Supply Chain Diversification from China to Southeast Asia-5

Policy Comparisons and Key Findings

April 2024

Executive summary

In certain policy domains, Southeast Asia-5 (SEA-5)* is closing the gap with China

- Labor costs in SEA-5 are lower than in China, but China boasts a labor force three times larger than SEA-5 combined.
- While most SEA-5 countries have lower labor productivity than China, Thailand and Indonesia are narrowing the gap, with Malaysia even surpassing China in productivity
- SEA-5 generally offers lower corporate tax rates than China and extensively employs tax incentives to attract more foreign investments

Supply chain diversification to SEA-5 is underway, but completely replacing China poses challenges

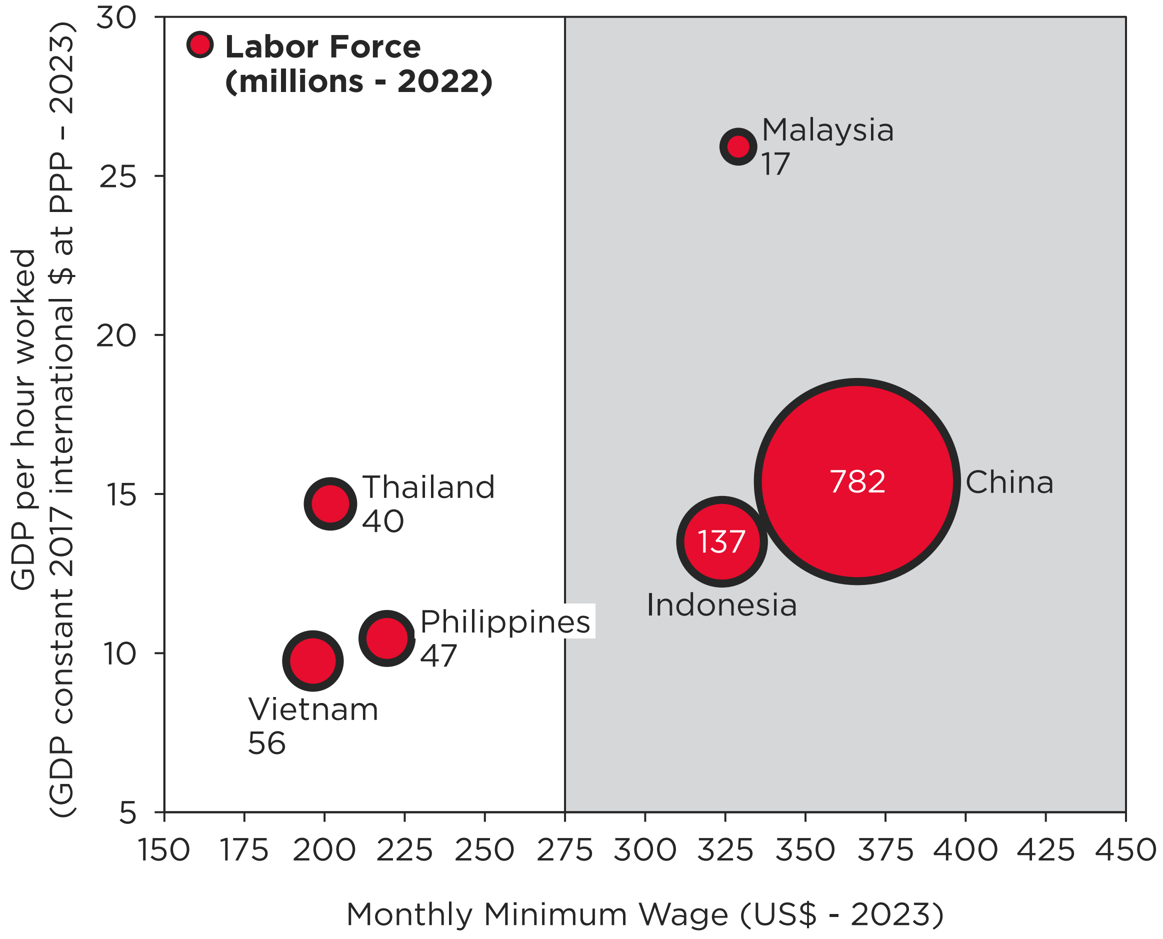
- Escalating geopolitical tensions, particularly between China and the US and EU, are driving businesses to diversify their supply chains to SEA-5
- SEA-5 faces challenges fully replacing China due to its entrenched position in the global value chain and SEA-5′s reliance on imported intermediate goods from China
- Climate concerns are driving SEA-5 to expand manufacturing capacity while minimizing carbon intensity

