REFSA Notes

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TRUMP'S TARIFFS: A DOUBLE-EDGED SWORD FOR MALAYSIA

Lim Li Lian
Deputy Director, REFSA

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Coming from an entrepreneurial background, Trump has a transactional and zero-sum approach, which he has brought to his role as the President of the United States. Less concerned with global values and more about nationalism, prioritising the tangible rather than the intangibles, Trump's foreign policy is more about economic benefits to America rather than projecting American influence or promoting democracy. This is evident in how he frames US's security guarantees to Taiwan and Japan, questioning what the US gains in return.

IMPLICATIONS OF THE THREATENED TARIFFS ON MALAYSIA

Trump has threatened 60% tariffs on all imports from China and a blanket 10-20% on all other imports. These tariffs will have various effects on Malaysia, both positive and negative. **In the short run, the 60% tariffs on Chinese goods will negatively impact Malaysia through the supply chain**, as a significant portion of Malaysia's trade involves exporting intermediate goods to China that are eventually bound for the US markets. Goods made and exported from China will suffer, together with their supply chains, a significant part of which lies in South East Asia and Malaysia. What about goods that are made in Malaysia? **Some Malaysian sectors may benefit as competition from Chinese-made goods decreases.** The blanket 10% tariffs on all imports mean that the nearest competitor might no longer be China-made but rather US-made goods.

At this juncture it is crucial to ask what exactly the US imports from Malaysia. It is mostly electrical and electronic components and equipment. Given that Malaysian manufacturers are largely not their own brand producers, it is the multinational corporations (MNCs) that will need to reorganise their supply chains. **In the short run you will see Malaysia-based production facilities ramping up,** as has been observed over the recent few months when REFSA spoke with semiconductor players. In the medium term, companies will seek policy visibility while making the cost benefit analysis to determine whether establishing production facilities in the US makes sense in the long run.

Citing production in the US is not as straightforward not least due to conflicting rhetoric from Trump. On the one hand his "Make America Great Again" pledge seems to be focused on rebuilding a domestic industrial base. On the other hand he has vowed to be tight on immigration, threatening to deport all illegal immigrants. This would not be an issue if the US had a huge unemployment problem but the US jobs market has been rather strong. The unemployment rate currently stands at 4.1% compared to the long term average of 5.69%. In addition, the globalisation policy pursued by the US from the 1990s has meant the hollowing out of its manufacturing base and consequently a transfer of tacit manufacturing knowledge and capabilities to foreign shores. All this increases the costs of manufacturing in the US. Until there is more visibility on the viability of US industrial policy, again expect to see more ramping up of production as well as production facilities such as in Malaysia.

Companies will also seek more policy visibility from China. The US is taking a page from its old chip war playbook with Japan in the 1980s, where threatened tariffs and sanctions forced Japanese memory chip makers to concede to US demands. Facing a blanket tariff on all its imports, and with other countries likely to follow with their own barriers to Chinese-made goods, China may be more willing to negotiate. China has also signalled a pivot towards more domestic demand-focused policy measures, which will be welcomed by both its domestic companies and MNCs.

CHINA'S TRADABLES SECTOR REACTION

The blanket 60% tariff on all Chinese imports gives Chinese companies four options: **reroute, abandon price as the competitive variable, look for alternative markets, or engage in "identity-washing".** Rerouting could involve establishing manufacturing sites in intermediary countries. While small amounts might go unnoticed, large quantities would likely attract attention through trade deficits, as seen with Vietnam. It would be one of those badly kept secrets that the Trump administration could easily clamp down on with sanctions. Yet this option remains the easiest and most cost-effective solution for Chinese companies and will likely be the preferred short-term choice for as long as they can get away with it.

The second option, to compete on variables other than price, is a good long-term solution but marks a significant departure from current business models. It is challenging to name a coveted or leading tech China brand, except maybe Huawei (and look where that led).

The third option, to look for other markets, is already underway, and many countries are feeling the negative effects of Chinese goods seeking new outlets. Countries such as Brazil and India, typically friendly to China, are imposing trade barriers such as tariffs on Chinese imports to protect domestic industries. This strategy will likely face backlash similar to that of the US from a growing number of countries, eroding China's goodwill among the global south.

Singapore has become the preferred hub for the fourth option, giving rise to the term "Singapore-washing", which describes Chinese companies establishing their headquarters in Singapore, and their directors and management changing their citizenship to Singapore. The large influx of Chinese companies and nationals into Singapore has distorted its asset markets and led to discontent among its citizens. There is growing interest from Chinese companies to do the same in other parts of the world.

