American Association of the Indo-Pacific

aaip | IPEF Taskforce

The Indo-Pacific Economic Framework for Prosperity

CLOSING ARGUMENTS

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EXECUTIVE SUMMARY

The Indo-Pacific Economic Framework for Prosperity (IPEF) finds itself at a critical moment, grappling with skepticism, the geopolitics of diversification, and the elusive promise of tangible economic benefits. There are three key areas of doubt among IPEF members that must and can be overcome: the agreement's very nature, the vagaries of U.S. domestic politics, and doubts over economic and commercial gains.

U.S. domestic politics adds another layer of complexity. Washington›s appetite for trade agreements has waned as industrial policy has regained popularity. This has prompted skepticism among IPEF partners about the long-term objectives of U.S. trade policy. Yet, the IPEF is a point of optimism. The current U.S. administration has not only maintained but also fortified its commitment to the IPEF, signaling a nuanced but real shift in policy.

The question of diversification is also on the table. Contrary to some perceptions, aligning with the IPEF doesn't mean turning away from China, a critical trading partner for many IPEF members, including the United States. The COVID-19 pandemic has underscored the need for a balanced portfolio of trading partners.

While the IPEF agreement may not offer market access, it should not be underestimated. Drawing from other trade agreements, it is clear that even modest trade facilitation measures can yield substantial dividends. For instance, streamlined customs procedures and electronic document exchanges have led to significant time and cost savings for exporters in other contexts.

As negotiations draw to their final stages, it is apparent that the key requirements for an agreement that will maintain and improve the competitiveness of U.S. business in the region will not be met. These include:

- A commitment to address market access and broader trade and investment liberalization;
- A strong digital chapter similar in ambition to the USMCA agreement;
- A technical barriers to trade chapter;
- A health chapter similar to the U.S.-Korea FTA;
- Addressing intellectual property.

Despite this, key recommendations remain.

- The agreement must be future-proofed to adapt to evolving economic landscapes.
- It must also be receptive to stakeholder input, particularly from the private sector, which holds invaluable granular data.
- Financial commitments, especially from OECD members, are imperative for the agreement's successful implementation.

1. OVERCOMING SKEPTICISM

The skepticism toward the IPEF from many IPEF partner country stakeholders needs to be acknowledged and overcome. There are three elements to the skepticism.

The first concerns the nature of the agreement.

Partner country governments have embraced the IPEF as a means to broader economic engagement with the United States. However, most member countries are already party to multiple multilateral agreements (RCEP, CPTPP, ASEAN) or multilateral agreements with other IPEF member parties. Vietnam, for example, has four different trade agreements with Japan, and Australia has four different trade agreements with Malaysia. And many are continuing to liberalize and upgrade existing agreements.

The lack of market access in an environment where economic integration is accelerating, despite talk of 'deglobalization', also prompts further questions among stakeholders—particularly in the business community—as to the value of the agreement.

However, the United States remains the world's largest economy for the foreseeable future. For countries not to participate in the only multilateral engagement by the U.S. would be imprudent (see further detail in the next section).

The second concerns U.S. domestic politics.

The lack of support for the CPTPP in the lead-up to the 2016 presidential election and the eventual withdrawal from the agreement at the commencement of the Trump Administration has spurred well-founded concerns that there is little appetite for trade agreements and greater liberalization within current or future administrations, and in Congress.

These concerns are legitimate, but mitigating changes in domestic sentiment is impossible in any trading partner. However, partners can take some solace in the following:

- The Indo-Pacific economic strategy was first initiated under the Trump Administration as part of the broader approach to the region and subsequently has been maintained by the Biden Administration;
- The current administration is already supporting the implementation of the future agreement with the appointment of regional staff dedicated to the IPEF;
- The U.S. public still has a largely positive view of free trade.[1]

[1] Free Trade with Exceptions: Public Opinion and Industrial Policy | Chicago Council on Global Affairs

The third concerns potential economic and commercial gains. Economy-wide, sectoral, and firm-level gains are not necessarily clear.