* Indonesia, Malaysia, Philippines, Thailand, and Vietnam

SEA-5's labor cost is lower, but China's labor force is bigger

SEA-5's corporate tax is lower than China

SEA-5 LABOR COST, FORCE, AND PRODUCTIVITY V. CHINA



Source: CEIC, ILO, PwC, Onyx

CORPORATE INCOME TAX (CIT) RATE AND INCENTIVES

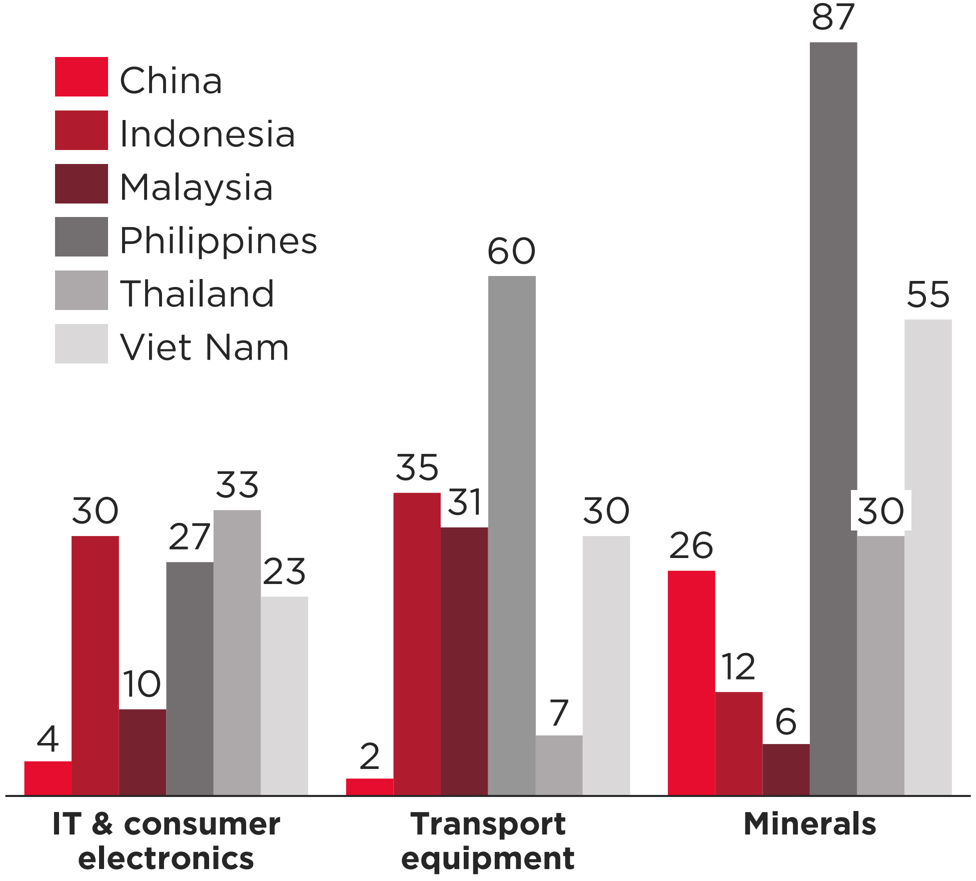
	Tax Rate	Tax Incentive
CHN	25%	▪ Reduced tax rate for high and clean-tech companies ▪ Geographical preferential tax rate
PHL	25%	▪ Income tax holiday for export-oriented enterprises
MYS	24%	▪ Tax incentives for manufacturing, EV and aerospace industries
IDN	22%	▪ Tax allowance for investments in specific sectors and regions
THA	20%	▪ Tax incentives for select sectors and R&D activities
VNM	20%	▪ Minimum CIT of 15% following OECD GMT; new non-tax incentives

