An Australia-Malaysia Free Trade Agreement: Australian Scoping Study

A report coordinated by the Australian Department of Foreign Affairs and Trade

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Executive Summary

In July 2004, Australia and Malaysia agreed to conduct parallel scoping studies of a free trade agreement (FTA). These studies were to provide a basis for the two Governments to decide whether to proceed to negotiations.

Australia and Malaysia would both gain from an FTA

This report is Australia's contribution to the parallel scoping studies. Its main focus is the impact of a free trade agreement on Australia. The study finds solid and worthwhile economic benefits for Australia from entering into a free trade agreement with Malaysia. Malaysia would benefit even more strongly.

Economic modelling commissioned for the study and summarized in Chart 1 suggests that an agreement would increase Australia's GDP by $1.9 billion over the period to 2027. Malaysia's GDP would increase by RM18.3 billion (around $6.5 billion) over the same period.[1] Malaysia gains more as the economy with higher trade barriers and a higher ratio of trade to GDP. These estimates use generally conservative assumptions about the impact of a free trade agreement. They do not take into account the gains from greater cooperation in a wide range of areas, including, for example, standards and customs procedures. They do, however, assume immediate implementation of a comprehensive agreement. Welfare gains would be somewhat smaller, particularly for Malaysia, in the event of slower implementation or negotiation of an agreement with very limited services liberalisation.

Malaysia is an important regional economy

Malaysia's annual GDP, at around US$103 billion, is around one fifth the size of Australia's. But Malaysia is far more significant in regional and global trade than this would suggest. In 2003, Malaysia ranked 18th as a world exporter and importer of goods. Its two-way trade in goods and services was bigger than Australia's, comprising over 200 per cent of its GDP. Malaysia is also one of the most dynamic economies in the region, suggesting that opportunities for trade and investment will grow strongly over time. Output in the September quarter of 2004 was 6.8 per cent above that in the September quarter of 2003.

The trading relationship is complementary

Australia's two way trade with Malaysia was valued at some $8.6 billion in 2003-04. The trading relationship is highly complementary. Key Australian merchandise exports reflect Australia's strengths in agricultural and mining commodities, processed foods and metal-based and elaborately transformed manufactures. They include raw sugar, refined copper, unwrought aluminium, dairy products, wheat, coal and

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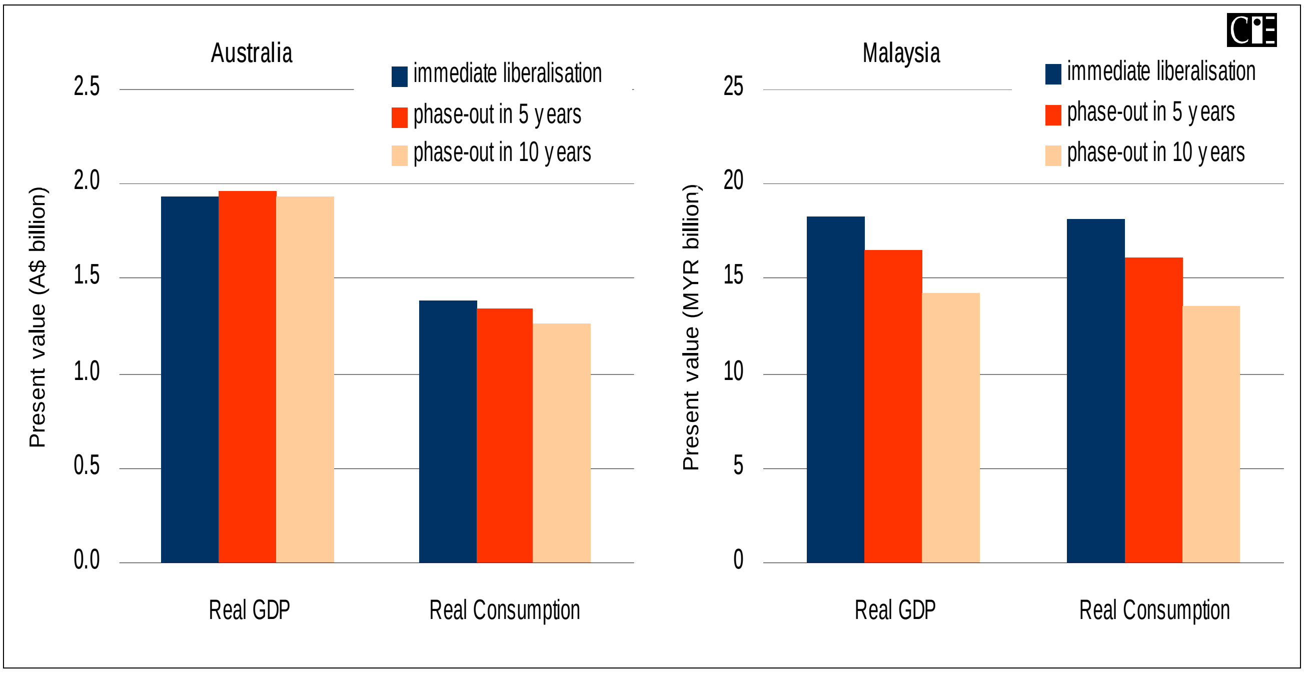
[1] These estimates represent the 2005 net present value over 2005-2027 of liberalisation starting in 2007.

medicaments. Major services exports include education and tourism. Australia's major merchandise imports from Malaysia reflect Malaysia's strengths as an energy exporter and a major exporter of manufactures. They include crude oil, computers, integrated circuits, radios, office machine parts and telephone equipment. Major services imports from Malaysia include transport and travel services.

Chart 1

Gains from an FTA Under Different Phase-In Scenarios[a]



[a] 2005 net present value for the period 2005 to 2027 discounted at a 5 per cent real interest rate.

Data source: APG–Cubed modelling simulation by the Centre for International Economics.

Malaysian investment in Australia is strong

Malaysian investment in Australia has grown strongly in recent years. It is now the 13th largest investor in Australia, with total investment (direct and portfolio) some $6.2 billion at the end of 2003. By comparison, Australian investment in Malaysia has decreased from peak levels reached before the East Asian economic crisis of 1997-98, with total Australian investment in Malaysia around $485 million (of which $263 million was direct investment) at the end of 2003. A free trade agreement would provide an important opportunity for Malaysia to increase its attractiveness as a destination for Australian investment, as well as investment from other countries.

Government and private sector cooperation is strong

Economic links between Australia and Malaysia are underpinned by close cooperation between the two governments, as well as strong private sector contact and people-to-people links. There is substantial cooperation in areas such as education, defence, counter-terrorism, policing and immigration. Both countries work together in multilateral and regional bodies, including the World Trade Organization (WTO), Asia Pacific Economic Cooperation (APEC) and the AFTA-CER Closer Economic Partnership which links the Association of Southeast Asian Nations (ASEAN), Australia and New Zealand. Cooperation on trade and investment is supported by the Australia Malaysia Business Council (AMBC) and Malaysia Australia Business Council (MABC).

Despite relatively low tariffs, there are significant impediments to merchandise trade

Much of the merchandise trade between Australia and Malaysia takes place at low or zero tariffs. There are, however, significant impediments to bilateral trade which a free trade agreement could address. Barriers to Australian trade exports are important in areas such as processed foods and agricultural products, manufactures and services trade. Malaysian tariffs in some areas of manufacturing, including motor vehicles and many steel manufactures, are extremely high. There are important non-tariff barriers, which include import licensing for a number of products, applied partly with the aim of protecting infant and strategic industries.

Malaysia's services regime is protected, but Malaysia would gain from competition

Malaysia's services regime is growing in strength but it remains relatively protected. There are restrictions on commercial presence in many sectors, and in some cases licensing and residency requirements for services providers. Services which are affected by significant barriers include legal services, telecommunications, accounting services, architectural services, engineering services, education services, insurance services and banking. Malaysia would gain strongly from opening these sectors to greater competition. This would be a priority objective for Australia in an FTA with Malaysia.

Malaysia would gain from improved access to the Australian market

From Malaysia's perspective, there are significant barriers in Australia in the more protected manufacturing sectors – passenger motor vehicles and parts, and textiles, clothing and footwear. Under an FTA, Malaysia would also gain an important competitive edge in a number of other sectors, where tariffs are 5 per cent. In addition, a free trade agreement would help to preserve Malaysia's competitive position in the context of new preferential agreements Australia has negotiated with Singapore, Thailand and the United States.

Liberalisation in agriculture would benefit both economies

Case studies in major sectors confirm that there would be benefits to both economies from an FTA. While the majority of Australian agricultural exports to Malaysia face very low or zero applied tariffs, there are notable exceptions which could be addressed in FTA negotiations. Preferential liberalisation could see some increase in Australia's exports to Malaysia of dairy products, some meat products, some processed foods, beverages and some horticultural products. Some export industries would also benefit from Malaysia binding its current duty free entry. Malaysia, for its part could expect to increase some of its agricultural exports to Australia. There would be increased opportunities for two-way investment in the agricultural sector which would benefit both countries, as well as opportunities for closer cooperation on issues such as labelling, halal certification and sanitary and phytosanitary (SPS) issues.

There would be gains from liberalisation in the auto sector

In the manufacturing sector, Malaysia's tariffs vary greatly, with scope for increased Australian exports in many industries. In the motor vehicle sector, for example, Australia would be expected to increase its exports of larger vehicles which currently face very high tariffs and significant non-tariff barriers in Malaysia, as well as specialised automotive components. Malaysia, for its part, would become more competitive (or help to maintain its competitiveness against other suppliers like Thailand) in exporting automobile components and smaller cars (indeed, distributors of Malaysia's Proton are already working to expand sales in Australia). The differing characteristics of the two automobile industries would limit adjustment in each industry, and there would be potential for greater specialisation and two-way investment.

… and for metals and metal manufactures

Australia's main metal exports to Malaysia – copper, aluminium ingot and unwrought zinc – enter duty free. However, under an FTA, there would be opportunities for increased exports of a number of other products which currently attract high tariffs (although export gains could be more limited where duty drawback applies). For example, various aluminium manufactures such as bars and strip attract duties of 25 to 30 per cent. Most hot-rolled flat steel faces a 50 per cent tariff. There would also be greater certainty for exporters from binding duties where applied tariffs are already zero. Malaysia would gain improved access to the Australian market for its exports of iron and steel products and aluminium bars, rods, tubes and pipe fittings.