Because there are no tariff reductions, there is no clear path for exporters to the U.S. that might give them market access equivalent to USMCA members, Korea, or other U.S. FTA partners in Central America.

However, the Trade Pillar, in particular, holds the potential for IPEF partners to reduce some of the 'stickiness' when exporting goods to the United States through customs and trade facilitation.

Malaysia, for example, has been seeking greater clarity on customs measures, particularly as they relate to U.S. Customs and Border Protection rulings on forced labor for rubber products; the IPEF is likely to provide new mechanisms for managing these types of trade disruptions.

Similarly, Indonesia has clearly stated that it wants to use the IPEF as a platform for participation in the global battery supply chain utilizing its large mineral reserves. It is seeking investment and access to subsidies under the Inflation Reduction Act as part of its approach to the IPEF.

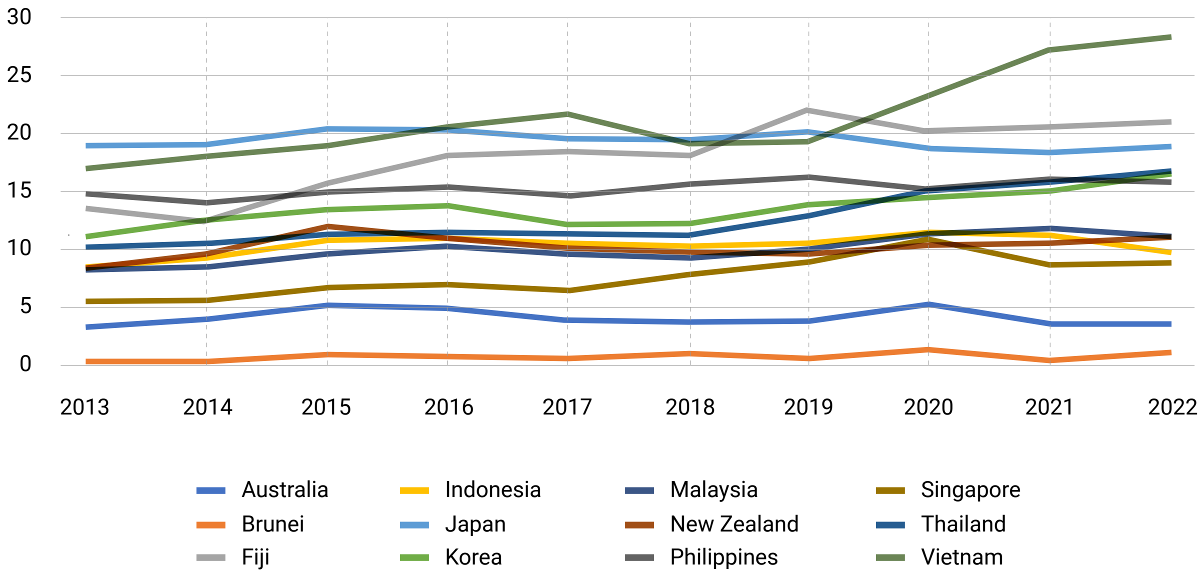
In other words, the commercial gains will not be obvious; they will more than likely be industry-specific and measured in compliance costs rather than duties paid.

[2] IPEF-Discussion-Paper-Series_Chapter-7_merged.pdf (nus.edu.sg)