SEA-5's trade performance is catching up in three sectors

And Malaysia and Thailand are closing in on logistics performance

2022 TRADE PERFORMANCE INDEX BY SECTOR

RANKING: 1 (HIGHEST) – 100 (LOWEST)



SEA-5 LOGISTICS PERFORMANCE SCORECARD V. CHINA

2023 INDEX: 5 (HIGHEST) – 1 (LOWEST)

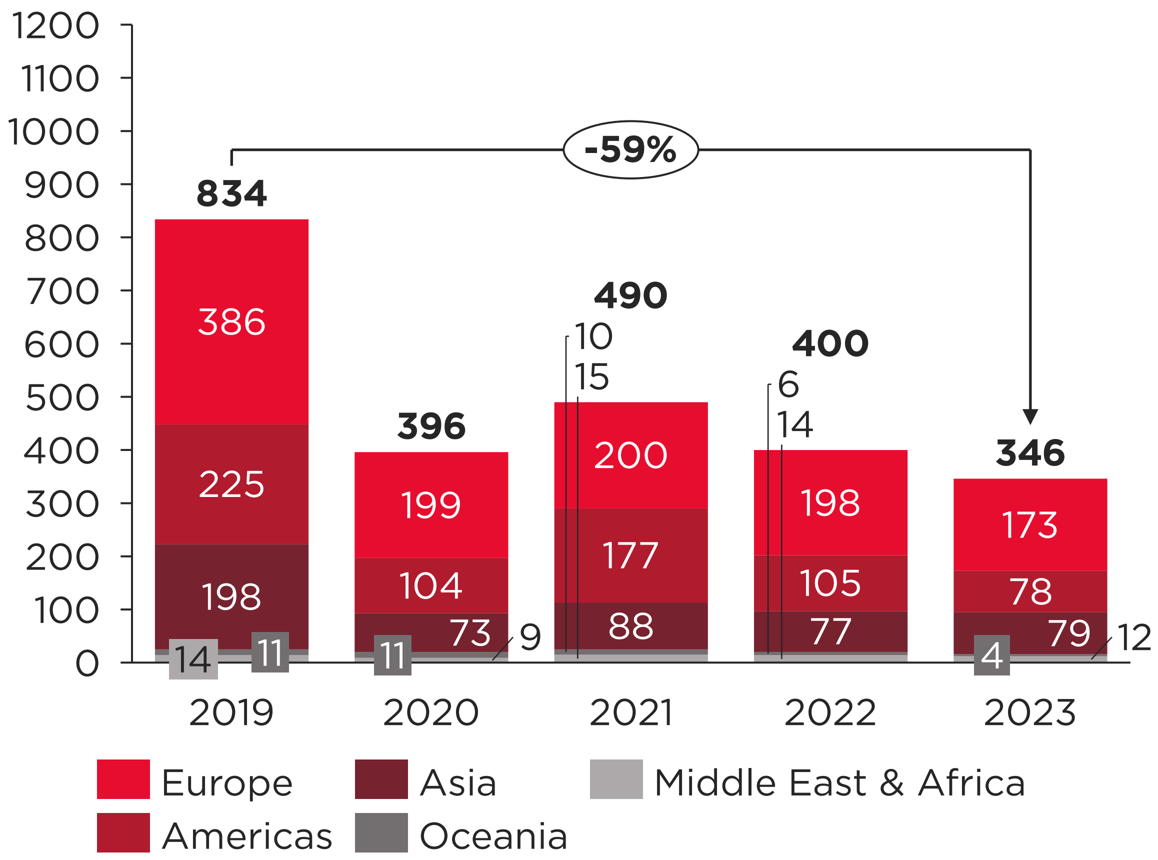
KEY LOGISTICS PERFORMANCE INDEX (LPI) DIMENSION	CHN	MYS	THA	VNM	PHL	IDN
OVERALL LPI	**3.7**	**3.6**	**3.5**	**3.3**	**3.3**	**3**
CUSTOMS	3.3	3.3	3.3	3.1	2.8	2.8
INFRASTRUCTURE	4	3.6	3.7	3.2	3.2	2.9
INTERNATIONAL SHIPMENTS	3.6	3.7	3.5	3.3	3.1	3
LOGISTICS QUALITY & COMPETENCE	3.8	3.7	3.5	3.2	3.3	2.9
TIMELINESS	3.7	3.7	3.5	3.3	3.9	3.3
TRACKING & TRACING	3.8	3.7	3.6	3.4	3.3	3

