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PERSPECTIVE

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What Can Malaysia Expect from IPEF?

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US Trade Representative Katherine Tai (C) speaks during a ministerial pillar meeting at the Indo-Pacific Economic Ministerial in Los Angeles, California, on 8 September 2022. Photo by Frederic J. BROWN/AFP.

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EXECUTIVE SUMMARY

- To re-engage economically with the Indo-Pacific region, US President Biden launched the Indo-Pacific Economic Framework for Prosperity (IPEF) in May 2022, with 14 countries signing on, half of them from ASEAN.

- More of a framework for setting rules and standards than a free trade agreement, it comprises four policy pillars: trade; supply chains; clean economy; and fair economy.

- For Malaysia, IPEF could help restore market access to the US by relaxing Withhold Release Orders (WROs) that ban exports of companies facing forced labour allegations.

- Malaysia also expects that the ease and frequency with which trade sanctions are applied in the future will be better managed as a result of IPEF.

- One problem with IPEF is that, without the inclusion of China, it is of limited usefulness to countries with China-centred supply chains, like Malaysia. Worse than that, any potential benefits could be more than offset if it fuels US-China tensions and leads to actions that further disrupt supply chains and trade.

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INTRODUCTION

In a bid to re-engage economically with the region, United States (US) President Biden launched the Indo-Pacific Economic Framework for Prosperity (IPEF) in Tokyo on 23 May 2022. Malaysia joined six other Association of Southeast Asian Nations (ASEAN) fellow members – Brunei Darussalam, Indonesia, the Philippines, Singapore, Thailand and Vietnam – to sign on as participating countries, together with Australia, Fiji, Japan, India, Republic of Korea, and New Zealand. These countries account for about 40 per cent of world GDP.

The much-awaited return of the US to the region as an economic partner was met with great expectations, and standards by which IPEF is to be judged have been set accordingly high, also leaving a lot of room for disappointment. Expectations may be unreasonably high because they are probably still based on the view that the US is the original guarantor of a rules-based trading order, rather than its more recent performance that has seen it undermine the World Trade Organisation's (WTO's) Dispute Settlement Mechanism and disregard some of its rulings, such as against the Trump tariffs on iron and steel, among other things.

This Perspective is in four parts. The next two sections provide context by first introducing IPEF and its structure before reviewing Malaysian trade policy, focussing on its free trade agreements (FTAs) and trade governance. The section after that deals with the two most important pillars for Malaysia, i.e. trade and supply chains. The discussion on these two pillars is combined because it does not make sense to separate the two from an economic point of view for a country like Malaysia, albeit that it might be from a national security or geopolitical standpoint for a country like the US. (For completeness, the pillars on clean and fair economy are discussed in the Appendix because there is little here that is likely to have material impact on Malaysian policy making.) A final section concludes.

WHAT IS IPEF?

IPEF is not an FTA or a traditional trade agreement but more of a framework for setting rules and standards. It is also a White House Initiative, and the Biden administration has indicated that it will not be submitted to Congress for approval but will be implemented in whole or in part through Executive Order (see Freeman 2022). The framework comprises four policy pillars: trade; supply chains; clean economy (energy, decarbonisation and infrastructure); and fair economy (tax and corruption). Employing a modular approach, member countries can choose which policy pillar to sign up for but have to abide by all the commitments within the selected pillar(s).

The lack of market access provisions through the exchange of concessions is greatly lamented, and calls for reconsideration to bring them back onto the negotiating agenda are frequent. IPEF is very much about market access, however, but just not in the way that it is traditionally understood. While it may not improve market access of IPEF members to the US, it will certainly affect market access of US firms to other members' markets, because almost every other item on the agenda, from digital trade rules to environmental or labour standards, will affect competitiveness. In the same vein, Malaysia's interpretation of market access, as will be shown, is also slightly different and IPEF could be used to serve its interests in this area.

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THE MALAYSIAN TRADE POLICY CONTEXT

Malaysia is a small, open economy that has a long history of embracing free and open trade and investment policies. In fact, prior to the 1997-98 Asian Financial Crisis, Malaysia was often hailed as a model worthy of emulation by the developing world of how such liberal trade and investment policies could transform economies and avoid the middle-income trap.