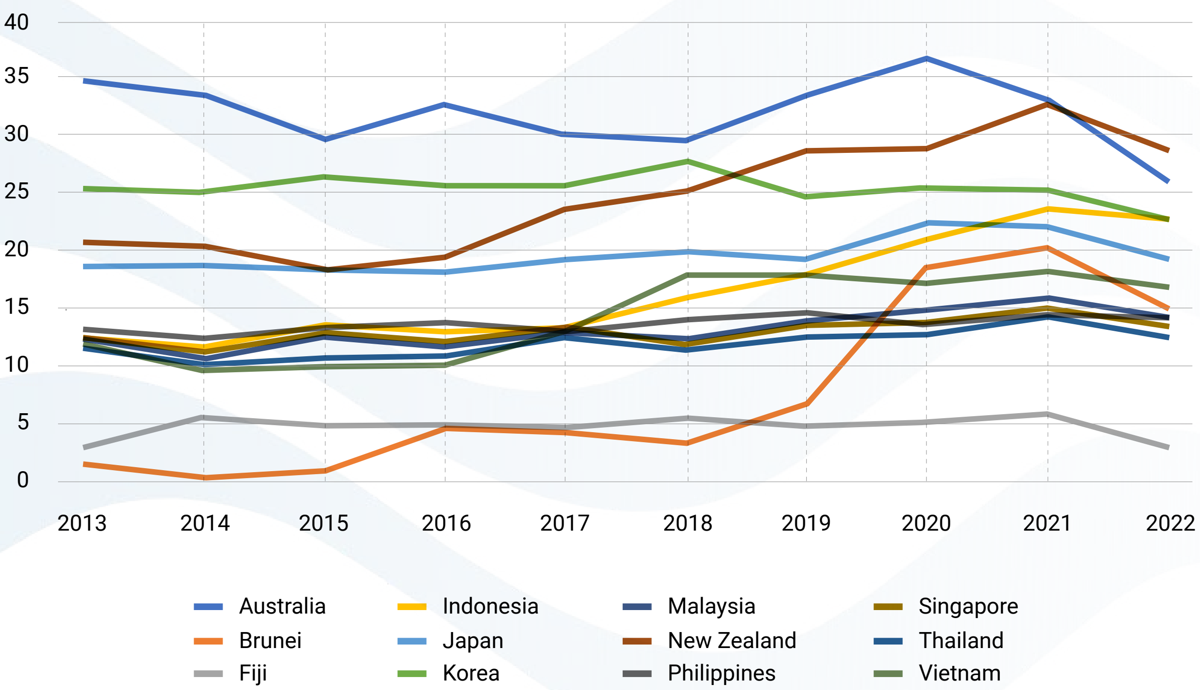
2. DIVERSIFICATION IS NOT CHOOSING SIDES

Concern has also emerged that support for the IPEF in Asia effectively means 'turning away' from China. However, the share of trade between the major trade groupings in Asia has increased with both China and the United States. The trade share of these partners remains higher with China. This is unsurprising given the existence of multiple trade agreements (ASEAN, RCEP). But for many IPEF member countries, China remains the most critical trading partner.

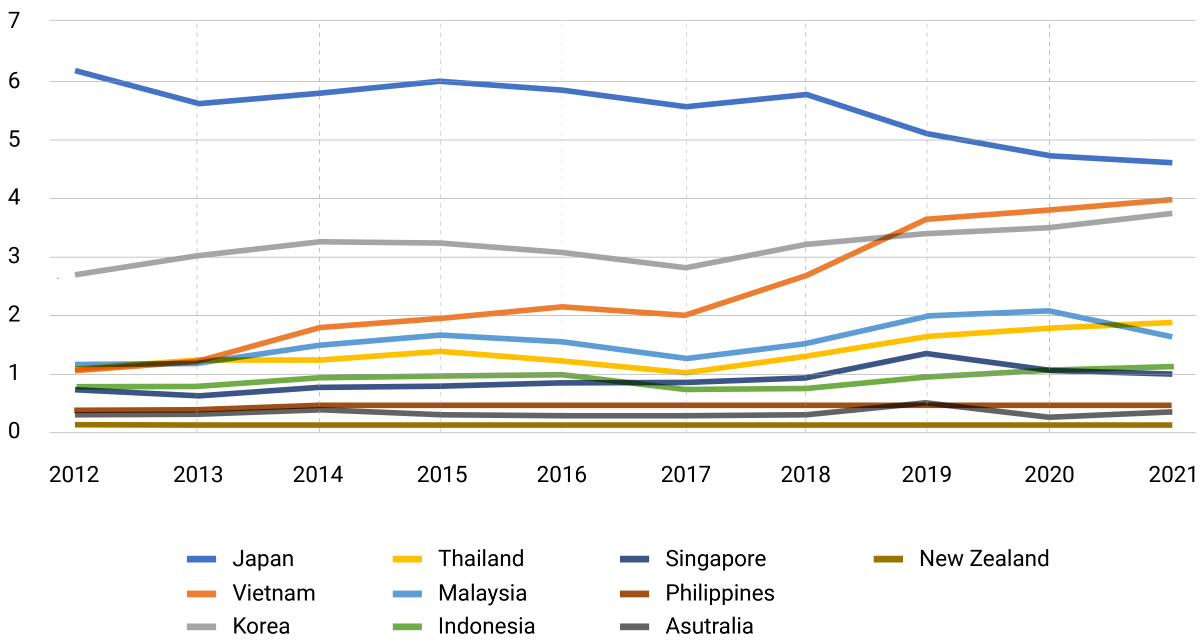
IPEF Members - Exports to U.S. as % of total exports:



