source: JRI based on CEIC.

Note: Total Trade = Exports + Imports. The data for ASEAN include Indonesia, Malaysia, Philippines, Thailand and Vietnam.

Figure 3. FDI to Southeast Asia by US and China



Source: JRI based on IMF(CDIS)

that Chinese companies are increasing their presence in ASEAN countries, especially in terms of fostering new industries such as EVs, where Chinese companies are said to have more influence than Japanese, U.S., or European companies. Under such circumstances, moves to exclude China are unlikely.

A prime example is Indonesia. The country has prohibited the export of certain mineral resources since January 2020, with the aim of advancing its industry². A similar policy was pursued unsuccessfully in the past, but this time around the measure has been a success so far. This is thanks to the strong support of Chinese companies. In fact, there has been a surge in direct investment from China to build new refinery, and instead of the mineral resources themselves, Indonesia has seen a significant increase in exports of goods produced by refining and processing them. In addition, the country’s industry is becoming more sophisticated, with Chinese companies moving into not only the mining, refining, and processing of mineral resources, but also the manufacture of EV batteries that use these resources. Such Chinese investment is an important driver of Indonesia's economic growth, and there is little tendency to see the growing dependence on China as a problem.

4. Japan may take a leading role in getting ASEAN on board

Although the U.S. has been active in restructuring supply chains, it has not been able to successfully integrate ASEAN countries, and its IPEF-based strategy has not been working well. This is not something that can be ignored by Japan, which is strengthening its ties with the U.S. as the latter restructures its supply chains. It is also in Japan’s interest to actively support the U.S. in implementing this strategy.

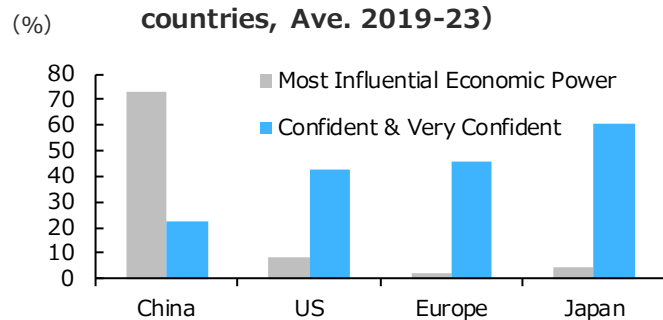
In an international-affairs survey of Southeast Asian researchers and public officials conducted by ISEAS, a Singapore-

based research institute, Japan was ranked first for the fifth consecutive year as a “trustworthy” country. While Japan’s economic influence has waned significantly compared to the past, the level of trust in the country remains high (Figure 4). To change the attitudes of ASEAN countries and promote friend-shoring as a major trend, the Japanese government may focus on the following three policies:

(1) Deepening the economic zone based on the TPP - establishing it as a framework to replace the dysfunctional IPEF

First, it may lead discussion on positioning the TPP at the center of a framework for an economic zone that can involve ASEAN. In contrast to the IPEF, which has many ambiguous rules, the TPP has clear rules. Also,

Figure 4. The State of Southeast Asia Survey (Answers about perception for major countries, Ave. 2019-23)



Source: ISEAS-Yusof Ishak Institute

Note: Around 1,300 respondents from Academia, Business, Government, other organisations in ASEAN participated in this survey.

² See Matsumoto [2022] and Matsumoto [2023].

unlike the RCEP, which includes China, the TPP is a high-quality agreement in terms of tariff elimination and common rules. Currently, the only ASEAN countries that are members of the TPP are Vietnam, Malaysia, Singapore, and Brunei. Joining the TPP will be a difficult task for some ASEAN countries³, but in addition to the easy-to-understand benefits, such as the economic agreements, the TPP also has a clearly articulated direction to aim in: free markets. To encourage cooperation in supply chain restructuring, TPP membership is ideal.

Of course, in order for this to work, the U.S. will also need to join the TPP. The Japanese government is reported to have already repeatedly urged the U.S. to return to the TPP. In January 2023, White House press secretary Jean-Pierre told reporters that the U.S. is working to deepen economic ties with IPEF participating countries. She stressed that U.S. policy has not changed. Negotiations over a return to the TPP are expected to continue to be difficult, but in its discussions with the U.S., the Japanese government may need to clearly point out that the IPEF is not working well, and take action to significantly turn the tide.