Malaysia has pursued liberalisation through its participation in the WTO and through unilateral actions and FTAs. As of June 2023, Malaysia is implementing 18 FTAs (Table 1) and is negotiating five more.[1] It has bilateral FTAs with 4 IPEF member countries – Australia, India, Japan and New Zealand – and is in the process of negotiating one with two others – Republic of Korea and the US.

Table 1

Malaysia's Trade Agreements 'In Effect', June 2023

IPEF Members (1)	Trade Agreement	Entry into Force
IPEF (7)	ASEAN Free Trade Area	1993
IPEF (3)	ASEAN-Australia and New Zealand Free Trade Agreement	2010
--	ASEAN-Hong Kong, China Free Trade Agreement	2019
IPEF (8)	ASEAN-India Comprehensive Economic Cooperation Agreement	2010
IPEF (8)	ASEAN-Japan Comprehensive Economic Partnership	2008
--	ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement	2005
IPEF (8)	ASEAN-Republic of Korea Comprehensive Economic Cooperation Agreement	2007
IPEF (2)	Australia-Malaysia Free Trade Agreement	2013
IPEF (7)	Comprehensive and Progressive Agreement for Trans-Pacific Partnership	2018
IPEF (2)	India-Malaysia Comprehensive Economic Cooperation Agreement	2011
IPEF (2)	Japan-Malaysia Economic Partnership Agreement	2006
--	Malaysia-Chile Free Trade Agreement	2012
--	Malaysia-Pakistan Closer Economic Partnership Agreement	2011
--	Malaysia-Türkiye Free Trade Agreement	2015
IPEF (2)	New Zealand-Malaysia Free Trade Agreement	2010
IPEF (2)	Preferential Tariff Arrangement-Group of Eight Developing Countries	2011
IPEF (11)	Regional Comprehensive Economic Partnership	2022
--	Trade Preferential System of the Organization of the Islamic Conference	2022

Source: Asia Regional Integration Center, ADB. https://aric.adb.org/fta
Notes: The number in parentheses refers to the number of countries participating in IPEF

Despite negotiations having commenced in 2006, Malaysia does not look like ever concluding an FTA with the US, and this raises the question as to the extent IPEF can effectively substitute for the absence of such an FTA. The short answer appears to be 'very little, if at all'. So far, the US is not providing the same treatment to IPEF members as it is to countries that it has an FTA with. A stark contrast that highlights this discrepancy arises in relation to the clean economy pillar and 'green' investments (more later).

The question of overall value-addition combined with the recent political and policy climate in Malaysia may also affect the appetite to aggressively pursue a new and challenging agreement like IPEF. Since 2020, Malaysia has had four Prime Ministers and three Ministers of the

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Ministry of International Trade and Industry (MITI). To provide context, it has had the same number of Prime Ministers and Minsters of MITI in the last 3 years as it has had in the preceding 3 decades. In short, the political and trade policy environment has been in a state of flux over recent years. This is one reason for the delay in ratifying the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which finally happened on 30 September 2022, making it only the 9th (out of 11) member to do so.

Some stability has returned with the current Anwar Ibrahim administration, with Tengku Zafrul Aziz, the former Finance Minister, in charge of MITI. The CPTPP came into effect on 29 November 2022, soon after the Anwar administration took office. The current administration has reiterated support for the CPTPP, despite some concerns from domestic lobbies, and the Minister of MITI had the following to say in January 2023: "There were obviously some issues that were raised by various groups, and we have addressed that by taking action to mitigate some of the concerns, so we are very much committed to participating in it (CPTPP)."[2]This bodes well for the current administration's free trade credentials, and therefore for the IPEF.

TRADE AND SUPPLY CHAINS (PILLARS 1 AND 2)

As noted, pillars 1 and 2 on trade and supply chains, respectively, are the most important to Malaysia. In fact, most of Malaysia's trade involves supply chains and separating the two does not make much economic sense for a country like Malaysia. Nevertheless, the issues covered in the trade pillar have already had a significant impact on trade relations with the US, particularly as they relate to labour and environmental standards.

