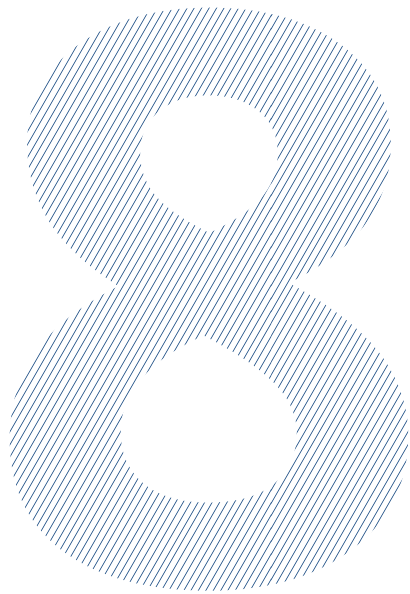


# The Making of the Indo-Pacific Economic Framework for Prosperity (IPEF)



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# **Malaysia's Interests in the IPEF:** Managing Trade Frictions and Restoring Market Access

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Jayant MENON

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To re-engage economically with the Indo-Pacific region, United States (US) President Biden launched the Indo-Pacific Economic Framework for Prosperity (IPEF) in May 2022. For Malaysia, the 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 the IPEF. These potential benefits of the IPEF need to be weighed against a worst case scenario where the creation of the IPEF further fuels US-China tensions. Another problem is that the IPEF without China is almost economically meaningless 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 leading to actions that further disrupt supply chains and trade.

## List of Abbreviations

|              |   |
|--------------|---|
| <b>APEC</b>  | Asia-Pacific Economic Cooperation                                     |
| <b>ASEAN</b> | Association of Southeast Asian Nations                                |
| <b>BEPS</b>  | Base-Erosion and Profit-Shifting                                      |
| <b>CMIM</b>  | Chiang Mai Initiative Multilateralisation                             |
| <b>CPTPP</b> | Comprehensive and Progressive Agreement for Trans-Pacific Partnership |
| <b>FDI</b>   | Foreign Direct Investment   |
| <b>FTA</b>   | Free-Trade Agreement  |
| <b>G7</b>    | Group of Seven  |
| <b>GATT</b>  | General Agreement on Tariffs and Trade                                |
| <b>GLCs</b>  | Government Linked Companies   |
| <b>IPEF</b>  | Indo-Pacific Economic Framework                                       |
| <b>IRA</b>   | Inflation Reduction Act   |
| <b>MITI</b>  | Ministry of International Trade and Industry                          |
| <b>RCEP</b>  | Regional Comprehensive Economic Partnership                           |
| <b>US</b>    | United States   |
| <b>USMCA</b> | United States-Mexico-Canada Agreement                                 |
| <b>USTR</b>  | United States Trade Representative                                    |
| <b>WROs</b>  | Withhold Release Orders   |
| <b>WTO</b>   | World Trade Organization  |



## 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) 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.

The much-awaited return of the US to the region as an economic partner was met with great expectations, and the standards by which the IPEF was to be judged were set accordingly high, also leaving a lot of room for disappointment, especially in terms of perceived benefits and costs. 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 Organization's (WTO's) Dispute Settlement Mechanism and disregard some of its rulings, among other things.

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 price for this flexibility is possible 'cherry-picking', which has already seen India pull out of the Trade Pillar and could leave difficult reforms behind.<sup>1</sup>

The IPEF is not a Free-Trade Agreement (FTA) or a traditional trade agreement. In this respect, the lack of market access provisions through exchange of concessions is greatly lamented and calls for reconsideration to bring them back onto the negotiating agenda are frequent. The 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 the 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 is also slightly different and the IPEF could be used to serve its interests in this area.

For Malaysia,<sup>2</sup> the IPEF is important in at least two ways, as it relates to the Trade and Supply Chain Pillars. The first relates to market access. In Malaysia's case, it is not so much about increasing market access to the US but about restoring market access where it has been denied and then preserving it. That is, reversing the remaining Withhold Release Orders (WROs)<sup>3</sup> that currently ban exports to the US market and ensuring that the ease and frequency with which trade sanctions are applied in the future is better managed.

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1 Jayant Menon, Tham Siew Yean and Maria Monica Widharja, "Biden wants Asia to trade with the US as an 'alternative to China' but details are scant", *Channel News Asia Commentary*, 3 June 2022, <https://www.channelnewsasia.com/commentary/us-biden-ipef-asean-indopacific-china-trade-economic-partnership-2722771>

2 Malaysia does not have an explicit Indo-Pacific strategy, although the Indo-Pacific is frequently referred to in various defence and other non-economic policies and strategies. Therefore, apart from participating in the ASEAN Outlook on the Indo-Pacific, it is the IPEF that will form the basis of any formal economic engagement with the US and the Indo-Pacific region.

