

# The End of the American Deficit: Navigating the New Era of American Protectionism (Part 2)

**Azfar Hanif Azizi**



## Building a New Architecture in a Post-Deficit World

### Introduction

In the first part of this analysis, we explored the immediate impact of the US "Liberation Day" tariffs and the restrictive parameters of the Agreement on Reciprocal Trade (ART). We established that the US pivot toward balanced trade or a potential surplus imposes severe limits on Malaysia's export-led growth model and sovereignty, trapping the nation behind a "balance of payments wall" as defined by Thirlwall's Law. However, to fully grasp the magnitude of this shift, we must look beyond the text of trade deals to the machinery of the global economy itself. The second part of this essay examines the structural void left by the US withdrawal from its role as the global consumer, the financial fragility this creates for the Global South, and the urgent strategic pivot required to survive in a world without a buyer of last resort.

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This view was prepared by Azfar Hanif Azizi, a researcher from the Khazanah Research Institute (KRI).

Author's email address:  
[azfar.azizi@krinstitute.org](mailto:azfar.azizi@krinstitute.org)

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## **The Irreplaceable "Consumer of Last Resort"**

One might suggest that Malaysia simply pivot its exports to other markets to replace the US demand ("South-South trade"). This assumes that other nations have the capacity to run sustained trade deficits. They do not.

The US capacity to run chronic deficits is unique, stemming from the "exorbitant privilege" of the US Dollar. Because the USD is the preeminent global reserve currency, the US can pay for imports by issuing its own debt. Global institutional investors and central banks have historically maintained an insatiable appetite for US Treasuries as a "safe haven" asset, although this confidence has shown signs of fracturing following the market volatility post-Liberation Day. This allows the US to rack up foreign debt without facing the capital flight that would befall any other nation.

While Malaysia has largely graduated from the problem of "Original Sin" and can borrow abroad in its own currency, as evidenced by significant foreign participation in the Malaysian Government Securities (MGS) market, it still lacks the monetary sovereignty of the US. Malaysia cannot run massive, chronic twin deficits for decades without investors eventually punishing the Ringgit. Therefore, the global trade loop remains broken without a primary demand driver (a developed nation willing and able to run a deficit).

## **The "Final Sink" and Structural Rigidity**

Furthermore, trade relationships are not fluid water pipes that can be redirected overnight. There is immense "switching cost" involved.

Malaysian manufacturing, particularly in the E&E (Electrical and Electronics) sector, is deeply integrated into Global Value Chains (GVCs). We produce intermediate goods—chips, components, parts. These are not finished goods that can be easily sold to Malaysian households to replace lost US demand.

Crucially, these supply chains ultimately terminate in a "Final Sink", historically the American consumer. Even if we export chips to China, China uses them to assemble mobile phones for the US market. If the US "Final Sink" closes, the derived demand collapses all the way up the chain. China cannot replace the US because China possess comprehensive industrial self-sufficiency and emphasises keeping its industries competitive and retains policies to ensure exports are very competitive, making it unlikely to become a net importer. Without a final consumer, the intermediate producer has no market.

## **Importing Fragility: The Collapse of Financial Self-Insurance**

Finally, the US shift toward balanced trade or a potential surplus creates an acute vulnerability for the financial systems of the Global South. While critics might argue that the US can supply global liquidity via private bank lending even without a trade deficit, this argument ignores the structural fragility such an arrangement imposes on developing economies. It fails to distinguish between gross liquidity (risky bank loans) and net safe assets (US Treasuries), disregarding the fundamental accounting identities of the Balance of Payments.

To understand this, consider the mechanics of a move toward balanced trade or a potential surplus. If the US moves to achieve balanced trade or a potential surplus, developing nations lose their primary source of net foreign exchange earnings. In the previous model, a US deficit allowed

countries like Malaysia to earn a surplus of USD, which was then invested in US Treasuries. These Treasuries served as net safe assets, a "war chest" owned outright by the developing nation.

However, in a scenario of balanced trade or a potential surplus, this flow constricts or stops entirely. Developing nations can no longer accumulate US Treasuries through trade. To obtain US dollar liquidity for banking or investment needs, they must instead borrow it from Western financial institutions. This shifts the financial structure from accumulating net safe assets (reserves) to accumulating gross liabilities (debt). The US banking system holds a claim on the developing nation (a risky asset), while the developing nation holds no new reserves to backstop its own system.

The global system thus shifts from a stable accumulation of reserves to a fragile reliance on credit lines. Developing nations are stripped of the capacity to purchase the safe assets needed to defend their currencies. By achieving balanced trade or a potential surplus, the US effectively closes the window for reserve accumulation, creating a structural safe asset shortage in the Global South. This is inherently deflationary, leaving the global financial architecture fragile and prone to sudden stops.

Crucially, this dismantles the implicit bargain of the post-Asian Financial Crisis era. Since 1997, developing nations have accumulated vast reserves specifically to "self-insure" their financial systems, allowing them to keep their capital accounts open to Western finance without being wiped out by volatility. The US trade deficit was the fountain of this insurance. By shutting off this flow, the US removes the primary mechanism that allowed developing countries to defend their monetary sovereignty while maintaining open markets. Without the ability to earn a safety buffer through trade, these nations may be forced to choose between extreme financial vulnerability or a retreat toward capital controls, reversing decades of financial integration.

### **The Path Forward: Strategic Autonomy and Regional Integration**

The strategic trade-offs associated with the ART, specifically the adjustments required of Malaysian policy autonomy, signal that the current model is no longer merely an economic liability, but a political one. To mitigate the pressure of having to align with agreements that place limits on our foreign policy and domestic agenda, Malaysia must prioritise building strategic autonomy.