(2) Government support for Japanese companies expanding into ASEAN: Investment on a scale to compete with money from China is required

Second, to compete with money from China, which is increasing, the Japanese government could boost its support for overseas business development by Japanese companies. The Japanese government has been implementing its own policies to encourage supply chain restructuring over the past several years, with a focus on reshoring. Subsidies provided under the Program for Promoting Investment in Japan to Strengthen Supply Chains swelled to 527.3 billion yen in total for FY2020 and FY2022⁴. And the FY2021 and FY2022 supplementary budgets included 617 billion yen and 450 billion yen, respectively, for establishing production facilities for advanced semiconductors, for a total of more than one trillion yen. On the other hand, in the FY2020 budget, the amount allocated to the Overseas Supply Chain Diversification Support Project, which finances the offshoring of production facilities, was just 35.17 billion yen, while in the FY2022 budget the amount allocated to the Project to Promote Overseas Market Development and Establishment of Supply Chains in Friendly Countries was a mere 19 billion yen. There are several other budget-funded programs that, in a broad sense, support the establishment of production facilities overseas, but even so, the amount of government money being spent on reshoring is higher. If this were to change and the government began spending a large amount of money on supporting Japanese companies considering expansion into ASEAN, it would be possible to induce Japanese companies to invest more in the region than Chinese companies do.

Since many industries saw offshoring in the past to improve efficiency on the cost side, promoting reshoring alone, which goes against this trend, will only lead to a lack of balance in terms of economic efficiency. If rash decisions are made and numerous factories are relocated back to Japan, making them less competitive internationally, Japanese companies will be weakened, and this could lead to a vicious cycle in which Asian countries, including Japan, become increasingly dependent on China, which is the opposite of what they want.

³ The TPP is a framework that presents considerable hurdles to countries with immature domestic industries, as it requires high levels of liberalization through the elimination of tariffs. Although China has already applied for membership, it is unlikely to join due to issues such as its subsidies to state-owned enterprises and its use of forced labor. See Nogimori [2021].

⁴ See the budget overview document on the Ministry of Economy, Trade and Industry website (<https://www.meti.go.jp/covid-19/supplychain/index.html>).

To successfully restructure supply chains while maintaining economic efficiency, friend-shoring, a policy promoted by the U.S. for leveraging relationships with allies and friends, will be essential. The Japanese government could move beyond inward-looking policies and set a course of action to strengthen Japanese industry as a whole, with an eye toward cooperation with other countries, especially in the important region of Southeast Asia.

(3) A focus on new industries when providing support for overseas business expansion - A structure for identifying the needs of ASEAN countries is essential

Finally, the support measures should be taken to increase the number of companies entering new industrial sectors desired by ASEAN countries. Until now, Japanese private-sector companies have tended to develop their businesses by replicating their success in Japan in emerging countries. In this day and age, however, the products that Japan offers under that business model may be out of sync with the products desired by ASEAN countries. Japanese companies excel in products focused on energy transition (hybrid vehicles rather than EVs, energy from high-efficiency thermal power generation rather than renewable energy, etc.), but are these products may not be needed. In many ASEAN countries, businesses need to make a clean break from the old, as the governments there have adopted strategies for decarbonization and are moving to accelerate the spread of EVs⁵.

Many emerging countries emphasize “leapfrogging,” i.e., skipping intermediate developmental stages and adopting cutting-edge technologies and products. It should be noted that Chinese companies have been quick to respond to local needs, as evidenced by the rapid increase in market share of Chinese-made EVs in Thailand and Indonesia.

5. Conclusion

Given China's already significant economic influence and the risk of incurring cost disadvantages in competing with it, it would be nearly impossible for any country in the world to achieve a complete decoupling from China. However, it is possible, and beneficial, to alter or avoid an economic structure that is highly dependent on China (i.e. De-risking). Further dependence on China, including in trade, would exacerbate political and economic imbalances and could have a negative impact on long-term global economic growth.

The U.S. has come up with a strategy, which includes the IPEF, for decoupling from China, and has adopted a hardline stance of willingness not only to reduce dependence on China, but also to achieve complete decoupling in certain industries. In reality, however, this strategy has barely worked, as the U.S. has been unsuccessful in bringing the ASEAN countries on board. Against this backdrop, Japan, which has a strong relationship of trust with ASEAN, may play a supporting role in friend-shoring.

⁵ Of course, aiming to transition to decarbonization in one bound entails great risks. EVs are often high-priced, and the income bracket that can afford them has not expanded sufficiently in emerging economies, so they might not become very popular. And if EVs were to proliferate rapidly, demand for electricity would rise sharply, so unless progress is made with electric power transition, fossil fuel-reliant power generation would rise, which could increase the environmental burden. In many ASEAN countries, there is little awareness of such risks. If Japanese companies adopt a business approach of actively promoting energy transition-oriented products, which are their forte, the Japanese government will need to be more proactive in communicating the current risks to ASEAN and encouraging their governments to change their policies.

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