3 "Withhold Release Orders and Findings List", US Customs and Border Protection, <https://www.cbp.gov/trade/forced-labor/withhold-release-orders-and-findings>

Second is balancing key relationships and managing the fallout from the escalating US-China trade and technology war. With the Regional Comprehensive Economic Partnership (RCEP), the world's largest FTA, Malaysia may hope that the IPEF will provide greater balance in managing its relationship with its two key trade and investment partners, China and the US. Thus, jumping on the IPEF bandwagon now may be part of its 'balancing' strategy as it avoids having to pick sides and therefore risk being cut off from either the US or China. But will the IPEF's creation or Malaysia's membership of it help with or hinder this balancing act? Only time will tell.

At the very least, the IPEF should not fuel US-China tensions and worsen the fallout on regional trade and supply chains. At the 2023 Group of Seven (G7) Summit in Tokyo, President Biden tried to clarify that the US objective was not to decouple (from China), but to de-risk and diversify.<sup>4</sup> This statement would have been welcomed by Malaysia and other ASEAN countries whose manufacturing supply chains are intricately linked to China. The big question, however, is whether this statement will translate into action, with a stalling of punitive measures initially, followed quickly by a reduction in them, or whether it will turn out to be a play on words. If it turns out to be just ratcheting of the rhetoric, as many fear, then the real risk to the ASEAN region will quickly shift from China to the US.

The paper is divided into five parts. The next section provides context by examining the political economy of the IPEF and the underlying motivation of the US in proposing it in the way that it has. This section also provides an overview of Malaysian trade policy, focusing on its FTAs, and trade governance. Section 3 deals with the two most important pillars for Malaysia, 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, although it might from a national security or geopolitical standpoint, for a country like the US. The pillars on Clean and Fair Economy are discussed in Section 4. The discussion on these two pillars is combined because there is little here that is likely to have a material impact on Malaysian policy making. A final section concludes.

### Political Economy of the IPEF and Malaysian Trade Policy

To understand the likely impact of the IPEF on Malaysia and other members, it is important to first come to terms with the motivation underlying it. To do this, it is useful to understand the environment within which it was created, by reviewing recent changes that have occurred in the trade policy setting agenda in the US under President Biden.

For decades, US trade policy was run by the US Trade Representative's (USTR's) office. The USTR negotiated all key trade agreements and was strongly pro-trade and liberalisation. Under the Biden Administration, some argue that the power to set the trade agenda has shifted to the Commerce Department.<sup>5</sup> This shift in power has already had a profound influence on US trade policy. Unlike the USTR, whose mission is to promote trade and investment through advancing liberalisation and maintaining a rules-based order, the Commerce Department is focused on the defence and

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4 At the closing press conference of the G7 meetings in Japan on 21 May 2023, President Biden stated that: "We're not looking to decouple from China. We're looking to de-risk and diversify our relationship with China." See Trevor Hunnicutt and Jeff Mason, "Biden sees shift in ties with China 'shortly'", *Reuters*, 21 May 2023, <https://www.reuters.com/world/biden-sees-shift-relations-with-china-shortly-says-g7-wants-de-risk-not-decouple-2023-05-21/>

5 Edward Alden, "Why the U.S. Trade Office No Longer Runs Trade", *Foreign Policy*, 7 March 2023, <https://foreignpolicy.com/2023/03/07/ustr-tai-trade-biden-america-first-china-decoupling/>

promotion of US companies and the protection of US technologies. It has also been overseeing the rollout of the massive subsidies being offered to re-shore semiconductor manufacturing, restricting sales of advanced US technologies to various Chinese companies and various other distortionary and protectionist policies. In addition to semiconductors, the subsidies being offered to the production of clean energy and electric vehicles is already affecting competitors not just in China but also US allies in Europe.<sup>6</sup> This had led one commentator to conclude that “the US shift to a more nationalist trade policy, driven by domestic industrial interests and national security concerns, will be durable”.<sup>7</sup>

The stark contrast between the USTR and the Commerce Department is also why the IPEF is a White House initiative. The USTR and Commerce Department simply could not come to agreement on how the IPEF should be structured and the White House was forced to take it over.