Mutually beneficial educational links could be further developed under an FTA

In the services sector, there are considerable opportunities to further promote bilateral trade and investment in ways which would benefit both countries. In education, for example, around 20,000 Malaysian students are studying in Australia, and a further 12,000 study in Malaysia at branch campuses established by Australian universities or in twinning or similar arrangements. But some students contemplating study in Australia may be deterred because the Malaysian Public Services Department (JPA) does not recognise all Australian degrees and courses or give adequate recognition to the additional year of study which an Australian Honours degree involves. Delivery of educational services by Australian institutions in Malaysia is also restricted in a number of ways (for example, by limiting the period of advanced standing or recognition of prior learning that foreign universities can offer). Addressing problems such as these would benefit Australia as a provider of quality education services. It would also contribute to improved educational outcomes for Malaysia, including in strengthening local Malaysian institutions through partnership with Australian institutions and in helping Malaysia to become a regional centre for education.

Win-win outcomes are possible in other services sectors

Win-win outcomes are possible in other services sectors as well. For example, there is potential for increased Australian investment in Malaysia's telecommunications sector if Malaysia were to adopt more liberal, less burdensome and clearer rules governing commercial presence and address other regulatory issues. Liberalisation of the financial services sector would provide new opportunities for Australian firms seeking entry to that market, but would also benefit Malaysia by introducing greater competition in an area which provides critical services to other firms.

Similarly, Australian firms and service providers would benefit from more liberal access to the Malaysian market for legal, accounting, architectural and engineering services, where supply through commercial presence and movement of suppliers to Malaysia is quite restricted. But Malaysia would also benefit substantially. Importantly, Australian firms in these areas are not so large as to provide a significant challenge to their Malaysian counterparts, but are likely to provide niche services important to Malaysia's economic development.

An FTA would provide a basis for stronger cooperation on issues such as standards and e-commerce

An FTA would provide a basis for much stronger cooperation and further liberalisation on a wide range of issues. It would tend to encourage closer inter-agency cooperation between the two Governments. Possible areas of greater cooperation and/or further liberalisation include customs procedures, industrial technical barriers to trade, investment, the movement of natural persons, electronic commerce, competition policy, intellectual property, and government procurement. Cooperation in these areas would substantially increase the gains from an FTA for both countries.

On customs procedures, for example, there would be scope, among other things, to cooperate to improve the efficiency of customs procedures, to advise each other of changes in customs regulations and procedures, to work together on implementing paperless trading initiatives, and to move toward more formal cooperation on issues such as commercial fraud. There would be scope to develop an enhanced consultative mechanism covering agricultural issues, including SPS issues, based partly on the current Malaysia Australia Agricultural Cooperation

Working Group (MAACWG). It would also be possible to develop further existing cooperation on halal food production and marketing, an initiative arising from the Australia-Malaysia Joint Trade Committee (JTC). The JTC could provide a forum to advance other issues, for example, in e-commerce, by encouraging the use of electronic trade administration documents and working together on issues like privacy and on-line data protection and unsolicited electronic material.

Any FTA would need to be WTO-consistent and WTO-Plus

Any FTA negotiated with Malaysia would need to be consistent with WTO rules. Among other things, this means that it should cover substantially all trade in goods and services, with the latter understood as no *a-priori* exclusion of any services sector or mode of supply under the General Agreement on Trade in Services (GATS).[2] It would also be important for any FTA to build on Australia's and Malaysia's commitments in the WTO, for example, by addressing issues such as investment liberalisation which are only partly covered by WTO disciplines.

Negotiation of an FTA would be complementary to the broader ASEAN-Australia, New Zealand FTA negotiations, which were agreed at a Commemorative Summit of these countries in November 2004. The two processes could proceed in parallel. It is likely that a bilateral agreement would achieve earlier and deeper liberalisation and comprehensively address worthwhile opportunities specific to the bilateral relationship.

Adjustment issues would be modest

Under an FTA, many firms would gain new opportunities. But some could face increased competition. Overall, however, adjustment issues are likely to be modest for both Australia and Malaysia. In the case of passenger motor vehicles, for example, Australia specialises on larger vehicles, while Malaysia's focus is on smaller cars. Trade in textiles and clothing between the two countries is limited. Services industries in both countries are likely to benefit under an FTA (for example, addressing impediments to trade in education services is likely to benefit the educational sectors of both Australia and Malaysia). Economic modelling carried out for the study confirms that the change in output for most sectors brought about by an FTA is likely to be very small in comparison with those occurring as a result of changes caused by rising incomes, changing consumer tastes and new technologies.

Slowing liberalisation will mean more limited gains

Where adjustment issues exist, they can, to some extent be addressed by longer phasing arrangements for tariff and other barriers. However, it is important to note that longer phasing will also reduce gains. Economic modelling carried out for this

[2] The GATS modes of supply are discussed further in Chapter 4.

study shows that the decline in welfare gains is particularly pronounced for Malaysia when phasing is extended. Malaysia's gains would also be significantly reduced if it were to undertake only limited services liberalisation.

An FTA is consistent with the broader policies of both countries

A free trade agreement is consistent with the broader policies being pursued by both countries. For Australia, an FTA would deepen its integration with the ASEAN economies, building on agreements negotiated with Singapore and Thailand. It would help to promote Australia's commercial interests in Malaysia as it liberalises trade on a preferential basis with other economies, including in the region. It would serve to complement and reinforce liberalisation efforts in the regional and multilateral arena. More generally, an FTA with Malaysia would strengthen the broader bilateral relationship.

For its part, Malaysia would benefit from a closer relationship with the fourth largest economy in the region, and one of the most strongly performing developed economies over the last decade. Malaysia's attractiveness as an investment destination would increase, particularly if it were to liberalise further its investment regime and make it more attractive to business.

Australia should enter negotiations with Malaysia for a comprehensive and WTO-consistent FTA

The study concludes that the case for a free trade agreement with Malaysia is very strong. Accordingly, it recommends that Australia seek to enter into negotiations with Malaysia to establish a comprehensive and WTO-consistent free trade agreement.

On goods, any FTA should cover all tariff and non-tariff measures. It should address comprehensively impediments in services sectors, including education, professional services, telecommunications and financial services. There would also be significant benefits from steps to strengthen cooperation and/or promote liberalisation in such areas as customs procedures, industrial technical barriers to trade, investment, the movement of natural persons (particularly business persons), electronic commerce, intellectual property, and government procurement. Any FTA should include provision for review, so that it becomes a basis for developing further cooperation over time.

Nothing in this study should be understood to pre-judge the way in which particular issues might be addressed in FTA negotiations, if and when the two Governments decide to commence negotiations.

Chapter 1. Introduction

At the Eleventh Australia-Malaysia Joint Trade Committee (JTC) Meeting in Melbourne in July 2004, Australia and Malaysia agreed to conduct parallel scoping studies of a Free Trade Agreement (FTA) between the two countries, to be concluded in the first quarter of 2005. These were to form a basis for determining whether the two countries should proceed to negotiations.

Australia's trade relationship with Malaysia is strong. Two-way merchandise trade between Australia and Malaysia totalled almost $7 billion in 2003-04, making Malaysia Australia's 10th largest trading partner. Services trade reached almost $1.7 billion in that year. Each country occupies important niches in the other's markets, for instance Malaysia's electronics and petroleum products in Australia, and Australia's education services, agri-foods and base metals in Malaysia. Bilateral trade is supported by very strong people-to-people links and substantial cooperation in a wide range of other areas, including education, defence, counter-terrorism, police links and immigration.

Cooperation has continued to develop as a result of the growth of the two economies and stronger Government-to-Government links. The JTC meeting of Trade Ministers is playing an increasingly important role in strengthening and broadening bilateral cooperation on trade and other economic issues. Malaysia and Australia are also working closely together on trade issues in the World Trade Organization (WTO), including through the Cairns Group; in the Asia Pacific Economic Cooperation (APEC) process; and in the ASEAN Free Trade Area (AFTA) - Closer Economic Relations (CER) Closer Economic Partnership (CEP). Cooperation on trade and investment is supported by bilateral business councils in each country - the Malaysia Australia Business Council (MABC) and the Australia Malaysia Business Council (AMBC).

Still, there is scope to strengthen further the bilateral trade and investment relationship. Although bilateral trade in goods is substantial, there are impediments to trade and investment in both economies. Considerable opportunities exist to further develop services trade and investment links to the benefit of both Australia and Malaysia. Australian investment in Malaysia is particularly small when considered against the background of Malaysia's strong growth prospects and significance as a trading power.

This study has been prepared within the context of renewed optimism about the prospects for concluding the WTO Doha Development Agenda. Achieving a timely and substantial outcome from the WTO Round remains the highest priority of Australia's trade policy. But it is clear that, irrespective of the outcome of the Round, bilateral free trade agreements that build on the WTO and other arrangements, and promote mutually beneficial business opportunities, will continue to be pursued in East Asia. Both Australia and Malaysia have been positioning themselves to protect and advance their interests in this new environment. Australia has recently negotiated bilateral FTAs with Singapore and Thailand in ASEAN and with the United States and is carrying out a joint feasibility study on a possible FTA with China. Negotiations on a wider agreement involving ASEAN, Australia and New Zealand began on 21 February this year.

For its part, Malaysia is party to an ASEAN-wide FTA on goods with China which was announced in November 2004 and has been involved in negotiations for a similar arrangement with India. ASEAN will commence negotiations in 2005 for FTAs with Japan and the Republic of Korea, as well as Australia and New Zealand. Malaysia is also negotiating an FTA bilaterally with Japan. It has concluded a Trade and Investment Framework Agreement (TIFA) with the United States, which may form the basis for moving to a free trade agreement between the two economies. Malaysia is also considering the option of free trade agreements with a number of other countries. It is also conducting a separate scoping study on a possible FTA with New Zealand.

Aims and Outline of the Study

The aim of this study is to assess the benefits and costs to Australia of a bilateral FTA with Malaysia. It seeks to assess in some detail the implications of an FTA for economic welfare, the impact on trade, investment and commercial linkages, and competitiveness. Malaysia also looks in detail at implications for the major sectors of the Australian economy, including agriculture, mining, manufacturing and services. It discusses possible implications for employment and adjustment costs in these sectors.

The terms of reference for the Australian study require that it consider the broader trade, political and strategic implications of an Agreement. These include its consistency with Australian trade policies; the potential for an FTA to enhance support for the WTO; its contribution to progressive liberalisation in and among APEC members; and its contribution to the expansion of trade and investment under the AFTA-CER CEP. The study also looks at the value of the Agreement as a framework for pursuing bilateral trade concerns.

