

THE PRESIDENTIAL INBOX

U.S.-China Trade Conflict: Opportunities for U.S. Economic and Security Interests in Developing Southeast Asia

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Topline

The current conflict with China over its highly restrictive trade barriers and violations of American intellectual property rights (IPRs) has created a dilemma for U.S. companies that depend on Chinese partners to manufacture goods under their labels or provide critical parts and components for their global operations. Intellectual property--copyrights, patents, trademarks, and processes--represent the "crown jewels" of U.S. high technology and are critical to maintaining our commercial and military edge against an ever more assertive Chinese challenge. President Trump's call for U.S. companies to get out of China has intensified many companies' ongoing efforts to reduce the role of Chinese partners in their global "supply chains." Getting out of China requires relocating to somewhere else. The President has acknowledged that most of this production is unlikely to come home to the U.S. because of higher costs and other factors. The President and Congress can help the relocation of U.S. production to countries and regions that are strategically beneficial to U.S. security and economic interests by:

The Presidential Inbox is an ongoing series examining the international challenges that will face the next presidential administration and providing concrete recommendations for presidential action.

- Using and significantly broadening the vision for the landmark October 2018 BUILD Act (Better Utilization of Investments Leading to Development) to help facilitate the relocation of U.S. companies from China to nearby Southeast Asia countries or other suitable locations.
- Using the new International Development Finance Corporation (DFC), the main feature of the Act, to significantly support U.S. private investment in Vietnam, Malaysia, Indonesia and other developing countries in Southeast Asia through loans, loan guarantees, political risk insurance and in some cases limited equity investments for private sector projects.
- Using the U.S. Agency for International Development (USAID), State, Commerce, Energy and other relevant departments and agencies to promote the necessary legal, policy, regulatory reforms and private sector and governmental capacity to help make potential relocation countries better able to attract and accommodate expanded U.S. manufacturing and services investment.

The Problem

For several years U.S. companies have been looking at alternatives to China in Southeast Asia and some other developing regions. This response responds partly to rising nationalism in China and policies that make doing business more difficult. Even more troubling, China in the past several years has launched an aggressive program to become a major technological power through theft, stealth and even reportedly embedding spyware in components it sells to U.S. and allies' companies, governments, and institutions.

Despite much controversy over how the Trump administration is carrying out its confrontation with China over trade and investment barriers, American sanctions and other actions against these blatant Chinese IPR violations enjoy broad public, congressional and business support.

The immediate consequences of the tit-for-tat U.S. and Chinese tariff increases and sanctions against major Chinese companies like Huawei, have been felt in the heretofore close relationships between U.S. tech companies and their Chinese suppliers. While some attempts to diversify supply sources have hit the headlines, such as those by Apple and Google, the sheer size and technology level of the Chinese industrial base alone makes relocation of production a daunting challenge. Many of the largest American tech companies are so dependent on their Chinese suppliers that it likely will take years, if ever, to establish fully comparable alternatives, but with the help of increased and more effective governmental support, the foreign supplier base of U.S. companies can become significantly more diversified.

Essential Context

Chinese Influence Via BRI is Growing

Relocating U.S. supply chains from China to neighboring countries also faces challenges from Xi Jinping's massive and extremely well-financed "Belt and Road Initiative" (BRI). Through the BRI, launched in 2013, China has been fast expanding its economic and geopolitical influence around its periphery in Asia as well as in Africa and South America. With both land-based and maritime "Silk Roads" the BRI encompasses every kind of economic infrastructure from sea and land ports, roads and highways, conventional and high-speed rail, bridges, energy, telecommunications, and even exclusive Chinese housing estates in neighboring capitals.

Most of the BRI projects are incorrectly characterized as investment when in reality they are primarily financed by loans that are not very concessional and have to be repaid. Some projects have involved major political corruption, poor designs and shoddy construction, and have proved politically destabilizing. Almost all are carried out by giant Chinese state-owned construction and electrical power companies using mostly imported Chinese labor and little or no training and transfer of know-how to the host country.

Critics of the BRI projects warn that they threaten to turn Beijing's smaller and poorer neighbors into captive extensions of the greater Chinese economy. Saddling developing countries with high debt burdens crowds out better-conceived and more broadly beneficial private sector or public-private partnerships projects with better financing terms. Moreover, while the extent of the problem remains a matter of debate, a number of notable project failures in Sri Lanka, Pakistan and Malaysia and related corruption scandals suggest that many Chinese projects fail to deliver the expected benefits while leaving governments with unsustainable debt burdens.