Former MITI Minister Azmin Ali has indicated that Malaysia sees IPEF as providing a platform to open engagement with the US in resolving the withhold release orders (WROs) that have been imposed by US authorities on Malaysian exports (MIDA 2022). US authorities currently have six active WROs on Malaysian companies, four on rubber gloves and two on palm oil, due to allegations of forced labour. The WROs prohibit the import of products originating from companies facing forced labour allegations.

Will IPEF be able to deliver on helping address the WROs or other punitive trade measures? Two out of the six WROs have been modified in early 2023 and there is another precedent of sorts that provides room for optimism that IPEF can help. Just two weeks after IPEF was launched on 23 May 2022, the Biden administration lifted a transhipment ban that had been imposed following a complaint by a US-based solar company. Malaysia (along with Cambodia, Thailand and Vietnam) was suddenly provided with a 24-month tariff exemption in the US market for their exports of solar cells and modules. The timing suggests a possible link between the two events.

Therefore, even if IPEF does not include the exchange of market access concessions in the traditional sense, it may provide the opportunity to reverse binding restrictions and restore market access for countries like Malaysia. It may also allow Malaysia an avenue to better manage similar issues should they arise in the future.[3] The recent relaxation of WROs on two companies and the 24-month tariff exemption following the transhipment allegations on solar products suggest that this might be possible. Nevertheless, the increasing influence of the US Department of Commerce in setting the trade agenda (see Alden, 2022; 2023) has increased the weaponisation of trade policy. This needs to be checked and better managed for fear that

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its impacts on a growing number of non-trade related areas will cause significant disruption to countries on the receiving end.

Malaysia is keen to grow its digital economy and the rules relating to it coming from IPEF may be significant. If the IPEF negotiations on digital trade and data flows can further the agenda beyond that of other bilateral (eg. the Framework of Cooperation with Singapore), regional (CPTPP, but also ASEAN, APEC, etc.), or multilateral (WTO) initiatives, then the impact of IPEF could be transformative. Details are still sparse, but the potential is certainly there to make IPEF a significant part of Malaysia's trade policy. The negotiations in this area are not without risk, however. With the European Union and China also pursuing their own approaches to digital governance, the possibility of a "splinternet" emerging that fractures the global system needs to be avoided.

Malaysia will also be impacted by the first tangible results of the year-long negotiations, relating to supply chain resilience. Following the meeting in Detroit on 27 May 2023, US Commerce Secretary Gina Raimondo announced "substantial progress" towards an IPEF Supply Chains Agreement, although the final text is yet to be agreed upon.

Three new structures are being created to operationalise the agreement:

1. The first is the IPEF Supply Chain Council, which is supposed to better coordinate supply chain activities and help build resilience and competitiveness in certain critical sectors. The council will apparently oversee the development of "action plans" for these sectors that may help companies identify and address supply chain vulnerabilities.

2. Second is an IPEF Supply Chain Response Network that is designed to give early warnings to IPEF countries of potential supply disruptions. With a new "emergency communications channel", it is expected that IPEF members can streamline communication and coordinate a response when one or more IPEF parties faces a supply chain crisis.

3. Finally, an IPEF Labor Rights Advisory Board made up of government, worker, and employee representatives is being proposed. This Board is apparently required to identify areas where certain labour rights are being violated.[4]

Although a tangible outcome such as the IPEF Supply Chain Agreement after just one year should be welcomed, the operational details are not yet available and need to be studied before any judgement on its practical use can be made. A careful study of the Press Statement on the Substantial Conclusion of IPEF Supply Chain Agreement Negotiations, posted on the US Department of Commerce official website,[5] reveals very little of substance, unfortunately. In fact, Beattie (2023) describes the announcement, which is all that is available as of July 2023, as "a mass of abstract verbiage with a tangle of subclauses festooned with adjectives and adverbs layered two or three deep." In short, it is mostly aspirational and very thin on practical details, with what little details that are provided being so heavily qualified that they can be interpreted to suit a diverse range of interests.

