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Tough but fruitful for Team Zafrul

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IT wasn't an easy negotiation to get Malaysia's tariffs with the United States down to 19% from 25% earlier, but Tengku Datuk Seri Zafrul Abdul Aziz (pic) says final discussions swung the pendulum in Malaysia's favour at the last minute.

A one-hour interview with StarBiz 7 revealed that the Investment, Trade and Industry Minister and his team faced significant challenges, as they effectively negotiated with one hand tied behind their backs.

The reason: Malaysia's red lines, which include bumiputra policies, government procurement rules that favour local parties, excise duties on cars to protect the local automobile industry and strict *halal* certification rules.

The other big challenge is how the deal has been compared with other countries. Consider the case of Vietnam and Indonesia. These neighbouring countries have opened up their economies to US goods like never before.

Malaysia, with its red lines, did not come out of the negotiations the worse for wear, as the 19% tariff is comparable to countries in the region. Anything more would have been disastrous.

But then, what about the US\$240bil in committed investments, one may ask. Or the latest threat by US president Donald Trump to impose 100% tariffs on semiconductor manufacturers to compel them to set up production in the United States?

Did we have to make these investment commitments when our Asean neighbours' tariff negotiations didn't include similar conditions?

Tengku Zafrul says most of the amount is based on committed investments by corporations in Malaysia, stressing that the government did not have to commit to spending a sen.

As for the latest semiconductor tariff salvo from Trump, he says for now, Malaysia's semiconductor exports to the United States remain exempt but anything can change, as this stance is subject to review.

"We made the point that since reducing the trade defi-

cit is the major issue to be tackled, then these investments will achieve that. The US negotiators did bring up the issue that these should not count as most of these are committed investments, but we held our ground about the deficit argument.

"In addition, we said that there will be new purchases by Malaysia in the form of liquefied natural gas (LNG) and coal," explains Tengku Zafrul.

Recall that as part of the US\$240bil investments, Petrolim Nasional Bhd will have to purchase US\$3.4bil per year of LNG while Tenaga Nasional Bhd will purchase US\$42.6mil of coal per year.

But to get to these committed investments, a lot of work had to be done in the background by Tengku Zafrul and his team. This entailed engaging with government-linked companies, government-linked investment companies and multinational companies (MNCs) operating in Malaysia. This included discussions with the giant MNC semiconductor companies in the country.

One concern had been that the MNCs would be forced to buy US equipment, which in turn could have meant that they would be prevented from buying from local players. That in turn would have meant that the entire domestic semiconductor ecosystem could have been negatively impacted.

Instead, Tengku Zafrul explains that these investments were what these companies had committed to and so this will not change the local semiconductor landscape.

More importantly, he says, is the fact that there is no government spending in this deal. "There is zero impact to the country's fiscal position".

Excerpts of the interview:

StarBiz 7: How would you describe the negotiations so far?

Tengku Zafrul: It was very different from any other. It was not a typical free trade agreement negotiation. The time was shorter.

We had to study what other countries were gaining or conceding. Another challenge was that Miti lacked jurisdiction over many matters, so we had to consult other ministries and agencies, which were naturally reluctant to make concessions.

We played a coordinating and convincing role within the administration.



■ **Tengku Zafrul and his team effectively negotiated with one hand tied behind their backs**

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■ **Malaysia has to be ready and be in a position to leverage on industries where our companies cannot be easily displaced**

And then we briefed the Cabinet and convinced them we were doing the right thing. We went into the negotiation with the United States with our best offer and proceeded from there. All the time, The Sword of Damocles, in the form of higher tariffs, hung over us. We had negotiated with the US Secretary of Commerce and US trade representatives.

They kept pushing for an offer they felt was good enough to bring to the US president.

That said, they were very professional, not forcing anything on us. They gave us good advice on what would work and what would not cut it for them.

They also advised on what issues were sensitive to the president or to their national and economic security.

The Prime Minister has said defending jobs was the main reason for the deal with the United States. What would happen to job creation and future domestic direct investment (DDI) and foreign direct investment (FDI) flows, if tariffs did not drop to 19% (from 25%)?

Any tariff is bad but at 25%, it would have been even worse as we would be less competitive than our neighbours.

There may be some relocation of manufacturing out of Malaysia to Vietnam, Indonesia or Thailand if companies believe this is permanent.