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, unilateral actions and FTAs. As of June 2023, Malaysia is implementing 18 FTAs (Table 1) and is negotiating five more.<sup>8</sup> It has bilateral FTAs with four IPEF member countries – Australia, India, Japan and New Zealand – and is in the process of negotiating with two others – Republic of Korea and the US. Despite negotiations having commenced in 2006, Malaysia does not look like concluding an FTA with the US anytime soon. The question that then arises is by what extent the IPEF can effectively substitute the absence of a bilateral FTA with the US. The short answer appears to be “very little, if at all”. So far, the US is not providing the same treatment to the IPEF members as it is to countries with whom it has an FTA. A stark contrast that highlights this discrepancy arises in relation to the Clean Economy Pillar and ‘green’ investments (see Section 4).

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6 Edward Alden, “Biden’s ‘America First’ Policies Threaten Rift with Europe”, *Foreign Policy*, 5 December 2022, <https://foreignpolicy.com/2022/12/05/biden-ira-chips-act-america-first-europe-eu-cars-ev-economic-policy/>

7 *op. cit.*

8 The five FTAs that Malaysia is negotiating are with the European Union, the Gulf Cooperation Council, Iran, 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 (9)         | 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             |

**Note:** The number in parentheses refers to the number of countries participating in the IPEF.

**Source:** Asia Regional Integration Center, ADB<sup>9</sup>

The question of overall value-addition combined with the recent political and policy climate in Malaysia may also affect its appetite to aggressively pursue a new and challenging agreement like the IPEF. Since 2020, Malaysia has had four Prime Ministers and three Ministers of the Ministry of International Trade and Industry (MITI). To provide context, it has had the same number of Prime Ministers and Ministers of MITI in the last three years as it has had in the preceding three decades. In short, the political and trade policy environment has been in a state of flux over recent years. This is why Malaysia kept delaying ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) until 30 September 2022, making it the ninth (out of 11) members to do so.

Some stability has returned with the current Anwar Ibrahim Administration, with Tengku Zafrul Azis, 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

9 "Free Trade Agreements", Asia Regional Integration Center, <https://aric.adb.org/fta>

support for the CPTPP, despite some concerns from domestic lobbies. The Minister of MITI said 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 [the CPTPP]”.<sup>10</sup> This bodes well for the current administration’s free trade credentials, and therefore, for the IPEF.

Malaysia is already a beneficiary of the IPEF’s technical assistance and capacity-building activities, even claiming some responsibility for bringing it onto an agenda that has very few unilateral concessions. The IPEF Upskilling Initiative aims to provide seven million training opportunities to women across the region to acquire digital skills that prepare them for high-quality jobs. Malaysia has also called for the establishment of an IPEF Centre for Excellence to provide training and capacity building in areas covered by the various pillars such as supply chain resilience, energy transformation and decarbonisation.<sup>11</sup> These types of initiatives may go some way towards providing more incentives in the form of carrots in an agreement that is heavy on sticks.

## Pillars 1 and 2 – Trade and Supply Chains

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 it. Nevertheless, the issues in the Trade Pillar are already having 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 the IPEF as providing a platform to open engagement with the US in seeking a solution to the WROs that have been imposed by US authorities on Malaysian exports. 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 the 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 the IPEF can help. Just two weeks after the IPEF was launched on 23 May 2022, the Biden Administration lifted a transshipment ban that had been imposed following a complaint by a US-based solar company.<sup>12</sup> Malaysia (and Cambodia, Thailand and Vietnam) were suddenly provided 24-month duty-free access to the US market for their exports of solar cells and modules.

Therefore, even if the 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. The recent relaxation of WROs on two companies and the removal of the transshipment ban on solar products suggest that this might be possible.

10 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/>

11 “FACT SHEET: IPEF Upskilling Initiative”, US Department of Commerce, <https://www.commerce.gov/sites/default/files/2022-09/IPEF-Upskilling-Fact-Sheet.pdf>

12 See Nichola Groom, “US places tariffs on some big solar companies for dodging China duties”, *Reuters*, 19 August 2023, <https://www.reuters.com/sustainability/us-slaps-tariffs-some-big-solar-companies-dodging-china-duties-2023-08-18/>