Source: ITC, World Bank, Onyx

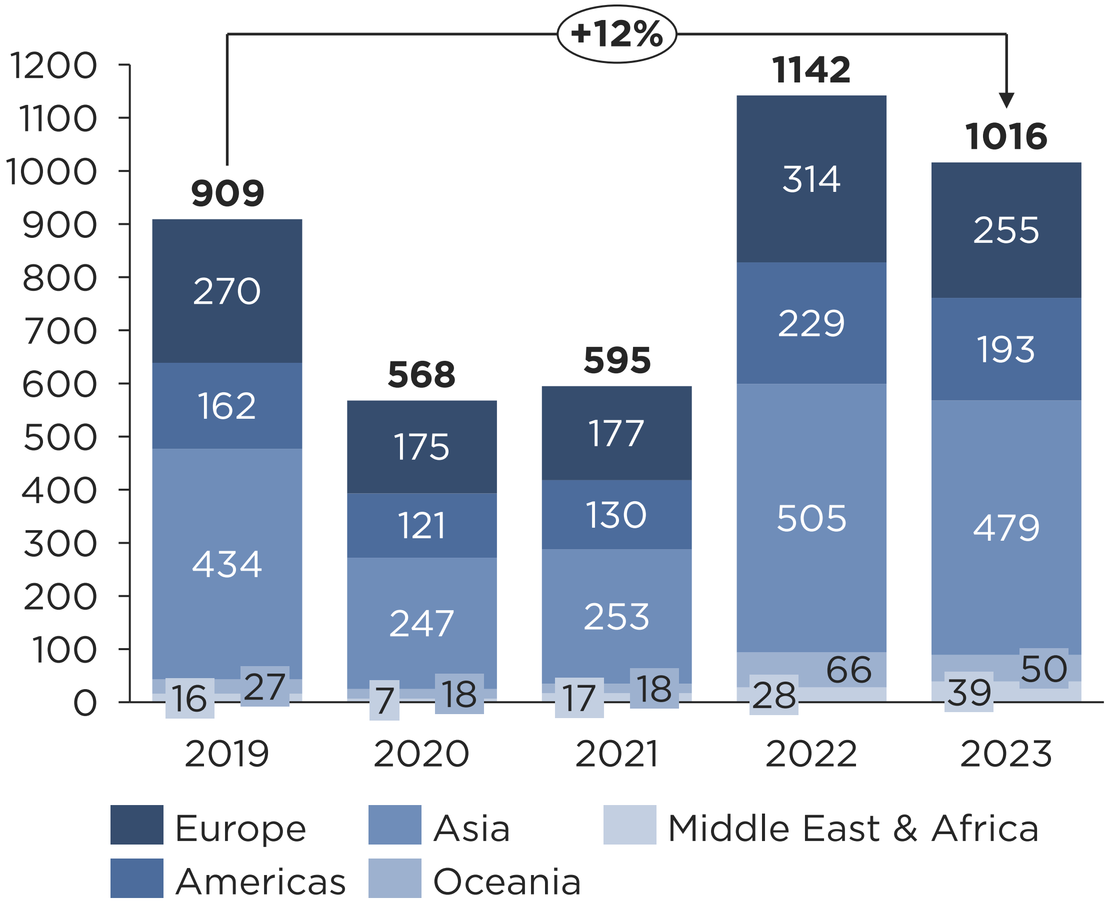
Investment in China plunges but increases in SEA-5