In preparing the study, the Department of Foreign Affairs and Trade has accorded high priority to consultations with State and Territory Governments, with industry and with other groups. Consultations were held in all State and Territory capitals during September and October of 2004. The Department of Foreign Affairs and Trade also received around 60 submissions from the public in relation to the study. These consultations and submissions have helped to inform both the broad judgments and the detail of the study.

The study consists of eight chapters. Specifically:

- Chapter 2 examines current bilateral trade and investment flows between Australia and Malaysia and briefly reviews economic cooperation between the two economies.
- Chapter 3 looks at the impact of preferential liberalisation on merchandise trade, services and investment, and on the national economy. It also looks at the broader strategic implications of closer integration between Australia and Malaysia.
- Chapter 4 addresses the implications of preferential liberalisation for key sectors, including agriculture, mining, manufacturing and services.

- Chapter 5 explores possible benefits of cooperation and further liberalisation in a range of other areas, ranging from customs procedures to education and product standards.
- Chapter 6 summarises the results of economic modelling commissioned by the Department of Foreign Affairs and Trade on the impact of a bilateral FTA.
- Chapter 7 explores the possible architecture of a free trade agreement with Malaysia, including the implications of proceeding to an agreement with Malaysia, while also negotiating a broader arrangement with other ASEAN members and New Zealand.
- Chapter 8 draws together the findings of the study and presents its recommendations.

Chapter 2. Australia-Malaysia Trade and Investment Links

The Malaysian economy is one of the success stories in the East Asian region. Its economic transformation over several decades has seen it emerge from a commodity exporter, focusing on rubber and tin at the time of independence in 1957, to a major world trader of manufactured products. Although it is a relatively small economy, around one fifth the size of Australia, its trade exceeds Australia's.

Malaysia's economic development has led to a complementary trading relationship with Australia. Australia is a major supplier of agricultural products to Malaysia, along with mineral and metal-based manufactures required for its industrial sector. Malaysia is also a significant market for Australian services. It was the fifth largest source of students in Australia in 2003. Malaysia is a major supplier to Australia of crude oil, electrical and electronic equipment. It is now the 11th largest source of foreign direct investment in Australia.

The trading relationship is important to both economies. Malaysia is Australia's 10th largest trading partner for goods and the third largest in ASEAN. Australia is Malaysia's 14th largest trading partner. Two-way merchandise trade between Australia and Malaysia accounts for 3 per cent of Australia's total merchandise trade and 2 per cent of Malaysia's.

Cooperation with Malaysia is already strong and is based on long-standing and cooperative links across a broad range of sectors. As identified in Chapter 1, cooperation extends to education, defence, counter-terrorism, police links, immigration and technology, as well as trade and commerce, among others.

2.1 The Australian and Malaysian Economies

Table 2.1.1 compares some of the key characteristics of the Malaysian and Australian economies. Malaysia's GDP, measured at current prices, was US$103 billion in 2003. Australia, as the fourth largest economy in the region, had a GDP of over US$500 billion – equivalent to the combined GDPs of Singapore, Indonesia, Thailand and Malaysia. But the size of Malaysia's economy belies its significance as a trading nation, with Malaysia's exports of goods and services higher than Australia's.

The two economies are among the best performing economies in the region.[3] The Malaysian economy has grown at a real annual rate of 5 per cent over the last ten years. Inflation and unemployment have remained low. However, Malaysia's economy has suffered two substantial shocks in recent years (Chart 2.1.1). The East Asian economic crisis of 1997-98 saw a sharp decline in Malaysia's output in 1998. The slowdown in global economic growth in 2001 and a softening global demand for electronic and electrical products, led Malaysia's growth to fall sharply in 2001. These two shocks have meant that its growth performance has been more uneven than that of Australia.

[3] All of the countries in East Asia (North East Asia and South East Asia) plus Australia and New Zealand.

Malaysia's rapid economic development has transformed it from a rural economy to a manufacturing-based economy. Manufacturing production accounts for about a third of Malaysia's output compared with just over 10 per cent in 1970. Reflecting Malaysia's shift towards higher value manufactures, the electronics sector has expanded more than eightfold in real terms over the past 15 years, doubling its share of total manufacturing output from 14 per cent to 27 per cent in 2003. In recent years, Malaysia's industrial base has deepened further due to development in advanced technology and knowledge-intensive manufacturing sectors.

Table 2.1.1
The Australian and Malaysian Economies

Select Indicators	Australia	Malaysia
Population in 2003 (million)	20	25
Surface Area ('000 square Km)	7,741	330
GDP in 2003 (US$ billion, current prices)	508	103
GDP growth average annual 1993-2003 (%)	3.9	4.7
Per capita GDP 2003 (US$/person current prices)	25,429	4,127
Exports goods and services 2003 (US$ billion)	92	119
Imports goods and services 2003 (US$ billion)	107	97
Consumer Price Inflation, average 2003 (%)	2.8	1.1
Unemployment rate, average 2003 (%)	6	3.6
Secondary school enrolment ratio (% of relevant age group, 2001/02)*	88	69
Public expenditure on health (%GDP)	6.2	2
Infant mortality rate (per 1000 live births, 2002)	6	8

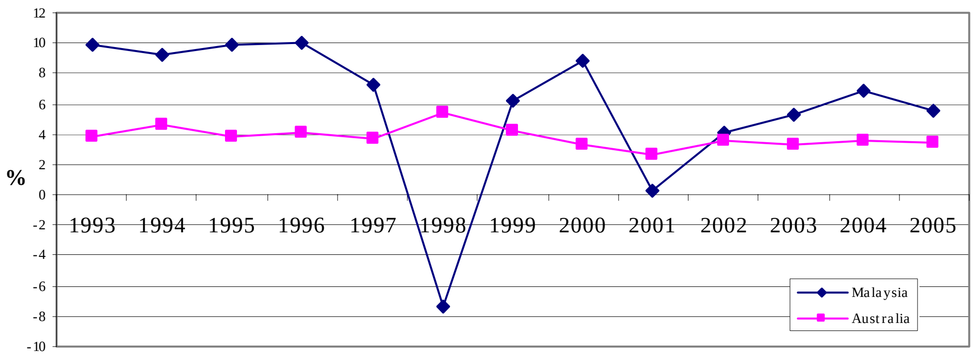
Source: World Bank, IMF, ABS, Department of Foreign Affairs and Trade.

* This is the ratio of children of official secondary school age (as defined by the national education system) who are enrolled in school to the total of secondary school age.

Australia's economy has also undergone substantial changes. While traditional agricultural and resource sectors remain important export-focused sectors of the economy, it has become predominantly a services-based economy, with services accounting for almost 80 per cent of economic activity. As in other developed economies, the relative share of manufacturing to GDP has been declining steadily for some years (from 17.5 per cent in 1980 and 14.3 per cent in 1990 to 11.8 per cent in 2003).

The Malaysian economy has continued to grow strongly in 2004, with output in the September quarter of 2004 6.8 per cent higher than the previous year (one of the fastest GDP growth rates in the region) supported by strong domestic and external demand. Malaysia has benefited from high oil and commodity prices and the upswing in global demand for manufactured goods, especially semiconductors. Domestic demand has been aided by an accommodating monetary policy as interest rates have remained low despite the high budget deficit.

Chart 2.1.1
GDP Growth in Australia and Malaysia



Source: CIEC database. 2004 and 2005 GDP figures are Consensus forecasts.

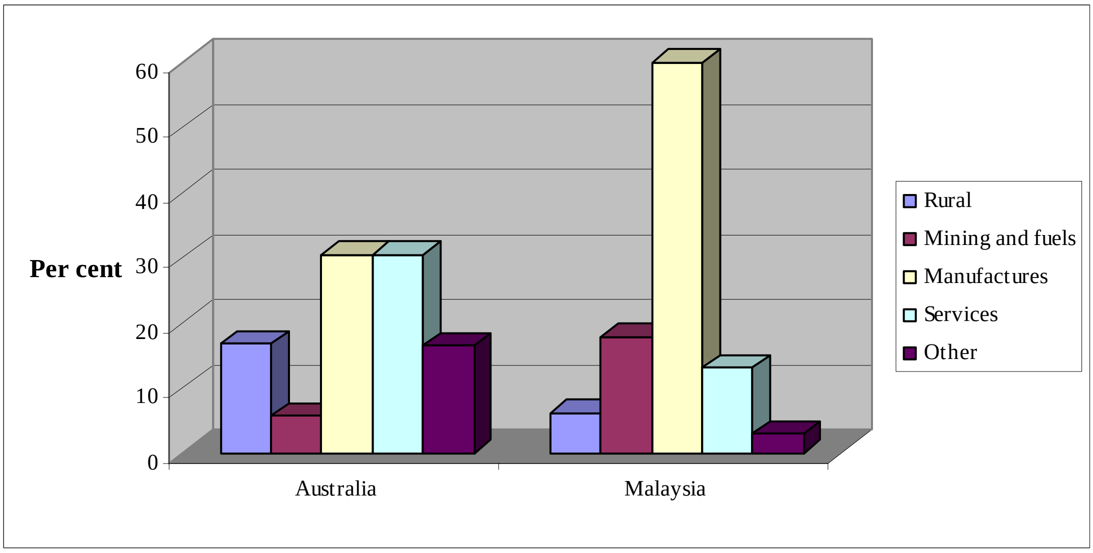
The Malaysian Government has committed itself to winding back its high budget deficit and aims to achieve a balanced budget by 2008. Strong export demand and private consumption are expected to continue to counteract the planned decline in government spending. Private consumption will continue to be underpinned by tax measures introduced in recent Budgets, including a reduction in personal income tax rates, lower import duties on certain intermediate goods and changes to tax holiday coverage for enterprises. These are also expected to continue to stimulate private sector activities. It is expected a goods and services tax will be introduced in 2007.

The Australian economy is expected to report growth of around 3.5 per cent for 2004-05, driven by strong domestic demand. Household consumption growth is expected to remain strong, underpinned by sustained employment growth, continuing moderate wage increases, low interest rates, past gains from housing and equity markets, and fiscal measures in the 2004-05 Budget. Business investment will continue to grow, though it is expected to moderate from current high rates.

Both economies have good prospects for further growth. In Malaysia's case, official forecasts are for growth of 7 per cent in 2004 and 6 per cent in 2005. The long-term aim of the authorities has been for Malaysia to achieve developed economy status by 2020. The Australian Treasury has forecast Australian GDP to grow by 3.0 per cent in 2004-05 and 3.25 per cent in 2005-06.

