Global Insights

Unpacking the Indo-Pacific Economic Framework and US Plans for the Asia-Pacific Region

In 2017, the US withdrew from the Trans-Pacific Partnership—a multinational agreement to reduce trade barriers. Fast forward five years, and US President Joe Biden is considering pursuing stronger collaboration between the US and Asia-Pacific nations. The recently announced Indo-Pacific Economic Framework for Prosperity (IPEF) is the administration’s attempt to facilitate deeper collaboration in the region.

Although critics of the IPEF claim that the model lacks key elements like market access, we think that it provides important insights into the administration’s stance toward the region.

This edition of Global Insights introduces readers to the IPEF, a US-led initiative focused on deepening the relationship between the US and participating nations in the Asia-Pacific region.
Last month, President Biden introduced the Indo-Pacific Economic Framework for Prosperity (IPEF)—a US-led multilateral model for engagement in the Asia-Pacific region. Unlike traditional free trade agreements, the IPEF does not address tariffs and therefore does not require congressional approval. This is an important distinction because at the moment there is no political appetite to pursue preferential free-trade agreements. Although critics of the IPEF claim that the new model lacks enforceability, we think the IPEF provides important insights that investors can leverage when deploying capital to the region.

Exhibit 1: Select Economic Blocs in the Indo-Pacific Region

The introduction of the IPEF comes nearly five years after the US withdrew from the TPP. Fourteen countries agreed to join the IPEF: Australia, Brunei, Fiji, India, Indonesia, Japan, South Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, the US and Vietnam. Together, they represent over 40% of global GDP (see Exhibit 2). Notably, Taiwan was not invited to join despite playing a critical role in the semiconductor supply chain. Intuitively, this makes sense, as many IPEF members would have been reluctant to include Taiwan for fear of upsetting China.

The IPEF rests on four pillars: 1) connected economy, 2) resilient economy, 3) clean economy and 4) fair economy. The connected economy pillar captures a wide range of issues including rules on cross-border data flows and data localization policies. The resilient economy pillar considers global supply chains. The clean economy pillar tackles renewable energy and infrastructure. Finally, the fair economy pillar encourages enforcement of anti-bribery and anti-corruption policies. Importantly, members can choose which pillars they would like to support.

Exhibit 2: IPEF Countries Represent Around 40% of Global GDP

Connected economy pillar. As nations prioritize data protection, popular support for the practice of territorializing data has grown. In fact, according to a July 2021 Information Technology & Innovation Foundation (ITIF) report, forced data localization measures now impact over 60 countries. Notably, data restrictions can weigh on growth and productivity and increase prices for goods and services (see Exhibit 3). If IPEF members harmonize data-sharing rules, GDP growth expectations could surge.
Exhibit 3: Restricting Data Flows Has a Significant Impact on a Nation’s Economy Over Five Years

-7.0
-2.9
1.5

GDP Productivity Downstream Industry Prices

Source: Information Technology & Innovation Foundation, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2021

Resilient economy pillar. The global pandemic and Russia-Ukraine conflict have exposed an overreliance by select trading partners on one another. In fact, a study by the World Bank demonstrates that a 10-day increase in domestic and international shipping times could have a significantly negative impact on trade, production and employment (see Exhibit 4). Therefore, broad efforts to diversify critical suppliers present an important opportunity for the Asia-Pacific region as manufacturers reassess supply chains.

Exhibit 4: Impact of 10-Day Increase in Delivery Times on the Global Economy

-16.8
-8.4
-4.3

Trade Production Employment

Note: Shows simulated effect of a global increase in domestic and international shipment times of 10 days from an average of 35 days initially.

Clean economy pillar. Renewables use and the establishment of energy efficiency standards are areas of focus for many Asia-Pacific nations. However, despite considerable progress, renewables share in total final energy consumption levels remains low (see Exhibit 5). If participating members coordinate efforts, renewable energy capital expenditures could increase.

Exhibit 5: Renewable Energy Deployment in the Region Remains Low

2016 Renewables Share in Total Final Energy Consumption

Source: Asian Development Bank, Morgan Stanley Wealth Management Global Investment Office as of 2019

Fair economy pillar. The IPEF seeks commitments to promote a fair economy. This includes reducing anti-competitive practices like corruption and tax evasion. By applying a standard across IPEF members, the framework can enhance the predictability of economic outcomes and lower the cost of doing business in participating economies (see Exhibit 6).

Exhibit 6: It Is Getting Easier to Do Business in the Asia-Pacific Region, but More Progress Is Needed

Note: An economy’s ease of doing business score is reflected on a scale of 0 to 100, where 0 represents the lowest performance and 100 the highest.
Investment Implications

**Tiptoe diplomacy.** The IPEF seeks to encourage greater cooperation in the region. However, we are unsure that the strategy is sufficient to counter China’s influence. Unlike the RCEP, the IPEF does not offer better access to markets, and we worry that countries will be pressured to choose sides without the IPEF offering the benefits of better trade and investment opportunity. Although the IPEF’s overall impact could benefit the Asia-Pacific region, the initiative could potentially have a long onramp for implementation, and decoupling Asia-Pacific nations from China will prove difficult (see Exhibit 7).

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**Exhibit 7: Decoupling From China Will Be Difficult**

Source: Economist Intelligence Unit, IMF, EIU, Morgan Stanley Wealth Management Global Investment Office as of May 25, 2022
Charts You Can't Miss

Exhibit 8: Select Asia-Pacific Region Per Capita GDPs


Exhibit 9: East Asia and Pacific Trends in Foreign Direct Investment


Exhibit 10: ASEAN May Be Poised for a Rebound Following a Decade of Underperformance

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of May 31, 2022

Exhibit 11: There Is Room for Improvement Should the US Prioritize Import and Customs Efficiency and Integrity

Note: The Boarder Clearance Efficiency Index assesses the effectiveness and efficiency of the clearance process of customs and other border control agencies in the eight major trading partners of each country.
Current Readings From Our Quantitative Framework

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Ongoing Development Spotlight

An important indicator of global growth, Taiwan’s exports have been rising, reaching an all-time high of $43.5 billion in March, for a 23rd straight monthly gain, before declining slightly, to $42.08 billion, in May. While May’s 12.5% year-over-year growth missed analysts’ predictions and was a deceleration from April’s 18.8% rate, it was still a sign of extremely strong demand for emerging technologies and digital devices. With concerns over upsetting China allegedly at the heart of Taiwan’s exclusion from the IPEF, the US has a strong desire to maintain access to its valuable technological exports. The announcement of the bilateral “Initiative on 21st Century Trade” between the US and Taiwan could serve as a stopgap given Taiwan’s exclusion from the IPEF. — Brad Fulton

Exhibit 12: Taiwan Remains an Important Part of Global Trade

GLOBAL INSIGHTS

Disclosure Section

Index Definitions

MSCI ASEAN INDEX captures large- and mid-cap representation across four emerging market countries, one developed market country and one frontier market country.

For other index, indicator and survey definitions referenced in this report please visit the following: https://www.morganstanley.com/wealthinvestmentsolutions/wmir-definitions

Glossary

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Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

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GLOBAL INSIGHTS

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