IPEF Members - Exports to China as % of total exports:



IPEF Members (Selected) - Share of U.S. imports:



The charts above indicate that:

- Some IPEF partners remain highly dependent on China as an export destination (e.g., Australia, principally due to iron ore and other mineral exports);
- For many, the U.S. is becoming a more significant export destination (e.g., Fiji);
- The share of U.S. imports from IPEF partners is becoming more important.

The COVID-19 pandemic made it readily apparent that a high level of trade dependence on any single economy is risky. This was felt not only by 'trade dependent' partners but also by those economies themselves. Chinese exporters noted that the lack of diversity in their own supply chains hindered maintaining production and sales in a time of disruption. Therefore, the ability to 'hedge bets' between the world's two largest economies is vital.

Financing is vital to facilitating more diverse and resilient supply chains. Supply chain financing programs use the higher rating of buying companies to enable suppliers to gain access to funding and working capital at lower costs. This extends financing further into the supply chain to reach the smaller MSME suppliers that often need it most and solidifies those relationships. The IPEF lacks a legal framework that could enable better financing rates for companies that meet a set of social and environmental standards.

The IPEF is unlikely to replicate the levels of economic integration between IPEF members and the region's economic powerhouses (China, Japan, Korea) any time soon. These three economies are currently pushing to upgrade existing agreements with their trading partners in the region.

That said, the significance of the U.S. as a trading partner for nearly all IPEF members indicates that any measures that can improve the competitiveness of exports—no matter how incremental—should be taken more seriously.

IPEF countries make up a relatively small share of U.S. imports. However, that share is growing. IPEF members must seek to maintain and improve their competitiveness in the U.S. market.

Equally, U.S. exporters are acutely aware that the lack of trade agreements within the Indo-Pacific is undermining the competitiveness of U.S. exports. This has been raised by Congressional lawmakers, noting that U.S. agricultural exports struggle to compete with those from exporters that face much lower tariffs in those markets.

This can further impact U.S. investments in the region. U.S. companies may seek to utilize U.S.-produced goods in their own overseas operations but source inputs from other countries.

The opportunity for SMEs should not be underestimated. Approximately 290,000 enterprises in the United States that export goods from the United States, and around 97 percent of these companies are small or medium-sized enterprises. The value of SME exports is around 460 billion USD. Significant numbers of U.S. SMEs export to Indo-Pacific economies, representing 70 billion USD in exports—around 20,000 SMEs export to South Korea alone.

3. DEFINING THE BENEFITS

The lack of assumed changes to trade flows based on lower tariffs and other factors in the IPEF agreement means quantitatively modeling changes in trade flows is difficult—and modeling potential economic benefits is difficult.

However, it is possible to look at existing examples of how improved customs and trade facilitation within trade agreements have improved outcomes for firms and economies.