Nevertheless, the increasing influence of the US Department of Commerce in setting the trade agenda (see Section 2) has increased the *weaponisation* of trade policy and this needs to be checked and better managed. Otherwise, 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 the IPEF may be significant. If the IPEF negotiations on digital trade and data flows can further the agenda beyond that of other bilateral (for example, the Framework of Cooperation with Singapore), regional (CPTPP, but also ASEAN, Asia-Pacific Economic Cooperation [APEC], et cetera.), or multilateral (WTO) frameworks, then the impact of the IPEF could be transformative. Details are still sparse but the potential is certainly there to make the IPEF a significant part of Malaysia's trade policy. The negotiations in this area, however, are not without risk. With the European Union and China also pursuing their own approaches to digital governance, the possibility of a 'splinternet' emerging, which 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:

The first is the IPEF Supply Chain Council for better coordination of supply chain activities and building resilience and competitiveness in certain critical sectors. The Council will oversee the development of 'action plans' for these sectors that may help companies identify and address supply chain vulnerabilities.

The second is an IPEF Supply Chain Response Network for giving early warnings to members on potential supply disruptions. With a new 'emergency communications channel', it is expected that the IPEF members can streamline communication and coordinate a response when one or more IPEF parties face a supply chain crisis.

Finally, an IPEF Labo[u]r Rights Advisory Board made up of government, worker, and employee representatives is being proposed. This Board is to identify areas where certain labour rights are being violated. Analysing the language in the agreement's press statement, some experts suggest the board can 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 Labo[u]r Mechanism.<sup>13</sup> An important difference with the USMCA's Rapid-Response mechanism relates to enforcement, however, as the IPEF mechanism is unlikely to be binding or reciprocal.

Although a tangible outcome such as the IPEF Supply Chain Agreement after just one year should be welcomed, the operational details, once available, need to be studied before reaching conclusions on its practical use. The Press Statement on the Substantial Conclusion of the IPEF Supply Chain

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13 Aidan Arasasingham, Emily Benson, Matthew P. Goodman, and William Alan Reinsch, "Assessing IPEF's New Supply Chains Agreement", CSIS, Washington, DC., 31 May 2023, <https://www.csis.org/analysis/assessing-ipefs-new-supply-chains-agreement>

Agreement Negotiations, posted on the US Department of Commerce official website,<sup>14</sup> reveals very little of substance, unfortunately. Indeed, the announcement, which is all that is available as of June 2023, has been described as “a mass of abstract verbiage with a tangle of subclauses festooned with adjectives and adverbs layered two or three deep”.<sup>15</sup> It is mostly aspirational and very thin on practical details, with whatever little details provided being so heavily qualified that they can be interpreted to suit a diverse range of interests.<sup>16</sup>

China’s not being a part of the IPEF and the Supply Chain Agreement is a major concern for Malaysia and the other ASEAN members involved in regional supply chains. 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 can undermine the usefulness of this pillar to ASEAN members of the IPEF, including Malaysia.

More than being of limited use due to the exclusion of 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 the IPEF members to buy into its ‘resilience and competitiveness’ framework and support its national security interests by limiting engagement and dependency on China. 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.<sup>17</sup> In exchange for this, members are being offered various capacity building and training programmes, and the possibility of greater Foreign Direct Investment (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 be useful only if its predictions are reliable. This in turn will depend on the willingness of member states to share information on a timely basis. Although supply chain networks are highly interdependent, countries involved can sometimes operate more as competitors than collaborators, and may be unwilling to share information on a timely basis, especially if the information is sensitive or proprietary in nature. An example of the problem that can arise is illustrated by the ASEAN+3 financial and economic surveillance process, which is also supposed to provide an early warning system of emerging risks and vulnerabilities for ensuring pre-emptive actions to avert a contagious financial crisis. The process has become a beauty contest of sorts, with members tending to highlight strengths rather than potential vulnerabilities, with the latter seen as failures of economic management. It appears that members are reluctant to air their dirty laundry in public and would rather prefer either

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14 “Press Statement on the Substantial Conclusion of IPEF Supply Chain Agreement Negotiations”, US Department of Commerce, 27 May 2023, <https://www.commerce.gov/news/press-releases/2023/05/press-statement-substantial-conclusion-ipef-supply-chain-agreement>

15 Alan Beattie, “The US trade pledge to the Indo-Pacific is empty”, *Financial Times*, 8 June 2023, <https://www.ft.com/content/42a87796-8228-445b-8ad5-63a5c35d5144>

16 To illustrate the point, consider the following statement, which is representative of many of the pledges made in the press release: “ensure that workers and the businesses, especially micro-, small-, and medium-sized enterprises, in the economies of IPEF partners benefit from resilient, robust, and efficient supply chains by identifying disruptions or potential disruptions and responding promptly, effectively, and, where possible, collectively.”