This requires a fundamental shift in our industrial strategy consistent with the logic of escaping the middle-income trap. Malaysia must transition from the "In" phase, where we are merely integrated as assemblers in US-led Global Value Chains, to an "Out" phase of strategic detour. In this phase, we must reduce reliance on Western lead firms and focus on building indigenous technological capabilities and own brands.

However, Malaysia faces a constraint of scale. While our domestic market can support full production chains in specific sectors, it is likely too small to sustain the economies of scale required for broad-based full-spectrum capabilities across all high-tech and capital-intensive industries. The solution lies in regional integration and distributed industrialisation with like-minded neighbours and partners across the world. By treating the combined markets of willing ASEAN partners and the Global South as our "domestic" market, Malaysia and its coalition can create a collective full-spectrum production base.

This does not require a rigid supranational institution like the European Union, nor does it necessitate waiting for consensus across a fragmented ASEAN, currently strained by bilateral tensions such as those between Thailand and Cambodia. Instead, it can follow the "Airbus model"

of industrial cooperation among a coalition of the willing. Just as European nations pooled their specific industrial strengths to create a global aerospace giant capable of challenging American dominance, like-minded ASEAN nations can form consortiums where each country specialises in a distinct component of the supply chain: Malaysia in Integrated Circuit (IC) design, Indonesia in advanced battery manufacturing, and Thailand in electric vehicle production, to produce competitive final goods. ASEAN nations must awaken to the reality that their traditional strategy, competing against one another for a shrinking slice of US market access, is now a race to the bottom. In this new protectionist era, the choice is no longer between competition and cooperation, but between collective resilience and individual irrelevance. Crucially, this regional strategy resolves the "Final Sink" dilemma. Sceptics might ask, if the US stops running deficits, who will replace it as the global consumer? The answer is that we do not need a new deficit runner; we need a new volume driver. As established by the Balanced Trade Multiplier mentioned in Part 1, ASEAN nations can drive mutual growth simply by increasing the gross volume of intra-regional trade, even if that trade remains balanced. By exporting advanced electronics to Thailand and importing high-capacity batteries from Indonesia, Malaysia can achieve the high throughput required for economies of scale and technological upgrading without relying on a single external nation to absorb a net surplus.

While ASEAN has historically struggled with economic coordination, the existential threat of US protectionism could perhaps provide the catalyst for unity that was previously missing, transforming regional cooperation from a diplomatic aspiration into a survival strategy. This regional market serves as the incubator for local brands to mature, allowing Malaysia to eventually re-enter the global market ("In") not as a subordinate supplier, but as a lead firm with independent products.

### **Redefining Financial Stability: From Accumulation to Capital Flow Management**

However, industrial capacity alone cannot guarantee stability if the financial system remains vulnerable. In the absence of trade surpluses to build vast USD reserves, developing nations lose their primary insurance policy against capital flight. While encouraging Local Currency Settlement (LCS) can offer some relief by reducing the transactional need for dollars in regional trade, it is a minor buffer against the larger tide. Regionally, there must be a concerted effort to revitalise and operationalise the Chiang Mai Initiative Multilateralisation (CMIM). Established in the wake of the Asian Financial Crisis, this currency swap arrangement offers a critical layer of regional self-insurance, yet it must be strengthened to function as a genuine liquidity backstop independent of Western conditionality. The more significant shift required, however, is the end of fully open capital accounts. Developing nations must embrace Capital Flow Management (CFM), strategic regulations on speculative "hot money" inflows, as a permanent feature of their macro-prudential toolkit. If we cannot build a large enough wall of reserves to withstand the waves of global finance, we must build a system that dampens the waves themselves.

Ultimately, this path of economic independence paves the way for greater monetary sovereignty. By building the domestic capability to produce the vast majority of essential goods, from capital machinery to consumer staples, Malaysia significantly reduces the "import leakage" that currently drains the economy during stimulus periods. If domestic demand can be satisfied by domestic production, the government gains the policy space to stimulate growth without triggering a balance of payments crisis. Furthermore, if Malaysia and its partners can produce critical, high-value exports that the world relies on, global demand for the Ringgit will become structural and persistent. This demand strengthens the currency fundamentally, reducing

exposure to the "exorbitant privilege" of the US and liberating our central banks from the tyranny of the global dollar liquidity cycle. In this transition, our trade surplus with the US should be reframed not as a perpetual growth engine, but as a temporary resource. We must use our current USD earnings to finance the purchase of technology and capital goods needed to transform our economy, effectively "harvesting" the US market to build the independence required to eventually decouple from it.

## Conclusion

The US ambition to achieve balanced trade or a potential surplus fundamentally undermines the development model of the Global South, effectively dismantling what has historically been the main engine of export-led growth and the mechanism of financial self-insurance that has underpinned emerging market stability for three decades. The "Agreement on Reciprocal Trade" may have lowered the immediate tariff pain from 24% to 19%, but it is a temporary reprieve in a permanently altered landscape. The price of this reprieve, compromised autonomy via the "Third Nation" clause and the erosion of domestic policy autonomy via SOE restrictions, highlights the trap of the current model.

We are entering a period of radical uncertainty with no historical precedent: a global economy where the issuer of the reserve currency signals a determination to restrict the net liquidity the system requires. For developing nations like Malaysia, this signals the end of the post-Asian Crisis consensus. We must prepare for the possibility that the era where we could rely on the US as the "consumer of last resort" while maintaining open capital accounts is over. The path forward requires accepting this uncomfortable potential reality. We should stop waiting for a return to the old rules and instead aggressively build regional industrial capacity to drive growth and financial firewalls to manage stability. In this new protectionist era, survival may depend not on how well we can service the American market, but on how quickly we can build a self-sustaining alternative.