Both Malaysia and Australia are prominent in global trade. Malaysia was ranked the world's 18th largest exporter and importer of goods in 2003 and is the fourth most trade-reliant economy in the world behind Singapore, Hong Kong and Luxembourg. Its two-way trade in goods and services amounted to over 200 per cent of GDP in 2003. Australia was the 27th largest exporter of goods and the 20th largest importer in 2003. Its two-way trade in goods and services was around 40 per cent of GDP in 2003.

Chart 2.1.2
Australia and Malaysia Share of Exports by Sector



Source: DFAT STARS database (2003 Australia data and 2003 Malaysian data).

Malaysia's exports are now dominated by manufactured products – often with a substantial imported content. They include such items as semi-conductors, electronic equipment and parts, consumer electrical products and industrial and commercial electrical equipment. Other manufactures include chemical, wood and textile products. Overall, manufactured products accounted for about 80 per cent of Malaysia's exports in 2003. Malaysia continues to have significant export interests in primary products, especially palm oil, crude oil and timber. Its traditional commodity exports of rubber and tin are now under 1 per cent of exports, although Malaysia is a significant exporter of processed rubber products.

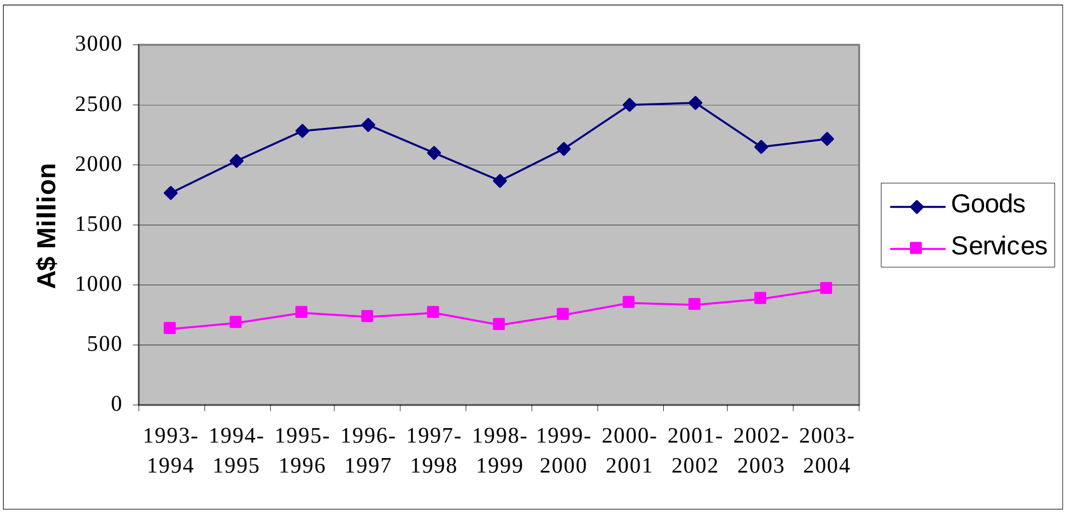
These export strengths are somewhat different from those of Australia (Chart 2.1.2). Australia has a large surplus in trade with Malaysia in processed and unprocessed food products. Services exports are also an important component of Australia's trade with Malaysia, especially in areas such as education and travel services. In contrast, Australia has a deficit on imports of manufactured goods with Malaysia, especially elaborately transformed manufactured goods. Overall, Australia runs a trade deficit with Malaysia.

2.2 Australia's Exports to Malaysia

In 2003-04, Australia exported to Malaysia around \$3.2 billion in goods and services. Malaysia is our 13th largest market for goods, and our 9th largest market for services.

Exports of both goods and services to Malaysia grew strongly in the period leading up to the 1997 financial crisis, from \$2.4 billion in 1993-94 to almost \$3.1 billion in 1996-97. Following declining exports between 1997-98 and 1999-00 under the impact of Malaysia's economic crisis, exports of goods and services expanded again between 1999-00 and 2001-02. However, the downturn in Malaysia's economy in 2001 and the onset of drought impeded Australia's exports to Malaysia. As a result, exports of goods and services to Malaysia declined again between 2001-02 and 2002-03.

Chart 2.2.1
Australia's Exports of Goods and Services to Malaysia



Source: DFAT STARS database.

Recent growth in the world economy, coupled with strong growth in the Malaysian economy and the end of the drought, has revived exports of goods and services to Malaysia. Currently, services exports are at their highest ever, though exports of goods have yet to recover to their peak in 2001-02.

Australia's Merchandise Exports to Malaysia

Australia's merchandise exports to Malaysia were valued at $2.2 billion in 2003-04, up from $1.8 billion in 1993-94. Key merchandise exports include raw cane sugar, refined copper, unwrought aluminium, milk and cream, wheat, coal and medicaments.

In 2003-04, Australia exported $681 million dollars worth of primary products to Malaysia, up over 45 per cent from 1993-94. However, the 1997 financial crisis, the economic downturn in 2001 and Australia's drought over 2001-03, has limited growth in these exports. As a result, Australia's exports of primary products to Malaysia in 2003-04 were 22 per cent below their peak of $871 million in 1996-97.

Fluctuations in Australia's exports of primary products mask divergent trends. For instance, while exports of processed and unprocessed foods have declined since their peaks in 2001-02, in 2003-04 they were still almost 100 per cent and 50 per cent respectively above their levels in 1993-94. In contrast, exports of "other rural' products which includes cotton, have been in constant and significant decline. In 2003-04, mining exports were more than 60 per cent below their peak of almost $90 million in 2000-01, but still almost 25 per cent above their level in 1993-94. In contrast, exports of fuels, while slightly down from their peak in 2002-03, have increased by over 125 per cent since 1993-94.

Table 2.2.1
Australia's Merchandise Exports to Malaysia by Major Category ($ million)

Item	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Primary Products	467.2	548.2	683.3	871.4	676.9	585.4	635.7	705.4	759.9	738.7	680.7
-Unprocessed food	104.8	113.6	135.3	160.6	153.9	137.5	149.1	195.5	211.7	199.7	158.6
- Processed food	166.6	207.5	277.7	461.5	281.8	247.1	275.2	312.2	342.6	295.8	327.6
- Other rural	113.5	139.3	144.2	132.8	130.2	74.9	46.0	53.5	58.0	49.4	36.9
- Mining	28.4	38.1	76.2	69.2	52.2	61.6	82.6	89.5	44.4	70.3	35.2
- Fuels	53.9	49.7	49.9	47.3	58.8	64.3	82.8	54.8	103.2	123.4	122.4
Manufactured Goods	676.3	891.5	980.5	1051.7	916.4	754.1	855.6	1112.8	1073.7	961.9	996.1
*- STMs**	226.9	304.6	321.5	311.4	242.5	326.5	279.6	298.6	336.0	281.4	350.8
*- ETMs**	449.3	536.9	659.0	740.3	674.0	427.6	586.0	814.2	737.7	680.6	645.2
Other exports	615.2	643.5	624.9	408.6	503.6	519.2	639.3	681.4	686.6	445.7	548.2
All merch. Exports	**1,758.7**	**2,033.2**	**2,288.7**	**2,331.6**	**2,096.9**	**1,858.6**	**2,140.7**	**2,499.5**	**2,520.3**	**2,146.3**	**2,224.9**

Source: DFAT STARS database.
* STMs are simply transformed manufactures, while ETMs are elaborately transformed manufactures.

In 2003-04, Australia exported about $996 million worth of manufactured goods to Malaysia, down 10 per cent from their peak of $1.1 billion in 2000-01, but still almost 50 per cent above their level in 1993-94. Exports of manufactured goods have fluctuated over the last ten years. In 2003-04, Australia exported a record $351 million worth of simply transformed manufactures (STMs). Exports of elaborately transformed manufactures (ETMs) were worth nearly $650 million in 2003-04, down 20 per cent from their peak in 2000-01, but an increase of almost 45 per cent from their level in 1993-94. 'Other exports', which consist largely of sugar and wheat, were down in 2003-04 from their peak in 2001-02, but were still up 22 per cent on the previous year.

Australia's top ten primary and manufactured exports are shown in Tables 2.2.2 and 2.2.3. Exports of sugar, wheat and milk have traditionally constituted Australia's top three exports to Malaysia. These exports increased strongly until 2001 (for wheat) or 2001-02 (for raw sugar and milk and cream), but subsequently declined. Refined copper has registered particularly strong growth and was Australia's second highest value merchandise export to Malaysia in 2003-04. Coal exports, while down from a peak in 2002-03, were still worth $93 million in 2003-04, a 440 per cent increase from 1993-94. Exports of high-value manufactured goods to Malaysia, such as medicaments, have grown consistently over the last 10 years. In 2003-04 these exports were 535 per cent above their level in 1993-94. Exports of aluminium, ferrous waste and scrap and wines have also grown strongly over the last ten years.

Table 2.2.2
Australia's Top Ten Primary Exports to Malaysia ($ million)

Item	1993-1994	1994-1995	1995-1996	1996-1998	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Raw sugar	na	na	na	na	222.0	250.5	268.8	258.9	345.3	235.9	237.0
Milk and cream	82.0	118.0	131.8	121.7	128.4	124.7	135.1	161.6	173.3	129.4	154.3
Wheat and Meslin*	165.0	182.0	205.0	241.0	179.0	201.0	233.0	224.0	244.0	179.0	114.0
Coal	21.3	19.6	34.6	34.8	41.7	52.3	50.3	47.1	77.7	115.5	93.7
Live bovine animals	11.6	19.0	21.6	30.7	22.7	23.0	25.1	33.5	41.0	44.8	31.2
Petroleum oils other than crude	9.1	23.4	10.8	10.8	15.5	10.2	5.2	5.4	5.9	5.6	27.9
Meat of sheep or goats, fresh, chilled or frozen	10.9	10.0	13.8	17.4	18.5	15.3	20.7	24.6	26.9	27.0	26.7
Gold	195.3	283.1	204.2	173.2	50.6	21.1	133.3	106.2	56.1	25.6	16.2
Meat of bovine animals, frozen	12.3	13.1	13.2	13.9	14.3	15.7	14.1	17.4	19.2	18.9	14.7
Citrus fruit, fresh or dried	17.9	19.6	22.0	22.2	24.8	19.7	19.2	30.0	32.5	25.9	14.1

Source: DFAT STARS database.
* Malaysian Department of Statistics, Calendar year data (ie:1993-1994 = CY1993).