Furthermore, the loss of US export market share will mean our manufacturers become less competitive to export to other countries, including China, as they will lack the production scale. There will be knock-on effects on the whole supply chain



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because the domestic MNCs and small-medium enterprises (SMEs) supporting the large foreign MNCs will be affected.

We have to consider all these, including that in terms of investments, the United States is also way ahead of others. There are also the knock-on effects on DDI and FDI if we had a higher tariff imposed on us.

Job creation is important for the government, and much of the employment generated comes from SMEs who are tied to the supply chain ecosystems of the MNCs. Should there be job losses in the manufacturing sector, then people won't spend, which will affect the domestic-oriented services sector.

This is why I explained to my counterpart in the negotiations that I have to protect our automotive industry, which employs over 700,000 people. We cannot just switch off like that. Another reason is that if we lifted restrictions for the automotive market, it will not just include US vehicles, but also those from China.

What are the chances of Malaysia's semiconductor exports remaining tariff-free, and should they be subject to tariffs, what will this mean for the future of the industry here?

I feel that the United States still believes in the strategic partnership of both our countries, and

they will be realistic about the sectoral tariffs. Electrical and electronic (E&E) products are 60% of our exports and out of that, 60% of it is semiconductors.

Malaysia plays a significant role in the semiconductor assembly and testing industry. If tariffs are imposed, production costs in this segment are likely to increase.

We don't know what are the US plans in the longer term for sectoral tariffs on semiconductors as they have until December to study the impact. It's hard to predict. Should it be tariff-free?

What does it mean for the future of the industry? For now, it is impossible to predict but I'm quite optimistic that they are

700,000
people in the automotive industry had to be protected, says Tengku Zafrul

US\$3.4bil
per year of LNG to be purchased by PETRONAS as part of the investment commitment

realistic, as even Nvidia has been cleared to sell its chips to China.

What I can say is that the US negotiators have been practical, they understand our red lines and they also understand Malaysia's critical role in the semiconductor supply chain.

I must also thank the US companies and the Malaysia Semiconductor Industry Association who assisted us by explaining the importance of the supply chain and the key partnerships we have here. We met with them in the United States and several of their representatives also met with Trump.

Trump still wants manufacturing to relocate to the United States, but he knows it is not so simple and that at the end of the day, he will do as much as he can to bring them back.

It's not possible to have entire supply chains of manufacturing industries to move to one country, there's risk involved too, and businesses can argue that.

We have to also think of China, as they will be asking us what we can do for them, after what we have negotiated with the United States.

Can the US negotiators foresee this happening? This is why I needed to protect our automotive industry, as similar terms will have to be given to China too.

But for other sectors, such as palm oil, rubber and cocoa, there have been verbal agreements that these goods will be exempt from tariffs, as the United States does not produce them and there is no competition. We are finalising a joint statement that will lead to the agreement as the next step.

What will this deal mean for Malaysia's trade balance with the United States and what does the government plan to do to make up for the loss of this trade surplus?

We have to be smart and diversify. Get more market access for our companies and also foreign MNCs with operations here. We also need to understand that it's okay to have a trade deficit. Singapore has a trade deficit with

the United States, is that bad? No, because it's a transshipment hub.

We have to look at the various reasons. If there's a strong current account balance (one of the three components of a country's balance of payments), a trade deficit is not a bad thing.

We will look at our comparative advantage and we will continue to seek out new markets and grow market share.

This is why we signed the free trade agreement (FTA) with the United Arab Emirates, the European Free Trade Association (Switzerland, Norway, Iceland and Liechtenstein) and Luxembourg.

We also recently concluded an FTA with South Korea and the Prime Minister will sign it when he attends the Asia-Pacific Economic Cooperation summit in late October. We have also started a second round of negotiations with the EU, and just started negotiations with the Gulf Cooperation Council. These talks will all continue.

Will there be a U-turn on the framework agreement?

As a government official, I will say no, they won't renege or make a U-turn on what has been agreed, but we don't know the answer. You will have to make your own assessments on it.

All I can say is that the US market is one that we cannot afford to ignore but the post-World War II economic model is also being questioned by many, as they see that growth among countries is not evenly spread out or inclusive.

Does free trade really benefit countries? For mid-sized economies like Malaysia's, it does.

Many countries still believe in the principles of multilateralism. A lot of countries still believe that there is a need for a World Trade Organisation. A lot of countries still believe in the Paris Agreement and all that.

Apart from exports, Malaysia still needs to be more competitive. We have to be ready and be in a position to leverage on industries where our companies cannot be easily displaced.