Indicating a diversification of foreign investment from China amid geopolitical tensions

NUMBER OF FDI PROJECTS TO CHINA BY ORIGIN
TOTAL FIGURE FOR 2019-2023



NUMBER OF FDI PROJECTS TO SEA-5 BY ORIGIN
TOTAL FIGURE FOR 2019-2023

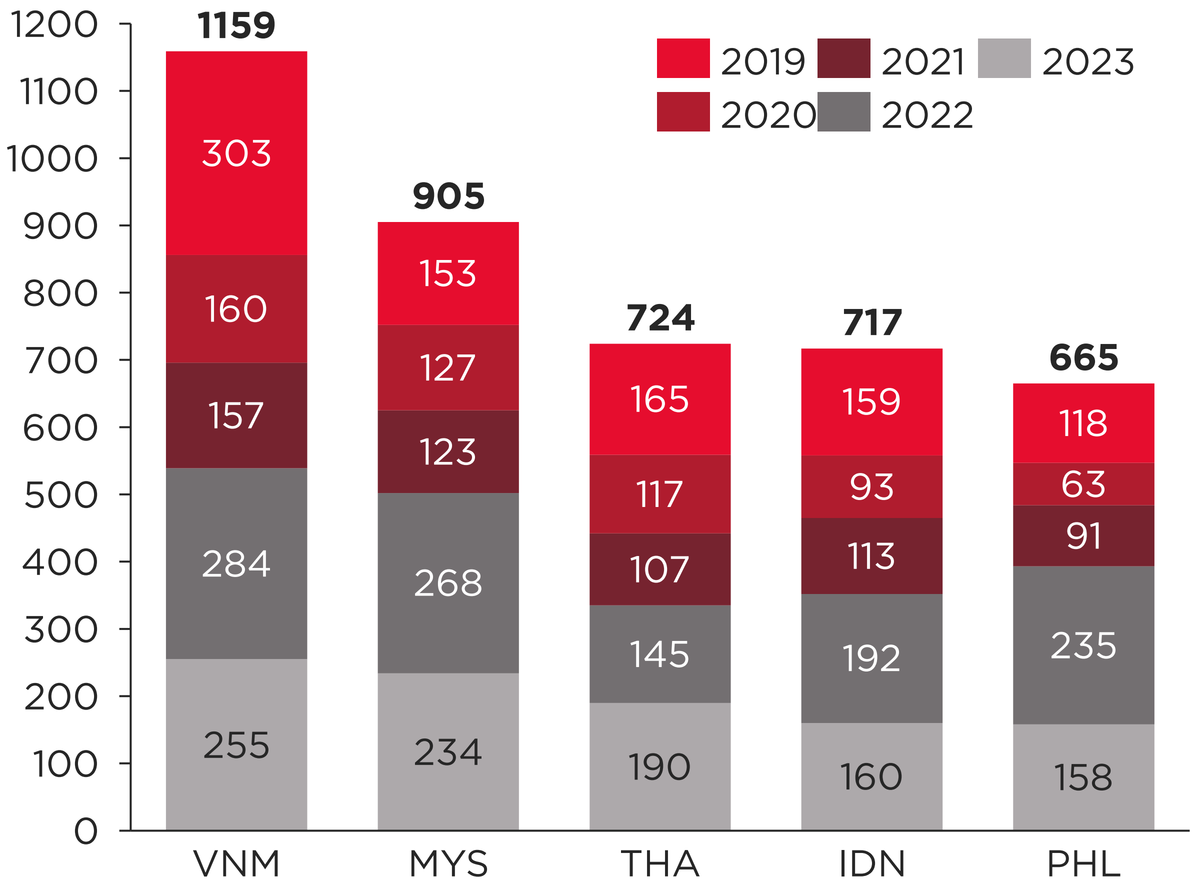


Source: GlobalData, Onyx

Vietnam and Malaysia are the top two destinations

Competitive labor costs and policy incentives are key attractors

NUMBER OF FDI PROJECTS TO EACH SEA-5 COUNTRY BY ORIGIN
TOTAL FIGURE FOR 2019-2023



Factors boosting FDI to VNM and MYS

- US-China tensions
- Economic environment improvements and labor cost competitiveness
- Government policy for tech and manufacturing industries
- Infrastructure investment and industrial development plan