MALAYSIA’S FIFTH OPTION FOR CHINA?

Malaysia could offer a fifth option to Chinese companies: **setting up minority joint ventures with Malaysian companies on Malaysian soil.** A marriage where Malaysia provides identity and neutrality, while the Chinese provide the capital and technological knowhow. Such a company will not be benefitting from subsidies from the Chinese government nor be under Beijing’s control, making it less likely to be targeted by sanctions aimed at neutralising the massive subsidies that Beijing provides to its domestic players, which unfairly distort global markets.

The neutral advantage of having a Malaysian identity carries significant weight in today’s world. Companies from the West are increasingly sourcing from non-China suppliers, cutting off China’s access to key markets along the supply chain. Such a joint venture would address these issues. In addition to providing neutrality, Malaysia’s strong historical ties with the Muslim world will open up new markets for Chinese companies (or at least ease access to them). The US could still try to target the joint ventures, but it would be difficult to justify if the companies are truly Malaysian in identity and nationality. For these Chinese companies, instead of focusing on exports as a source of revenue, it could pivot towards intellectual property (IP) licensing instead. By setting up manufacturing hubs in Malaysia through Malaysian joint ventures and licensing their IP to the joint venture in exchange for royalty payments, they will mitigate the risk of potential sanctions, maintain existing markets, open up new markets and still earn from royalties and profits.

The benefits for Malaysia would be knowledge and technology transfers, capital investments, upgrading of overall capabilities and access to bigger markets through improved product offerings. Some Chinese companies have already embarked on such a strategy, such as Geely’s 49.9% shareholding in Proton. Whether Proton would be viewed as a Chinese company is the question. An entity could be a minority shareholder but exercise much more control due to complicated shareholding structures. Ultimately, the question would rest on which party exercises ultimate control and influence, coupled with the company’s branding and identity.

On the other extreme, companies such as Sony in the 1950s licensed technologies from AT&T, allowing them to produce its first transistor radio, marking one of their first forays into higher-value electronics goods. Perhaps parties could conceive of an entity that involves a step up from such an arrangement, with minority investment from the Chinese entity, yet keep the identity and control largely indigenous. The key question is whether Chinese companies would be satisfied with such an arrangement, as they would be creating their own competitors with better market access and ceding control of their technologies to foreign entities. This option certainly merits more investigation.

Finally, how well Malaysia emerges from this is not only a function of how well it can implement domestic industrial policy - such as the New Industrial Master Plan 2030 and the National Semiconductor Strategy - to build Malaysian capabilities and companies, but also how well it can maintain its neutral stance. In today's world, "active neutrality" is a misnomer, **the "neutral stance" is now a dynamic phenomenon due to the rapidly changing geo-economic and geopolitical environment.** For "neutrality" to succeed for Malaysia, it requires two further dimensions. First, Malaysia needs to make a convincing case that "neutral" is good for Malaysia, China and the US. A big win would be to convince and bring China and the US into the fold as key stakeholders in this narrative. This might prove a worthwhile experiment while serving as a good fallback or alternative narrative to cultivate amidst growing trade tensions. Second is **"neutrality in numbers"**. The concept of individual non-aligned countries each acting in their own best interests, resulting in a group of neutral, non-aligned countries, is an attractive and very implementable proposition. Both dimensions reinforce each other and should be explored on an informal basis to start.

To summarize, **in the short term there will be positive and negative impacts to Malaysia's trade.** However, increasing trade deficits with the US need to be managed to ensure they are not contributed mainly by Chinese firms using Malaysia as a low-value added re-export hub. **In the medium term, it is essential to watch how the Chinese government and its firms react, which is also influenced by the interplay between the US government's stance on immigration and industrial policy.** Malaysia should explore the possibility of a fifth option for Chinese companies, but this strategy is viable only if the chances of the Chinese coming to a deal with the US are slim. Finally, **Malaysia should invest more resources in active neutrality as this is vital to its success in navigating the treacherous waters of the current trade war.**

REFSA Notes

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Tan E Hun is the Executive Director of REFSA.

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REFSA
Research For Social Advancement

Level 5, Block A,
Wenworth Building,
Jalan Yew, Off Jalan Pudu,
55100 KL

(03) **9285 5808**

www.**refsa**.org

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