What we do know, however, is that China is not a part of IPEF or this agreement, and this is a major concern to Malaysia and other ASEAN members involved in regional supply chains.

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This is because almost all manufacturing supply chains that involve Malaysia and other ASEAN countries are China-centred. It is with this pillar that the exclusion of China is most significant, and greatly undermines its value to a country like Malaysia. The high level of interdependence that characterises supply chains highlight the importance of including all players, especially critical ones like China. The exclusion of China is a major constraint and could undermine the usefulness of this pillar to ASEAN members of IPEF, including Malaysia.

More than being of limited use by excluding China, the supply chain agreement could actually harm Malaysia and other countries with China-centred supply chains. This is because the US expects to get IPEF members to buy into its ‘resilience and competitiveness’ framework and support its national security interests by limiting engagement and dependency on China. Arasasingham *et al.* (2023) argue that the US hopes the agreement will encourage other members to also start reshaping their supply chains in line with the broader US friend-shoring agenda that incentivises supply chain relocation to countries that do not pose a perceived national security threat. In exchange for this, members are being offered various capacity building and training programmes, and the possibility of greater FDI flows during an unspecified future. This is not a bargain that countries like Malaysia are likely to find beneficial.

When it comes to regional supply chains, an early warning system will only be useful if its predictions are reliable. This in turn will depend on how willing member states are to share information on a timely basis. Although supply chain networks are characterised by a high level of interdependence, countries involved can sometimes operate more as competitors than collaborators, and may not always be willing to share information on a timely basis, especially if it is considered to be sensitive or proprietary in nature.

The supply chain initiative needs to be able not only to identify emerging risks but also be able to respond to them in an effective and timely manner. All of this suggests that the details need to be examined before the initiative is hailed as a breakthrough, as some have already done.[6]

As noted earlier, embedded within the supply chains agreement is a new labour rights advisory board aimed at raising labour standards in supply chains. Labour issues were meant to be part of Pillar 1 on trade but has also found its way into Pillar 2 on supply chains and could arise in other pillars as well, further emphasising the so-called ‘worker-centric’ nature of IPEF. The extent to which this body will raise standards to protect workers as opposed to removing the cost competitiveness that developing countries have with labour supply, is yet to be seen. Suffice to say that developing countries tend to view the introduction of labour standards into trade negotiations with a high level of suspicion.

CONCLUSION

Using trade agreements to pursue non-economic ends, whether through formal FTAs or frameworks like IPEF, is neither new nor unique to the US. In fact, most trade agreements probably have more to do with international diplomacy and politics than with trade or investment. IPEF is not an exception. The outstanding trait with IPEF, however, is how much it asks of its members in return for how little it promises to provide – it is almost all stick and no carrot. This is particularly problematic since there is no mechanism to bind countries to make good on their commitments.

What Malaysia expects to derive from IPEF may differ from that of other members. For Malaysia, participation in IPEF could serve as insurance against punitive trade policy actions by the US and provide the opportunity to resolve existing trade frictions. IPEF could help restore market access by relaxing the remaining Withhold Release Orders (WROs) on four companies banning their exports to the US market. Malaysia also expects that the ease and frequency with which trade sanctions are applied in the future will be better managed as a result of IPEF.

A remaining unknown relates to digital trade. The potential exists for IPEF to be transformative for countries like Malaysia if it can deliver in this area in a way that moves the frontier while avoiding the risk of a "splinternet" emerging.

These potential benefits of IPEF need to be weighed against a worst case but highly plausible scenario where the creation of IPEF further fuels US-China tensions and leads to further retaliatory actions. This is likely if IPEF is viewed as an attempt by the US to export its national security agenda to the region. If retaliatory actions further disrupt the operations of regional supply chains, possibly causing bifurcation, then the cost to Malaysia and other ASEAN countries may be so high as to outweigh any benefits.

The problem is that the IPEF without China is, to a large extent, economically meaningless to countries like Malaysia, and potentially quite disruptive and costly. To expect that this might change would be unrealistic if a key underlying motivation of its main proponent(s) is to counter the rise of China's influence in the region, which appears to be the case.