Table 2.2.3
Australia's Top Ten Manufactured Exports to Malaysia ($ million)

Item	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Refined Copper	15.1	17.0	25.6	75.9	91.4	83.7	167.9	277.7	240.3	228.5	227.2
Unwrought Aluminium	64.9	99.8	113.7	85.6	54.2	98.8	86.8	104.1	172.8	122.8	147.9
Medicaments	16.7	22.7	33.0	35.9	43.1	30.1	50.7	81.4	65.7	86.2	106.0
Unwrought Zinc	30.6	30,7	32.9	37.0	43.8	90.3	63.4	65.9	51.0	46.9	59.6
Aluminium plates, strips, foils, tubes and pipes	8.3	11.0	11.5	18.6	14.7	9.3	23.9	49.8	23.0	26.6	38.4
Ferrous waste and scrap	0.2	3.0	29.9	18.3	0.6	6.8	35.7	35.3	28.8	54.1	25.1
Ferrous Products								2.4	7.7	2.9	19.2
Paints and accessories	9.5	10.8	32.6	27.4	29.6	28.8	29.9	47.8	40.5	19.4	18.0
Wines of fresh grapes	0.6	0.6	1.3	3.1	3.5	6.2	8.8	10.5	11.6	14.4	15.1
Unwrought lead	8.6	9.8	16.0	9.2	16.9	33.6	21.0	10.8	11.1	11.4	13.6

Source: DFAT STARS database.

Australia's Services Exports to Malaysia

Malaysian demand for Australian services has grown strongly over the last ten years, notwithstanding a slight downturn in the wake of the Asian financial crisis. Australia's service exports to Malaysia were valued at nearly $1 billion in 2003-04, representing approximately 3 per cent of Australia's services exports. These figures do not include services traded through the establishment of a commercial presence overseas, such as the provision of education services by Australian universities operating in Malaysia.

Nearly 75 per cent of Australian services exports to Malaysia are in the 'travel services' category, covering expenditure on goods and services by travellers, foreign workers and students. Of these, around two-thirds are education-related (for example, covering expenditure by students) and the bulk of the remainder are in the 'personal' travel and 'other' categories.

In 2003-2004, there were over 175,000 short-term visitor arrivals from Malaysia, making it Australia's second largest source of visitors from South-East Asia behind Singapore (252,600) and ahead of Indonesia (91,500) and Thailand (78,800).[4]

Table 2.2.4
Australia's Service Exports to Malaysia ($ million)

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
TOTAL	**659**	**754**	**852**	**839**	**885**	**972**
Transportation services	107	103	121	102	97	n/a
Travel services	458	519	592	629	634	754
- Business	*15*	*18*	*20*	*20*	*19*	*22*
- Personal	*443*	*501*	*572*	*609*	*615*	*732*
- Education related	*280*	*295*	*340*	*364*	*401*	*462*
- Other	*163*	*206*	*232*	*245*	*214*	*270*
Communication services	np	np	np	11	22	n/a
Construction services	1	np	np	np	1	n/a
Insurance services	0	0	0	np	0	n/a
Financial services	1	1	1	1	1	n/a
Computer & information services	2	6	5	3	2	n/a
Royalties & license fees	3	1	2	6	4	n/a
Other business services	45	67	90	65	100	n/a
Personal, cultural & recreational services	Np	23	11	15	18	n/a
Government services	8	8	7	7	7	n/a

Source: DFAT STARS database.

Exports of education services have grown strongly in recent years. There were 17,500 Malaysian students in Australia in 2002 and 19,800 in 2003, making Malaysia our fifth largest source of overseas students in Australia.[5] 'Other business services' (for example, legal, accounting, management consulting, engineering and architectural services) have also grown strongly, more than doubling since 1998-99 to reach $100 million in 2002-03.

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[4] Australian Bureau of Statistics.
[5] Department of Education, Science and Training, AEI – International Education Network.

Box 2.2.1

QBE Insurance Group

QBE Insurance Group is Australia's largest international general insurance and reinsurance group, and one of the top twenty-five insurers and reinsurers worldwide. QBE Group was first represented in Malaysia in 1905, later becoming QBE Insurance (Malaysia) Berhad. In April 2002, QBE merged with MBf Insurans Berhad to create the QBE-MBF Insurans Berhad. The QBE-MBF joint venture in Malaysia brings together two companies with established presences in the local market.

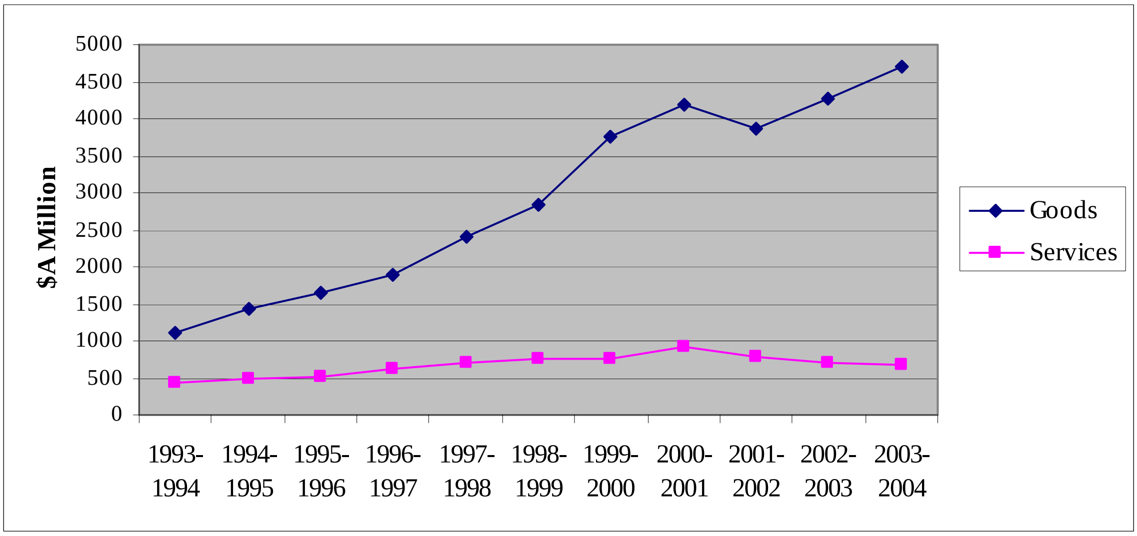
The QBE-MBF joint venture is primarily focused on business clients, both corporate and small-to-medium enterprise, with particular emphasis on the specialist classes of insurance. The company also underwrites a variety of personal insurances for individuals which includes householders' policies, private motor, personal accident, travel and personal liability. The company has an extensive branch network, supporting agents, brokers and clients throughout Malaysia.

2.3 Australia's Imports from Malaysia

Australia's imports from Malaysia have grown strongly over the past decade, rising from just over $1.5 billion in 1993-94 to almost $5.4 billion in 2003-04. Most of the growth in imports has come from the expansion of merchandise imports (Chart 2.3.1). As a result, Australia now has a substantial deficit in merchandise trade with Malaysia.

Chart 2.3.1

Australia's Imports of Goods and Services from Malaysia



Source: DFAT STARS database.

Merchandise Imports

Merchandise imports from Malaysia were valued at $4.7 billion in 2003-04, representing Australia's 9th largest import source. Australia's main merchandise imports from Malaysia are crude oil, computers, integrated circuits, radios, office machine parts and telephone equipment. Merchandise imports from Malaysia now represent 1.7 per cent of Australia's total merchandise imports.

Table 2.3.1
Australia's Merchandise Imports from Malaysia by Major Category ($ million)

Item	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Primary Goods	332.3	387.1	414.4	336.2	422.9	499.3	960.3	1,035.5	941.6	1,082.6	1,533.6
- Unprocessed food	21.1	19.4	12.5	10.7	10.9	11.1	13.7	12.9	15.0	24.0	10.4
- Processed food	113.3	140.5	159.3	145.4	167.1	176.7	153.2	154.6	173.1	198.2	198.1
- Other rural	156.2	173.4	100.1	106.5	100.8	92.5	108.8	91.9	90.3	100.5	87.7
- Mining	0.1	0.5	0.7	0.6	1.3	1.1	0.8	1.9	5.3	6.9	4.0
- Fuels	41.6	53.4	141.8	72.9	142.8	217.8	683.8	774.2	658.0	753.1	1,233.4
Manufactured Goods	752.0	999.0	1,190.6	1,524.7	1,932.9	2,291.0	2,723.3	3,046.2	2,761.0	3,012.9	3,037.0
*- STMs**	89.4	149.7	137.0	174.5	171.1	165.0	189.8	207.5	222.1	255.5	240.8
- ETMs	662.6	849.3	1,053.6	1,350.2	1,761.8	2,126.0	2,533.6	2,838.7	2,538.8	2,757.4	2,796.2
Other	18.9	34.8	30.8	30.1	48.7	54.4	81.8	95.0	154.4	165.9	134.4
All merch. Imports	**1,103.2**	**1,420.9**	**1,635.8**	**1,891.0**	**2,404.5**	**2,844.6**	**3,765.4**	**4,176.6**	**3,857.0**	**4,261.4**	**4,705.0**

Source: DFAT STARS database.
***** STMs are simply transformed manufactures and ETMs are elaborately transformed manufactures.

As shown in Table 2.3.1, Australia's imports of primary products from Malaysia grew from $332 million in 1993-94 to $1.5 billion in 2003-04, an increase of over 460 per cent. While imports of processed foods have increased over this period, the growth in primary imports has been largely driven by imports of fuel, which grew from just $41.6 million in 1993-94 to over $1.2 billion in 2003-04.

Imports of manufactured goods have also increased significantly over the last ten years, from $752 million in 1993-94 to over $3 billion in 2003-04. This growth has been driven by imports of both elaborately and simply transformed manufactures. Elaborately transformed manufactures, such as computers, electrical goods and telephony equipment were worth almost $2.8 billion in 2003-04, an increase of over 420 per cent in the last 10 years. Imports of simply transformed manufactures, such as plastics and rubber, also grew steadily from $89 million in 1993-94 to over $240 million in 2003-04.

Australia's top ten imports from Malaysia of primary and manufactured goods are shown below in Tables 2.3.2 and 2.3.3. While growth in imports of primary products over the last ten years has been largely driven by imports of crude and non-crude oil, imports of other primary goods have also experienced strong growth. Palm oil for instance, while down from its peak in 1998-99, is still almost 40 per cent up from its level in 1993-94.