WHAT TO WATCH FOR

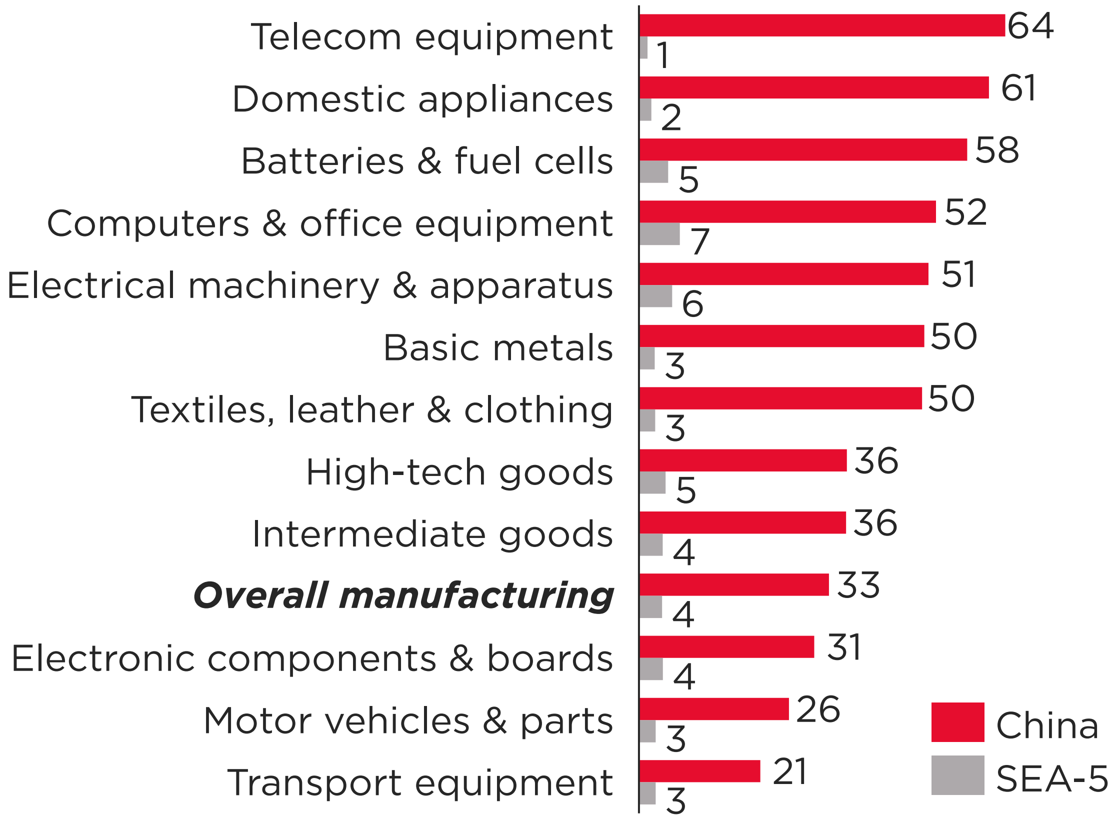
- Labor shortages
- Input cost pressure
- Logistics performance
- ESG – in particular, environmental concerns