17 *op. cit.* As in 10 earlier.

disguising or glossing over them, while focusing on the positive aspects, which undermines the purpose of the surveillance.

Another problem illustrated by the ASEAN+3 process, which could equally apply to the IPEF's early warning initiative, is the absence of effective remedial and response measures for addressing risks emerging from the early warning system. The Multilateralised Chiang Mai Initiative (CMIM), which is supposed to provide emergency liquidity support in the event of a rapidly evolving crisis, has never been used because the operational procedures remain unclear and arduous, almost as if it is designed not to be used.<sup>18</sup> Similarly, the global climate crisis was not due to any lack of early warning, but rather inter-generational choices and trade-offs.

The supply chain initiative should be able to not only identify emerging risks but also to respond to them in an effective and timely manner. The details must be examined before it is hailed as a breakthrough, as the US Commerce Secretary Gina Raimondo already has : "I can tell you I would have loved to have had that Crisis Response Network during [the COVID-19 pandemic]. It absolutely would have helped us secure American jobs and keep supply chains moving".<sup>19</sup> 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 is difficult to comprehend. If anything, the pandemic demonstrated how resilient supply chains already were, despite the incredible pressures they faced.<sup>20</sup> A properly functioning early warning system may at best help in limiting the fallout from a country- or region-specific shock, given the highly interdependent nature of supply chain networks, but certainly not a global shock.

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 have found their way into Pillar 2 on Supply Chains and might arise in other pillars as well, further emphasising the so-called 'worker-centric' nature of the 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. It would suffice to say that developing countries tend to view the introduction of labour standards into trade negotiations with a high level of suspicion.

### **Pillars 3 and 4 – Clean Economy and Fair Economy**

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 the IPEF. For Clean Economy, Malaysia has updated its Nationally Determined Contribution target to reach net-zero greenhouse gas emissions by 2050.

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18 Jayant Menon and Hal Hill, "Does East Asia Have a Working Financial Safety Net?", *Asian Economic Journal*, Vol. 28, no. 1, (2014): 1-17, <https://researchprofiles.anu.edu.au/en/publications/does-east-asia-have-a-working-financial-safety-net>

19 Quoted in David Lawder, "U.S.-led Indo-Pacific talks produce deal on supply chain early warnings", *Reuters*, 28 May 2023, <https://www.reuters.com/markets/asia/us-led-indo-pacific-talks-produce-deal-supply-chain-early-warnings-2023-05-27/>

20 Jayant Menon, "Supply chains are more resilient than they appear", *East Asia Forum*, 3 July 2022, <https://www.eastasiaforum.org/2022/07/03/supply-chains-are-more-resilient-than-they-appear/>



This is a major challenge.<sup>21</sup> The IPEF can play a complementary role in helping Malaysia meet its commitments, but not with its current configuration. At the moment, the 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 with IPEF members, 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 have FTAs with the US, 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 FTA partner countries.<sup>22</sup> This does not automatically extend to the IPEF members. The fact that the US signed a critical minerals agreement bilaterally with Japan in March 2023 that allows Japan to access IRA tax credits erodes the relevance of the IPEF to other members. It is this type of discrepancy and discrimination that is undermining the value of the IPEF in this area in particular, and as a serious attempt to economically re-engage with the region, in general.

With respect to the Fair Economy Pillar, it should be noted that Malaysia is already a signatory to the Multilateral Instrument to Prevent Base Erosion and Profit Shifting (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.<sup>23</sup> Furthermore, with Malaysia ratifying the CPTPP, there may be little that the IPEF can add to the binding commitments already made to the reform agenda in this area.

What is missing from the Fair Economy agenda is a mechanism for addressing the unintended consequences of industrial policy actions of one (or more) member(s) on the other(s). The question arises as to how a pillar on fair economy can be consistent with uncompensated impacts on the IPEF members of actions by the US targeting China for non-economic reasons, for instance. Malaysia and other supply chain partners may suffer the indirect consequences of actions designed to safeguard perceived threats to US national security, and there is no mechanism in place for redress or compensation. This issue needs attention because the measures being employed may not be fully covered by global trade rules, as they mostly relate to subsidies and export controls, not traditional measures such as tariffs or other import restrictions.