Over the last ten years, imports from Malaysia of manufactured goods have grown very strongly across a broad range of products. Import growth for computers, electrical apparatus, seats and furniture in these products since 1993-94 has been impressive, with computers being up almost 2000 per cent. Imports of electronic circuits and radios have fallen from their peaks in 1997-98 and 2000-01 respectively. However, imports of electrical circuits were valued at $287 million in 2003-04, up from $42.3 million from 1993-94, and imports of radios were worth $132 million in 2003-04, up from $74 million in 1993-94.

Table 2.3.2

Australia's Top Ten Primary Imports from Malaysia ($ million)

Item	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Crude oil	28.8	42.4	122.0	55.4	84.1	201.6	631.7	692.4	601.4	663.6	1,129.0
Non-crude oil	0.1	4.2	11.0	6.0	49.9	12.0	51.5	79.2	55.9	88.4	103.3
Palm oil	48.7	65.7	75.3	62.2	79.9	90.0	67.0	59.2	60.8	73.0	67.9
Cocoa oil	13.7	18.9	17.5	14.8	16.2	20.2	13.4	14.3	17.0	17.7	14.9
Cocoa powder	3.1	4.0	4.1	4.0	4.8	4.8	4.9	6.9	11.6	17.5	12.9
Coconut oil	3.1	4.1	6.2	7.0	8.9	9.2	10.9	8.4	11.6	12.0	12.7
Crustaceans	14.8	15.9	15.3	13.0	15.3	12.3	11.9	15.9	15.4	14.0	12.5
Animal or vegetable oil	4.0	5.3	7.0	7.6	6.9	4.8	5.0	4.7	4.1	5.7	9.7
Margarine	0.8	0.6	0.8	0.8	0.9	1.0	1.8	2.6	3.5	5.3	9.6
Prepared or preserved fish	2.6	2.9	2.8	2.6	2.9	3.5	5.1	7.2	8.1	7.9	7.9

Source: DFAT STARS database.

Table 2.3.3

Australia's Top Ten Manufactured Imports from Malaysia ($ million)

Item	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Computers	40.9	72.8	150.2	263.4	378.4	545.5	743.2	852.5	682.3	696.3	806.3
Electronic integrated circuits and microassemblies	42.3	41.3	65.8	166.7	312.4	302.9	261.6	236.1	197.0	242.5	286.6
Electrical aparatus for line telephony aor line telegraphy	2.7	4.5	13.1	27.8	39.5	60.4	60.8	96.8	105.9	116.1	152.7
Radios	74.4	127.4	136.7	140.2	128.2	124.3	121.9	148.2	144.3	166.7	131.6
Television sets	57.5	60.7	72.2	88.6	56.8	62.7	77.5	108.9	84.9	114.6	93.8
Seats (other than medical, surgical or barbers	16.0	19.7	20.5	33.6	45.0	57.0	86.0	72.3	81.3	93.2	93.7
Office machine parts and accessories	5.5	7.7	32.3	31.9	56.2	98.0	129.0	120.2	85.0	154.8	91.9
Furniture	15.3	18.4	22.7	34.0	42.7	57.0	85.5	78.6	82.2	87.9	90.7
Air conditioning machines	14.6	26.3	20.4	30.5	51.5	53.5	41.1	47.8	55.1	61.8	58.7
Transmission apparatus	3.7	3.8	3.5	4.1	33.1	96.4	126.6	182.1	87.1	74.3	58.2

Source: DFAT STARS database.

Australia's Services Imports from Malaysia

Australia's services imports from Malaysia were valued at $688 million in 2003-04, down from $918 million in 2000-01. Services imports from Malaysia account for 2.1 per cent of Australia's total service imports.

Australia's services imports from Malaysia are mainly in the form of transportation services (51 per cent) and travel services (44 per cent). Travel service imports are largely divided between business and 'other' travel (education-related travel imports were $15 million in 2003-04). Most of the decline in services imports from Malaysia since 2000 has been in transport services (see Table 2.3.4).

Malaysia remains a significant, but not a leading destination for Australian travellers – around 126,000 Australians visited Malaysia in 2003-04, according to Australian data. By comparison, in 2003-04, 271,000 visited Indonesia, 154,000 Thailand, and 149,000 Singapore.[6] However, Malaysian data suggest a much higher figure of around 145,000 Australian tourist arrivals in 2003. Past Malaysian data has recorded Australian tourist arrivals as much higher. This discrepancy can largely be explained by the fact that many Australians who visit Malaysia as part of a stopover or short stay en-route to a third country, are likely to list a country other than Malaysia as their destination on Australian travel documents.

Table 2.3.4

Australia's Services Imports from Malaysia ($ million)

	1998-1999	**1999-2000**	**2000-2001**	**2001-2002**	**2002-2003**	**2003-2004**
TOTAL	**744**	**774**	**918**	**790**	**692**	**688**
Transportation services	436	412	553	459	372	349
Travel services	244	270	304	284	258	302
- Business	*99*	*100*	*110*	*122*	*113*	*121*
- Personal	*145*	*170*	*194*	*162*	*145*	*181*
- Education related	*11*	*13*	*15*	*9*	*13*	*15*
-Other	*134*	*157*	*179*	*153*	*132*	*166*
Communication services	np	np	np	np	np	n/a
Construction services	0	0	0	0	0	n/a
Insurance services	0	0	0	0	0	n/a
Financial services	4	5	5	5	5	n/a
Computer & information services	2	np	1	np	1	n/a
Royalties & license fees	np	0	np	0	np	n/a
Other business services	11	3	9	15	14	n/a
Personal, cultural & recreational services	np	3	np	1	2	n/a
Government services	12	13	14	11	12	n/a

Source: DFAT STARS database.

[6] Australian Bureau of Statistics.

2.4 Investment Links

Australian Investment in Malaysia

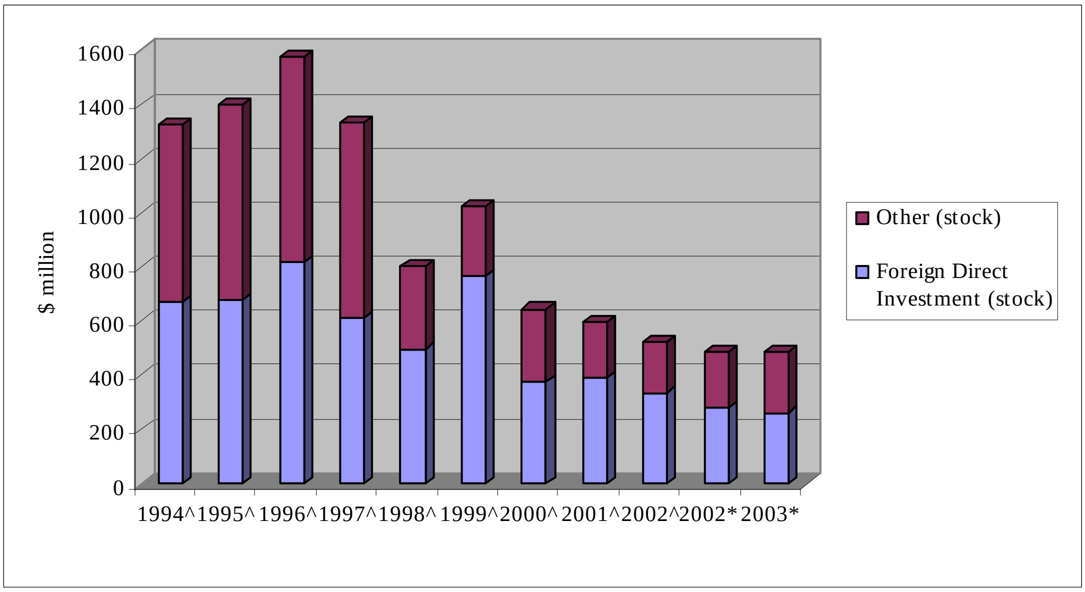
Australian investment in Malaysia has declined over the last ten years. From a peak of almost $1.6 billion at mid-1996, Australian investment in Malaysia at 31 December 2003 was worth $485 million, of which $263 million constituted foreign direct investment. Malaysia currently ranks 28th as a recipient of Australian foreign investment and 15th as a destination for Australian foreign direct investment.

Between mid-1994 and mid -1996, total Australian investment in Malaysia grew by almost 20 per cent, from approximately $1.3 billion to almost $1.6 billion (Chart 2.4.1). Australian foreign direct investment also grew by similar proportions. However, between mid-1997 and mid-1998, Australia's stock of foreign investment in Malaysia fell some fifty per cent to $803 million, reflecting disinvestment by Australian companies caused by the East Asian financial crisis. Foreign direct investment (FDI) stocks declined by 40 per cent. There was a rebound in the year ending 30 June 1999, possibly as a result of the depreciation of the Malaysian ringgit, but there were further falls in subsequent years. Investment levels have steadied at almost $500 million since 2002.

Australian investment in Malaysia represents only 0.1 per cent of Australian investment abroad and 0.2 per cent of Australian foreign direct investment. It is also low when compared with Australian investment in the other ASEAN countries. At the end of 2003, Australian investment stocks in ASEAN were worth $16.3 billion. Of this amount, nearly $11.9 billion was invested in Singapore, twenty five times the amount of investment in Malaysia, while over $2.1 billion was invested in Indonesia. Part of this investment reflects Singapore's role in the region as a financial centre and as an *entrepot* – a place of transit for goods on their way to countries like Malaysia.

Chart 2.4.1

Composition of Australian Investment in Malaysia



Source: DFAT STARS database.

^ Financial Year data at 30 June**,** * Calendar year data at 31 December.

Table 2.4.1
Stock of Australian Investment Abroad ($ million)*

Country	2001	2002	2003
USA	207,482	192,872	211,044
EU	122,609	143,394	148,418
New Zealand	25,701	30,362	37,088
Japan	25,557	19,866	21,873
ASEAN	15,436	17,221	16,340
- Singapore	10,132	12,526	11,896
- Indonesia	2,916	2,657	2,128
- Philippines	894	672	731
- Malaysia	565	486	485
- Thailand	245	278	480
Total	**468,160**	**471,218**	**508,218**

Source: DFAT STARS database.
* Combined stock of direct and portfolio investment at 31 December.

There are nevertheless a number of prominent Australian companies with an ongoing commitment to operations in Malaysia, such as Leighton, BlueScope Steel (see Box 2.4.1), Ansell International, Boral, CSR, Macquarie Bank, Monash University Malaysia (see Box 4.1.1), Curtin University, and the Swinburne University of Technology. All have contributed significantly to Malaysia's industrial and infrastructure development, as well as expanding the range of education and financial services available. It is estimated about 400 Australian companies have offices or joint venture arrangements in Malaysia. There are also a number of Australian franchises and licensed retail operations in Malaysia.