Source: GlobalData, Onyx

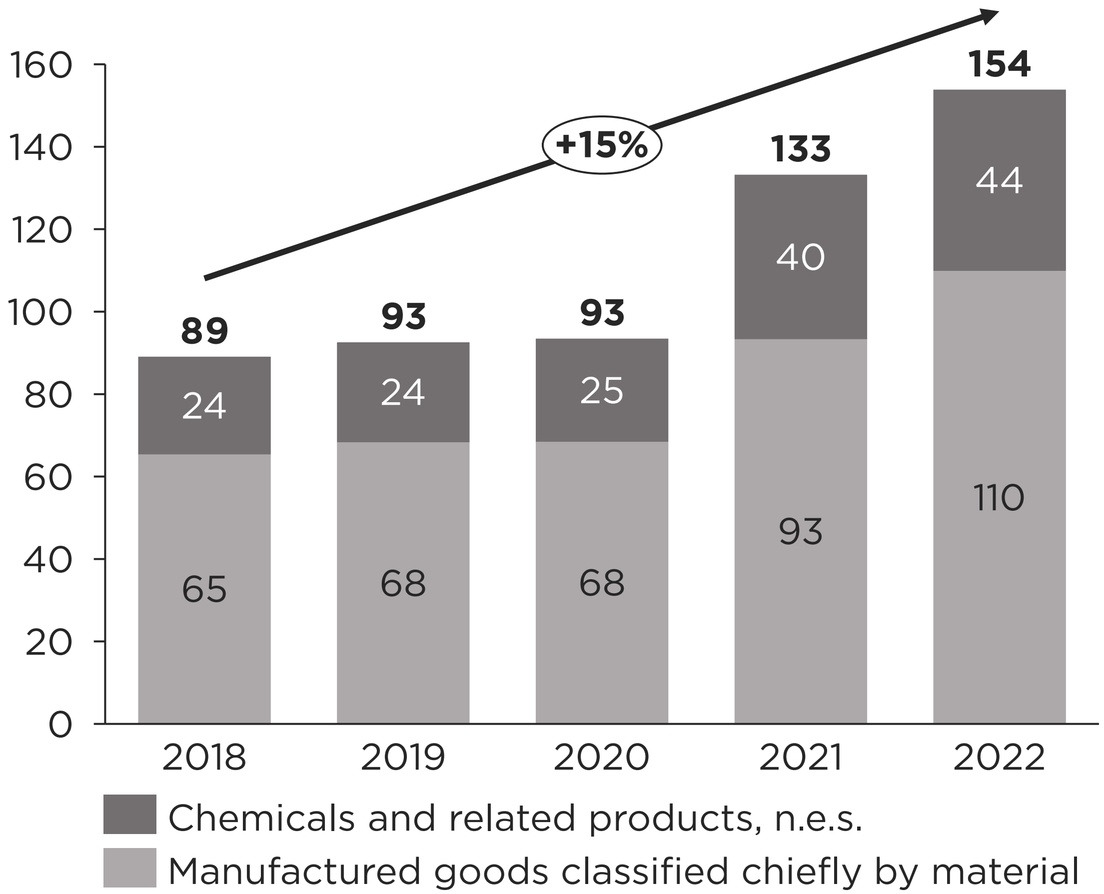
However, fully replacing China is challenging for SEA-5

Due to China's deep positioning in global value chain and SEA-5's dependency on intermediate goods import from China