Although discriminatory subsidies are forbidden under WTO disciplines, contraventions have been widely ignored. Even when an attempt is made to justify such measures on national security grounds – as permitted under Article XXI of the General Agreement on Tariffs and Trade (GATT) – the legitimacy of the claim is often suspect. If a WTO ruling determines the national security claim spurious, the US has simply ignored the decision, as it did with the ruling on the Trump-era tariffs on steel, for instance. Indeed “US decisions as to whether a country, company, product or technology

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21 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. See Mei Mei Chu, “Malaysia needs to invest \$375 bln in renewables to reach 2050 climate goals – report”, *Reuters*, 9 March 2023, <https://www.reuters.com/business/energy/malaysia-needs-invest-375-bln-renewables-reach-2050-climate-goals-report-2023-03-09>

22 See “Inflation Reduction Act of 2022 (IRA): Provisions Related to Climate Change”, Congressional Research Service, 3 October 2022, <https://crsreports.congress.gov/product/pdf/R/R47262>

23 Jayant Menon and Thiam Hee Ng, “Do State-Owned Enterprises Crowd Out Private Investment: Firm Level Evidence from Malaysia”, *Journal of Southeast Asian Economies*, Vol. 34, no. 3, (September 2017): 507-522.

threatens US national security are shielded both from public and judicial scrutiny and deliberately ignore economic costs".<sup>24</sup> These costs, however, are not confined to the US but are also imposed on the country being targeted as well as its trading and supply chain partners. When the supposed original guarantor of the rules-based trading order becomes one of its major violators, any new proposals purporting to promote fair trade or fair economy needs to be carefully scrutinised.

### Conclusion

Using trade agreements for pursuing non-economic ends, whether through formal FTAs or frameworks like the 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. The IPEF is not an exception. The outstanding difference with the 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. Unless this changes, the policy impact of the IPEF, as opposed to the fanfare that is likely to accompany the conclusion of negotiations, will be vast. The IPEF may happen but will hardly be noticed in practical terms. There is still time to negotiate a better agreement. But even if little changes between now and its conclusion, expected at the APEC Summit in San Francisco in November 2023, the impact of the IPEF will vary by country and sector.

What Malaysia expects to derive from the IPEF may differ from other members. For Malaysia, participation in the IPEF could serve as insurance against punitive trade policy actions by the US and could provide the opportunity to resolve existing trade frictions. Therefore, Pillars 1 and 2 on Trade and Supply Chains will be most significant. With the Trade Pillar, it is not so much about increasing market access to the US, which the IPEF does not currently provide, but rather with restoring and preserving market access by reversing the remaining WROs that currently ban exports to the US market by targeted companies. Malaysia also expects that the ease and frequency with which trade sanctions are applied in the future will be better managed due to the IPEF. The recent relaxation of WROs on certain companies and the removal of the transshipment ban on solar products suggest that this might be possible.

A remaining unknown relates to digital trade. The potential exists for the 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 the IPEF need to be weighed against a worst case but highly plausible scenario where the creation of the IPEF further fuels US-China tensions that lead to further retaliatory actions. This is likely if the 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, leading to possible bifurcation, then the cost to Malaysia and other ASEAN countries will be high enough to outweigh any benefits.

The reality, however, is that the IPEF without China is, to a large extent, economically meaningless to countries like Malaysia, and potentially disruptive and costly. To expect that this might change in the future 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.

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24 Gary C. Hufbauer, "Washington's turn to neo-mercantilism", *East Asia Forum*, 4 June 2023, [https://www.eastasiaforum.org/2023/06/04/washingtons-turn-to-neo-mercantilism/?utm\\_medium=email&utm\\_campaign=newsletter2023-06-03](https://www.eastasiaforum.org/2023/06/04/washingtons-turn-to-neo-mercantilism/?utm_medium=email&utm_campaign=newsletter2023-06-03)

## About the author

**Dr Jayant MENON** is Senior Fellow, Regional Economic Studies, at ISEAS-Yusof Ishak Institute. At ISEAS, Dr Menon continues his work on trade and investment issues and economic development in the Asian region. His current research areas include economic impacts of COVID-19 in Southeast Asia, COVID-19 and the poor, the United States-China trade war and restructuring of Global Value Chains in Asia and the evolving regional economic architecture.

His last post was at the Asian Development Bank (ADB) as Lead Economist in the Office of the Chief Economist. He was also at the ADB Institute in Tokyo from 2005 to 2008. He started work as an academic in Australia, spending almost a decade at the Centre of Policy Studies at Monash University at its original campus in Clayton, Melbourne. He has also worked at the University of Melbourne, Victoria University, and the American University in Washington, DC. He holds adjunct appointments with the Australian National University, University of Nottingham, United Kingdom and IDEAS, Malaysia.