Box 2.4.1
BluesScope Steel Limited

BlueScope Steel Limited's first presence in Malaysia was through its majority owned subsidiary BlueScope Lysaght Malaysia, located in Sabah and which has been operating in Malaysia since 1968. BlueScope Lysaght Malaysia manufactures flat steel building and construction solutions including roofing, walling and structural steel products. BlueScope Lysaght Malaysia has been involved in some of Malaysia's largest and most prestigious construction projects, including the Petronas Twin Towers, Kuala Lumpur International Airport and The Star Light Rail Transport (LRT) System.

In 1995, BlueScope Steel Limited increased further its presence in Malaysia by establishing a joint venture company BlueScope Steel (Malaysia) (BSM) with PNB Equity Resource Corporation. BlueScope Steel Malaysia currently manufactures zinc/aluminium alloy-coated steel and Clean COLORBOND pre-painted steel. These products are now widely used in the building and construction industry in Malaysia and have been used in such major construction projects as the KLAS Cargo Terminal at Kuala Lumpur International Airport and the Mid Valley Megamall. BlueScope Steel Malaysia employs 187 people and in October was awarded the Malaysia Australia Business Council *2004 Business of the Year Award*.

<u>The Investment Climate in Malaysia</u>

Malaysia is potentially a very attractive market for Australian business, with strong economic growth, rising disposable incomes, growing urbanisation and increased consumer spending. These trends can be expected to support demand for better-quality housing, goods and services. Further, as their incomes expand, Malaysian consumers are increasingly demanding access to higher value goods and services, including healthcare products, leisure goods, education and tourism. Malaysia also has growing needs for infrastructure development. It can serve as a base for trade with other countries in the region.

Malaysia actively promotes foreign direct investment, though the associated regulations and guidelines are extensive. Its foreign investment policies are designed to foster industrial and export development (especially in manufacturing and high technology industries), and at the same time advance social objectives (such as promoting participation by Bumiputera in employment).[7]

In the past, foreign investment policy relating to the manufacturing sector sought to link approval for foreign equity with exports or technology transfer. Equity guidelines have been relaxed significantly in recent years. For example, in June 2003, the Malaysian Government announced that 100 per cent foreign equity holdings are allowed for investments in new manufacturing projects.

However, it is assumed that the following industrial guidelines still apply to manufacturing projects set up prior to June 2003:

- for FDI projects exporting at least 80 per cent of production, no equity limits are imposed;
- for FDI projects exporting 51 to 79 per cent of production, foreign limits up to 79 per cent are imposed. This is, however, dependent on the level of technology involved, potential spin-off effects, the size and location of the investment and the extent of local value added in production;
- for FDI projects exporting 20 to 50 per cent of production, foreign equity limits of between 30 and 51 per cent are permitted, subject to similar factors as above; and
- for FDI projects exporting less than 20 per cent of their production, a maximum of 30 per cent of foreign equity is permitted.

There are still significant foreign equity restrictions in many sectors. Proposals to acquire interests in Malaysian business and companies may require approval from Malaysia's Foreign Investment Committee (FIC) (see Box 2.4.2). For example, FIC approval must be sought for proposals to acquire interests in companies valued at over RM10 Million (approximately $3.5 million). Approval is also required where a single foreign investor intends to acquire 15 per cent or more of the voting rights of a company, or where a group of foreign investors intends to acquire 30 per cent or more

[7] A Bumiputera is an official definition used in Malaysia, embracing ethnic Malays as well as other indigenous ethnic groups.

of the voting rights of a company.[8] Foreign investors also face a number of restrictions in relation to the use of foreign labour.

Box 2.4.2

Malaysia's New Economic Policy and the Foreign Investment Committee

Introduced in 1970, Malaysia's New Economic Policy (NEP) has sought to eradicate poverty and restructure society to correct economic imbalances. The NEP has been one of the primary drivers of the dramatic socio-economic changes that have occurred in Malaysia over the last 35 years. As part of the NEP, the Malaysian government has sought to alter the pattern and extent of foreign ownership and control in the Malaysian economy.

In 1970, about 60 per cent of share capital in Malaysian limited liability companies was foreign owned. The Malaysian Government set itself the objective that by 1990 Malaysian companies would have 30 per cent ownership by Malays and other indigenous people (Bumiputera ownership), 40 per cent ownership by non-Bumiputera Malaysians and 30 per cent ownership by foreign interests. These objectives are reflected in the FIC Guidelines on the Acquisition of Interests, Mergers and Take-overs by Local and Foreign Interests.

The FIC Guidelines' equity conditions include the following:

- companies must achieve and maintain a minimum of 30 per cent Bumiputera ownership;
- companies which already have Bumiputera ownership of 51 per cent or more must maintain at least 51 per cent Bumiputera ownership; and
- companies with activities involving the national interest, including water and energy supply, broadcasting, defence and security, are limited to a maximum 30 per cent foreign ownership.

Following the East Asian Economic Crisis and the subsequent reduction of foreign investment in Malaysia, restrictions on foreign investment in certain sectors have been relaxed. Certain types of acquisitions are now exempted for the FIC Guidelines and 100 per cent foreign ownership allowed in:

- manufacturing companies licensed by the Ministry of International Trade and Industry (MITI);
- Multimedia Super Corridor (MSC) status companies; and
- companies that have been granted special status by the Ministry of Finance, MITI or other ministries.

The basis on which exemptions can be granted by various government agencies is currently unclear. Furthermore, there is uncertainly regarding whether these exemptions could be reversed.

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[8] Ministry of Finance, *Economic Report 2004/2005: Investors' Guide*, Percetakan Nasional Malaysia Berhad, Kuala Lumpur, Malaysia, 2004.

Foreign investment restrictions are particularly significant across the services sector. These impediments, together with other aspects of Malaysia's foreign investment regime and Malaysia's competition policy regime (which has implications for foreign investment), are discussed more fully in Chapters 3 and 5.

Malaysia currently has 16 incentive schemes designed specifically for various industries (manufacturing, tourism, agriculture, shipping and transport, manufacturing-related services, Multimedia Super Corridor and knowledge-based industries) as well as activities (environmental management, research and development, training, operational headquarters, regional distribution centres, international procurement centres, representative offices and regional offices) that it would like to promote. In the manufacturing sector, companies granted 'Pioneer Status' are taxed on only 30 per cent of their income for the first five years.

In the Malaysian Budget 2005, the government identified "the agricultural sector as the third engine of growth, after the manufacturing and services sectors".[9] Given Australia's expertise in this area, there are excellent opportunities for Australian investments in all aspects of Malaysia's agricultural sector. The Malaysian government is also keen to develop Malaysia as a leading producer and exporter of halal food.[10] This opens further opportunities for the development of food processing facilities in Malaysia.

The education sector has also been identified as another potential export industry. In order to develop Malaysia as a regional educational hub, the government has indicated that it will seek to encourage greater networking with leading educational institutions from other countries, and will promote increased enrolment in vocational and technical colleges.[11] There are already three Australian branch campuses situated in Malaysia and many Australian universities have substantial exchange and twinning arrangements with education institutions in Malaysia. As a result, Australia is well placed to assist Malaysia with the further development of its education sector.

<u>Malaysian Investment in Australia</u>

At 31 December 2003, Malaysia was the 13th largest investor in Australia, accounting for approximately $6.2 billion in foreign investment in Australian, and the 11th largest source of FDI. Malaysian investment stocks have increased around twelve-fold since mid-1994 (Chart 2.4.2).

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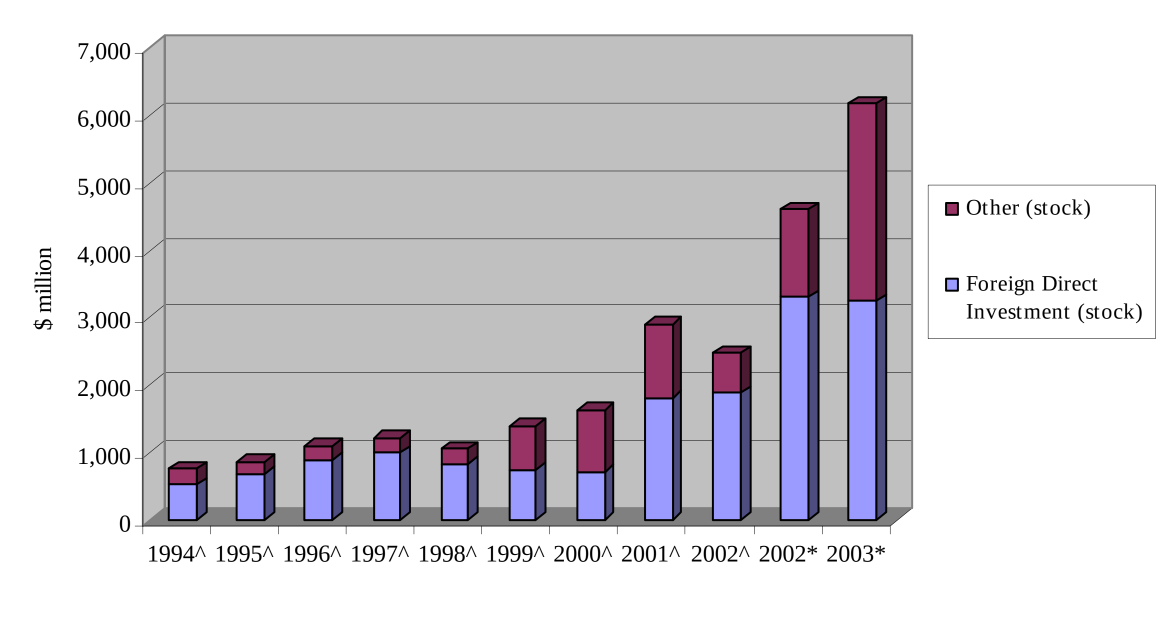
[9] Prime Minister Badawi, *Malaysia's 2005 Budget Speech*, at www.treasury.gov.my/budget05/BS2005.pdf, 10 September 2004, p.13.
[10] *Ibid.*, p.15.
[11] *Ibid.*, p.29.

Chart 2.4.2
Composition of Malaysian Investment in Australia



Source: DFAT STARS database.
^ Financial Year data at 30 June, * Calendar year data at 31 December.