Example 1: WTO Trade Facilitation Agreement

The WTO Trade Facilitation Agreement (TFA) sets out to expedite the movement of goods across the globe and increase cooperation between customs authorities on trade facilitation. In doing so, it seeks to reduce trade costs, which are an avoidable drag on trade and the global economy. Trade costs tend to be higher in developing countries. Modeling undertaken by the WTO secretariat indicates that implementation of the WTO TFA in Asia is the equivalent of reducing tariffs by almost 14 percent.

Example 2: ASEAN Single Window (ASW)

The ASW is designed to integrate the National Single Windows of the 10 ASEAN member countries into a single platform. This allows for the electronic exchange of trade-related documents, such as customs declarations and certificates of origin. According to a study by the Economic Research Institute for ASEAN and East Asia (ERIA), the ASW has reduced export times by up to 25 percent. This time reduction is largely attributed to the electronic exchange of documents, which eliminates the need for physical paperwork. The study also found that these time savings translate into cost reductions of up to 20 percent for exporters within the ASEAN region.[3]

Example 3: East African Community (EAC) Customs Union

The EAC Customs Union between Kenya, Tanzania, Uganda, Rwanda, and Burundi has implemented a range of trade facilitation measures, including the Single Customs Territory (SCT). The SCT allows for collecting customs duties at the first point of entry, eliminating multiple checks and reducing transit times. A study by TradeMark East Africa found that the time to import goods from Mombasa to Kigali reduced from 21 days to 6 days, resulting in cost savings of up to 30 percent for exporters within the EAC.[4]

[3] Hiroshi, K. (2018). "The Impact of the ASEAN Single Window on Export Competitiveness." Economic Research Institute for ASEAN and East Asia (ERIA).
[4] TradeMark East Africa. (2019). "Impact Assessment of the Single Customs Territory on the East African Community."

4. RECOMMENDATIONS

U.S. officials have made it clear that they expect the Clean Economy and Fair Economy pillars to be completed during the sixth round of negotiations in Kuala Lumpur in October and that these will form the basis of announcements on the margins of the APEC Ministerial in November.

The completion of the Trade Pillar is less certain. However, negotiators should not accept a rushed deadline. They must ensure that the Trade Pillar of the agreement meets a number of key requirements.

1. Future-proofing

The agreement must contain flexible accession provisions and an agreement-in-principle commitment towards greater economic integration and liberalization of trade and investment. If these are not included, negotiators must stay at the table.

In this case, negotiators must:

- Continue to move toward high standards on digital trade that–at a minimum–replicate the standards of the USMCA or, as a second preference, the CPTPP;
- Commit to remaining open to expanding the scope of the agreement to consider other chapters, including health, intellectual property, and technical barriers to trade.

2. Openness to stakeholder input

The Supply Chain Pillar has demonstrated some level of commitment toward obtaining stakeholder input on a range of issues. However, input from the private sector must be incorporated into any committee going forward. The Supply Chain Pillar's lack of serious engagement with the private sector ignores the fact that it is the private sector that has granular data on supply chains and a clear-eyed understanding of what will work for private sector operators. This absence should not be repeated with the Trade Pillar.

Private sector engagement will also be critical to implementing the IPEF pillars, particularly for Pillar Two (Supply Chain Council Action Plan) and Pillar Three (effective mobilization of financing for clean economy objectives).

3. Dispute settlement mechanisms

The agreement has no leverage without the ability to raise non-compliance by members and between members. The agreement must include an appropriate dispute settlement mechanism that applies to all parties.

4. Financial support for implementation

Parties, particularly OECD members, must demonstrate commitment to the IPEF with hard budget commitments to implement capacity-building programs and other activities such as the Upskilling Initiative. Without this financial commitment, concrete gains will not be realized.

In addition, the way in which public resources are used under the clean economy pillar, in particular, will be critical to scaling up private finance successfully and creating a platform for investment mobilization across the region.