MANUFACTURING OUTPUT, CHINA V. SEA-5
% OF WORLD TOTAL, VALUE ADDED, 2023



CHINA'S EXPORT OF INTERMEDIATE GOODS TO SEA-5
US$ BILLION

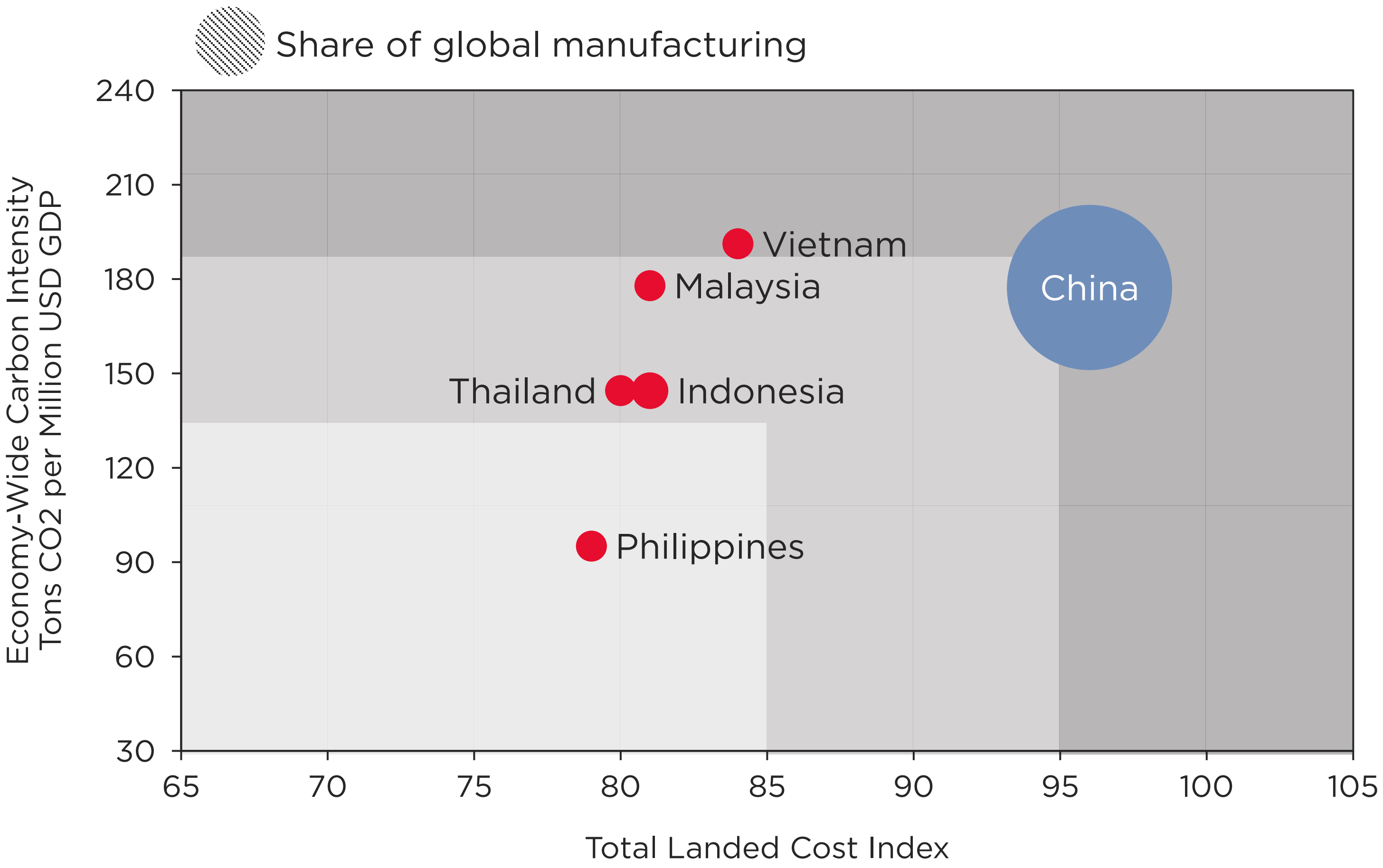


Source: TradeMap, Oxford Economics, Onyx

Increasing climate concern complicates de-risking efforts

SEA-5 needs to increase its manufacturing capacity while keeping carbon intensity low

TOTAL LANDED COST AND CARBON INTENSITY



LIMITED ALTERNATIVES

- China’s manufacturing base is more than 5x the size of SEA-5 combined
- Companies must invest heavily in new capacity paired with renewable energy

SEA-5 DUAL CHALLENGE

- Historically, industrialization has come with emissions
- SEA-5 countries will need to grow their manufacturing base while simultaneously decarbonizing

LOW-HANGING FRUIT

- Renewable power is the most scalable and economically viable solution
- Decarbonizing heavy industrial processes requires carbon costs of $50 to $100 per ton or more

Source: Oxford Economics, BCG, Onyx

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