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My Say: Emerging markets can benefit as the West decouples from China

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For at least the last two decades, a presence in China was seen by Western firms as a distinct competitive advantage over their peers. Now, all that seems to be changing. American and European suspicion of China has been rising as China seeks to control its technological destiny. For as long as China was a low-cost, low-value-added producer of basic goods, it fit into Western needs for cheap consumer products. But as China moved up the value chain and made known its intention to master and indigenise advanced technology under its Made in China 2025 policy, Western backlash followed. A China seeking technological parity with the West, particularly in key industries like artificial intelligence, 5G, semiconductors, aerospace and bio-technology was simply not acceptable to Western policymakers. What began as the imposition of tariffs evolved into outright sanctions, particularly against Chinese tech giants like ZTE and Huawei.

It was Steve Bannon, one-time strategist for Donald Trump, who in 2018 made the case that as the US was too dependent on trade with China, it should seek to "decouple". Today with rising geopolitical tensions, the decouple narrative has taken on new life with the Europeans joining the chorus. For the emerging markets of the world, this decoupling, if it gains traction, promises tectonic change. The numbers, and therefore the stakes, are huge. In 2020, total trade between the US and China was US$615 billion. While US exports to China were about US$165 billion, its imports from China were US$450 billion, almost three times more. China-EU total trade for the same year was US$709 billion. As of 2020, China has replaced the US as the EU's main trading partner. Given these numbers, any realignment can bring huge benefits to emerging markets, especially the Asian ones.

There are myriad factors, both push and pull, that are driving this decoupling phenomenon. Pull factors, like the supply chain shocks that were particularly bad for Western firms with China-centric production, the US CHIPS Act, the possibility of even more sanctions by Western governments and closer monitoring of business ties, especially in high tech and in supply chain-critical areas, are all reasons for multinational corporations (MNCs) to rethink their China strategy. In addition, China itself seems to be providing several push factors. The Chinese government's handling of its zero-Covid policy and the resulting business disruption, the obvious nationalist drift with increased emphasis on ideology and security and less on economic growth, and what in Western eyes appears to be the hounding of business elites and their businesses in the name of "common prosperity", all fly in the face of what the world has come to expect of Chinese policies. The reformist policies originating from Deng Xiao Peng, which have always been pragmatic, highly sensible and very effective, are making way for tighter regulation.

With policies on both sides, China and the West, drifting further apart and hardening, businesses have little choice but to review their strategies. Already it appears that an "anywhere but China" thinking may be prevalent among Western firms seeking to locate new production sites. For emerging markets that have long been bypassed in favour of China, these businesses are a huge source of new investments as they pivot away from China. The Western world simply cannot produce the many products that

China now exports to it, certainly not at the prices their consumers want and have been used to. The alternative for Western firms is therefore to divert to locations that offer the most of what China can.

Apart from benefiting from potential new investments diverted away from China, emerging markets can also benefit from Western firms already in China that for strategic reasons would want to place new expansion facilities outside. Known as the "China +1" strategy, the idea is to keep existing Chinese facilities but move new expansion outside. The objective being both diversification to reduce the risk of the supply chain shocks experienced earlier this year and minimise if not avoid incremental geopolitical risk. Already companies like Apple have moved the assembly of several products to Vietnam and India. Given the immense size of China and Western commitments already there, the investment overflow from a China +1 strategy can be massive for emerging markets. A third potential source of investments could be from Chinese firms seeking to minimise, if not avoid, the tariffs and other restrictions on products originating from China.

As businesses like MNCs recalibrate their current China-centric supply chains, emerging markets can play both sides of the decoupling process — being recipients both of new investments diverted away from China and of investment outflows from China as MNCs seek to hedge their Chinese exposure through a China +1 strategy.

The last time something similar happened was catalysed by the Plaza Accord of 1985. Back then, it was a currency agreement forced by the West on Japan and the Asian tigers, intended to correct the trade imbalance by realigning exchange rates. As Japan and the Asian tigers were forced to relocate their production as their currencies rose, the decks were rearranged and a tectonic shift happened in global production capacity. Emerging markets — especially those in Asean, such as Malaysia, Thailand, Indonesia and Vietnam — fuelled by the boom in foreign direct investment became world beaters, recording the fastest gross domestic product growth rates. Given the sheer size of the numbers this time, the potential benefits could be much larger. The geographical spread of the relocation too could be much wider than the previous focus on Asean

Developing nations aspiring to a piece of this pie would be well advised to take a preemptive approach. A passive wait-and-greet policy may not work. More than just positioning themselves, aspiring nations should identify the kind of industry suited to their needs, identify the players within who may want to relocate and reach out to them with the right incentive package. As the skill and talent pool of China's labour force, more than the low cost, is what attracts Western firms, an offer to heavily subsidise the reskilling of their labour to meet the investor's specific needs should be money well spent.

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