US Investment Opportunities in Southeast Asian Countries are Significant & Welcomed

China can dominate in infrastructure investment when governments focus on upfront rather than lifecycle costs, while the United States more than holds its own in investment and localized production for global markets in Southeast Asia.

Despite the undeniable impact of the BRI funding as measured in hundreds of billions of U.S. dollars, actual Chinese business investment, while growing, is still comparatively small. At around \$329 billion in 2016 (latest data), American companies' direct investment in the 10 countries of the Association of Southeast Asian Nations (ASEAN) is greater than that of Japan, South Korea, China and India combined. While the U.S. runs a trade deficit with ASEAN as a whole, U.S. exports are dominated by high value-added/high technology products and services.

The least developed countries of the region, especially Cambodia, Laos and Myanmar, thus far have held little attraction for U.S. business, mostly because of the relatively small size of their markets, the lack of a fair and effective legal system, poor transportation and other important infrastructure, low education and skills and serious human and labor rights issues.

Their more economically vibrant neighbors, Thailand, Vietnam, Indonesia, Malaysia and the Philippines, however, are all approaching or have achieved middle income status and have fast growing, high consuming middle and professional classes. Their desire to participate in the global economy attracts them to the private sector-led market orientation business models of the U.S. Japan and the EU. Most ASEAN countries see the United States as an important balancer to China. Among the less developed ASEAN countries, Vietnam has emerged not only as a hospitable trade and investment partner, but also a quasi-security partner.

Take Advantage of Investment Authorities Passed in 2018

In 2018, Congress passed the BUILD Act, the most important feature being the merger of the quasi-independent Overseas Private Investment Corporation (OPIC) with the Development Credit Authority ("DCA") of the U. S. Agency for International Development (USAID) into a new International Development Financing Corporation (DFC). The DFC has been given an initial investment and lending cap of \$60 billion--twice that of OPIC before the reorganization-- and more flexibility in how it supports private sector development projects, including the ability to take a minor equity stake and cooperating with other countries' development financing entities.

The Build Act, which has only begun to be operational, has been most frequently mentioned both before and after enactment as a response to China's BRI. Thus far the only proposed project that has been mentioned is a proposal for cooperating with Japan and possibly Australia to build facilities to export U.S. liquid natural gas (LNG) to third countries in Asia, a project that would be of little relevance to companies trying to relocate their supply chains out of China. Observers in the business community profess to be in the dark about the status of the merging of two bureaucracies into the new export and foreign investment financing entity

Policy Recommendations

The administration and Congress should move more quickly to get the DFC up and running to promote U.S. commercial investment and exports in Southeast Asia and especially to help U.S. companies to relocate their operations out of China. The DFC's \$60 billion lending cap pales in comparison with China's hundreds of billion for BRI financing, but it is nonetheless a credible amount with which to lever U.S. private sector investment financing. American companies need enhanced U.S. Government support both to win infrastructure bids and to relocate their supply chain investment and partnerships from China to Southeast Asia and elsewhere. Three administration actions are likely to have the most impact:

- ➔ **Move faster to get the new DFC up and running** and proactively focus its expanded resources and flexibility on helping U.S. companies relocate their operations out of China to Southeast Asia and other suitable regions and countries.
- ➔ **Initiate an all-of-government effort to promote legislation and policy changes** needed to make countries that would welcome increased U.S. trade and investment more attractive to American and other private sector companies.
- ➔ **Engage more deeply with Japan, Australia and other developed country governments and their major industry groups** to find areas of cooperation for development assistance and participation in projects where the respective industry sectors have mutually complementary comparative advantages.

Additional Resources

- **Mekong Power Shift: Emerging Trends in the GMS Power Sector.** A report in Stimson's *Letters from the Mekong* series: <https://www.stimson.org/content/letters-mekong-mekong-power-shift-emerging-trends-gms-power-sector>
- **Powering Up: Mekong Basic Connect.** A project summary highlighting sustainable investment opportunity in the Mekong Delta: <https://www.stimson.org/content/powering-mekong-basin-connect>
- **Toward a Sustainable water Energy Foot Future in Cambodia.** A report in Stimson's *Letters from the Mekong* series: <https://www.stimson.org/content/letters-mekong-toward-sustainable-water-energy-food-future-cambodia-o>