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APPENDIX

CLEAN ECONOMY AND FAIR ECONOMY (PILLARS 3 AND 4)

For the issues covered in the pillars on clean and fair economy, Malaysia's main policy response will be determined by either national actions and priorities or commitments to existing international agreements, rather than IPEF. For clean energy, Malaysia has updated its Nationally Determined Contribution target to reach net-zero greenhouse gas emissions by 2050. This is a major challenge[7] and IPEF could play a complementary role in helping Malaysia meet its commitments, but not with its current configuration. At the moment, IPEF will not have much of an impact unless it is upgraded to at least the standard applied in US FTAs.

The US has comprehensive FTAs in force with 20 countries, of which four are in IPEF, namely Australia, Republic of Korea, Japan and Singapore. Since Malaysia has not concluded an FTA with the US, it will not receive the same treatment as these four IPEF members or other non-IPEF countries that the US has an FTA with, and this discrepancy is at its greatest in relation to the green economy.

The Inflation Reduction Act (IRA) grants tax credits to companies if a certain percentage of the value of critical minerals in electric vehicle batteries, for instance, is extracted or processed in the US or in FTA partner countries but this does not automatically extend to IPEF members. The fact that a critical minerals agreement was signed with Japan in March 2023 as a bilateral deal that allows it to access IRA tax credits further erodes the relevance of IPEF to other members. It is this type of discrimination that is undermining the value of IPEF, in particular, and as a serious attempt to economically re-engage with the region, in general.

With respect to the pillar on fair economy, it should be noted that Malaysia is already a signatory to the Multilateral (Tax) Instrument to Prevent Base Erosion and Profit Shifting, or BEPS. There are also various governance issues relating to corruption and the performance of Government Linked Companies (GLCs) that need to be addressed, but this will mainly require national actions (Menon and Ng, 2019). Furthermore, now that Malaysia has ratified the CPTPP, there may be little that IPEF can add to the binding commitments already made to the reform agenda in this area.

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ENDNOTES

[1] The five FTAs that Malaysia is negotiating are with the European Union, the Gulf Cooperation Council, Iran, Republic of Korea and the US.
[2] Quoted in "Malaysia 'fully committed' to CPTPP, says Tengku Zafrul", *Free Malaysia Today,* 5 January 2023. https://www.freemalaysiatoday.com/category/highlight/2023/01/05/malaysia-is-fully-committed-to-cptpp-says-tengku-zafrul/
[3] While this is beneficial to Malaysia, it may compromise the integrity of trade policy measures in general, if it is subject to new forms of political or lobbying pressure.
[4] Analysing the language in the agreement's press statement, Arasasingham *et al.* (2023) suggest that the advisory board could recommend action under a new facility-specific mechanism for addressing allegations of labour rights inconsistencies similar to that in the United States-Mexico-Canada Agreement's (USMCA's) Facility-Specific Rapid-Response Labor Mechanism. An important difference with the USMCA's Rapid-Response mechanism relates to enforcement, however, as the IPEF mechanism will not be binding or reciprocal as congressional approval is unlikely.
[5] The full text can be found here: https://www.commerce.gov/news/press-releases/2023/05/press-statement-substantial-conclusion-ipef-supply-chain-agreement
[6] For instance, Commerce Secretary Gina Raimonda had the following to say in announcing the Agreement: "I can tell you I would have loved to have had that Crisis Response Network during COVID. It absolutely would have helped us secure American jobs and keep supply chains moving" (quoted in Lawder, 2023). How a Crisis Response Network that excludes a critical player like China might have helped keep supply chains moving during a global pandemic that shut down economies around the world for months on end seems incredibly optimistic. If anything, the pandemic demonstrated how resilient supply chains already were, despite the incredible pressures that they were faced with (see Menon, 2022). At best, a properly functioning early warning system may help with limiting the fallout from a country- or region-specific shock, given the highly interdependent nature of supply chain networks, but not a global shock.
[7] The International Renewable Energy Agency has noted that meeting the target would require a doubling in investments in renewable energy transition to at least US$375 billion in order to expand renewables capacity, infrastructure and energy efficiency (Chu, 2023).

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