The growth of Malaysian investment in Australia has been especially dramatic since 2002. Between 30 June 2002 and 31 December 2003, total Malaysian investment in Australia grew from $2.5 billion to almost $6.2 billion. This growth has been predominantly in debt instruments rather than in foreign direct investment.

A detailed sectoral breakdown of Malaysian direct investment in Australia is not available, but there are major Malaysian investments in Australia in energy, agribusiness, manufacturing, real estate (including hotels), restaurants, travel agents and the gaming industry.

Box 2.4.3
PETRONAS

Petroliam Nasional Berhad (PETRONAS) is Malaysia's national petroleum corporation and is wholly-owned by the Malaysian Government. It is an international oil and gas company with business interest in more than 30 countries, including Australia.

PETRONAS holds interests in natural gas delivery companies operating in Australia including the Australian Pipeline Trust (APA) and GasNet Australia. It also holds an important stake in the Australian portion of the Papua New Guinea-Queensland Gas Pipeline project and PRTRONAS is leading the construction of the offshore part of the pipeline, which is expected to begin delivering natural gas in early 2009.

Between the 31 December 2001 and 31 December 2003, Malaysian investment in Australian grew from approximately 0.25 per cent to just over 0.6 per cent of total foreign investment in Australia. During this period, Malaysia's FDI in Australia also grew from 0.65 per cent to over 1.3 per cent of total FDI in Australia.

ASEAN investment in Australian at 31 December 2003 was valued at $30.7 billion, equivalent to just over 3 per cent of total investment in Australian. Of the ASEAN countries, Singapore has consistently been the largest investor in Australia, with $22.1 billion invested at 31 December 2003. However, Malaysia's investments in Australia as a proportion of total ASEAN investments have grown from 5 per cent at 31 December 2001 to 20 per cent at 31 December 2003. In contrast, investment by other ASEAN countries in Australia has declined.

Table 2.4.2
Stock of Foreign Investment in Australia ($ million)*

Country	**2001**	**2002**	**2003**
USA	245,631	251,551	297,3111
EU	288,603	319,327	340,733
Japan	48,363	47,792	44,771
New Zealand	17,093	18,875	19,648
ASEAN	46,806	33,341	30,715
- Singapore	41,091	25,826	22,131
- Malaysia	2,219	4,617	6,179
- Philippines	2,369	1,964	1,812
- Indonesia	411	276	362
- Thailand	560	450	161
Total	**846,919**	**896,558**	**978,135**

Source: DFAT STARS database.
* Combined stock of direct and portfolio investment at 31 December.

The Investment Climate in Australia

As a developed country, Australia represents a prosperous market for Malaysian business. Australia's strong domestic economy, high disposable consumer incomes and intensive use of information technology make Australia an attractive market for consumer manufactures. Its rich resource endowment and skilled workforce have also made it an attractive destination for foreign investment.

Foreign investment in Australia is promoted actively through Invest Australia. Australia has an open, transparent and liberal foreign investment regime. Australia maintains a pre-establishment foreign investment screening process to ensure that foreign investments in Australia are not contrary to the national interest. Under the *Foreign Acquisitions and Takeovers Act 1975,* the Treasurer may reject a proposal for a foreign person to acquire control of an Australian business, or an interest in urban land, if he considers it to be 'contrary to the national interest'.

In 2003-04, there was a total of 4830 applications from all countries and only 64 rejections, all of which were in the real estate sector. Over the past 5 years, there have only been 3 non-real estate rejections.

Australia also has an open and efficient regulatory environment and is one of the lowest cost business locations in the industrialised world. Australia's overall tax burden as a share of GDP is significantly lower than the OECD average, including the 30 per cent company tax rate. Australia also has a comprehensive intellectual property regime with strong patent and copyright laws and its legal framework is the most advanced among developed economies for encouraging enterprise competition.

In addition to its well-developed and low-cost business infrastructure, Australia is politically stable with a multi-lingual, highly-educated and computer-literate workforce. Australia has low research and development cost structures and world class information technology and communications infrastructure. Its telecommunications and information technology market is the third largest in Asia and 10th largest in the world. Australia outranks major OECD countries (including the US, Japan, Germany and the UK) in terms of public expenditure on research and development as a percentage of GDP.

Australia's banking sector is deregulated, profitable and sound, and ranked second best for banking regulation and third-best for banking services in 2003.[12] Australia was ranked by the Institute of Management Development as the 4th most competitive nation in the world in 2004.[13]

2.5 Economic Cooperation Between Australia and Malaysia

Bilateral Government-to-Government Cooperation

Malaysia's rapid economic development, location, active participation in the region and its longstanding relationship with Australia across many spheres, makes Malaysia an important bilateral partner. Australia's bilateral relationship with Malaysia is diverse with active and cooperative relations across a broad range of activities.

Reflecting Australia's longstanding commercial links with Malaysia, a *Trade Agreement* was originally negotiated in 1958 between Australia and the then Federation of Malaya. On 1 January 1998, this Agreement was replaced with the *Trade and Economic Cooperation Agreement*, signed during the 1997 meeting of the Australia-Malaysia Joint Trade Committee. The Agreement provided for a deepening of the bilateral commercial relationship, giving a new impetus to both sides to explore opportunities for collaboration in industry, science, technology, trade and investment. The Agreement also encouraged the intensification of trade promotion efforts by both countries.

The highest bilateral body which oversees Australia-Malaysia commercial relations is the regular meeting of the Joint Trade Committee (JTC). The talks, first held in 1986, provide an opportunity to discuss bilateral, regional and global trade and economic issues of mutual interest. The forum has evolved over the years from one that largely addressed trade irritants to a forum with a forward-looking cooperative agenda which seeks to identify bilateral economic initiatives in areas of interest to the private sector.

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[12] These are 2003 ratings by the World Economic Forum.
[13] Institute of Management Development (IMD), *Competitiveness Survey*, 2004.

The JTC meeting, which includes participation by industry, also provides an important avenue for business to raise issues directly with Governments.

It was at the most recent meeting of the JTC in Melbourne on 26 July 2004 that Australian and Malaysian Trade Ministers agreed to undertake the parallel scoping studies on a possible bilateral free trade agreement.

The JTC has been used as a platform to pursue cooperative initiatives in a range of sectors, including agriculture, legal services, health, franchising and energy. Activities have included Ministerial-led visits, study tours, seminars and information exchanges on both sides. Agency-to-agency cooperation activities are an important element of on-going cooperation, for example, between Austrade and the Malaysian External Trade Development Corporation (Matrade), Invest Australia and the Malaysian Industrial Development Authority (MIDA), and the Australian Quarantine Inspection Service (AQIS) and Department of Veterinary Services (DVS).

Agriculture Cooperation

A key initiative arising from the JTC was the Australia Malaysia Joint Halal Food Production and Marketing Initiative agreed by Trade Ministers at the ninth JTC held in Perth in August 2001. The Initiative was designed to encourage Australian food exports into Malaysia which, under its halal certification regime, could be re-exported to third markets. Since the initiative was agreed, working groups in both Australia and Malaysia have met regularly to move the initiative forward and encourage private sector involvement. At the last JTC meeting, Ministers agreed to look at ways to expand the Initiative to cover non-food products.

The Malaysia Australia Agricultural Cooperation Working Group was established in December 2000 to progress areas of cooperation in agriculture that would provide mutual benefit to both countries. The Working Group has operated on an ad-hoc and informal basis through the Australian High Commission in Kuala Lumpur. At the last JTC, Trade Ministers agreed to reactivate this Group to pursue a range of trade and cooperation activities, including in the livestock and fisheries/aquaculture sectors, supply chain management and quality assurance. The inaugural Malaysia Australia Bilateral Plant Quarantine Technical Discussions were held in Kuala Lumpur in August 2003 and, more recently, in Brisbane in November 2004. The talks are expected to be held annually.

Education Links

Australia is the market leader in the provision of international education to Malaysian students. Education links date back to the early days of the Colombo Plan, when many Malaysian students came to Australia from the 1950s to 1980s under scholarships to undertake university study.

The bilateral education relationship is underpinned by a *Memorandum of Understanding on Cooperation in the Field of Education* signed in 1996 and renewed in 2001 for a further five years. The MoU provides for a number of areas of mutual cooperation, including the exchange of academic staff and students, mutual assistance in the area of technical and vocational education, and provision of scholarship schemes for study at higher education institutions. In December 1998, a *Framework Agreement on the Recognition of Academic Qualifications* was signed to supplement the MoU. The agreement promotes educational cooperation between Australia and Malaysia by facilitating the mutual recognition of school and academic qualifications and encouraging the development of credit transfer arrangements between Australian and Malaysian institutions. The Agreement was amended in 2002 by a Supplementary Arrangement to extend the comparability arrangements to the Bachelor degrees of seven Malaysian private universities.

Joint Working Group (JWG) meetings are the principal forum for government-to-government cooperation under the MoU. Australia will host the fourth JWG meeting, in 2005. Malaysia and Australia agreed at the third JWG meeting (Malaysia, June 2002) to establish a high level dialogue on vocational education and training (VET). The first VET Dialogue was held in Canberra in August 2003. The next VET dialogue is expected to be held in conjunction with the JWG meeting and will consider potential areas for collaboration and cooperation.

Regional and Multilateral Cooperation

Like Australia, Malaysia is a relatively open economy which recognises the importance of international trade for its prosperity. Malaysia and Australia are strong advocates for a robust rules-based international trading system as a means of ensuring a predictable and stable trading environment. Malaysia and Australia also work together to support multilateral liberalisation goals in the World Trade Organization (WTO) and regional fora such as the Asia Pacific Economic Cooperation (APEC) and the Association of South-East Asian Nations (ASEAN).

WTO and Cairns Group

While our different economies mean Australia and Malaysia approach aspects of the current WTO negotiations from different perspectives, we are both active members of the WTO and have developed a constructive, co-operative relationship where our national interests coincide.

Most significantly, Australia and Malaysia are members of the Cairns Group of agriculture fair traders, and work together in that context to further advance global agricultural liberalisation. Like Australia, Malaysia shares a desire for an improved environment for international agricultural trade, including greater market access.

Australia’s and Malaysia’s approaches differ to some degree in other aspects of the Doha round negotiations. In the non-agricultural market access (NAMA) negotiations Malaysia and others have sought flexibility to enable exceptions from tariff reduction commitments, particularly for countries like Malaysia which have already liberalised significantly. While recognising the commitment to ‘less than full reciprocity’, Australia would like to see an ambitious outcome encompassing substantial across-the-board tariff reductions. Australia will work closely in the next phase of negotiations with Malaysia and other WTO members to bridge these differences and produce a balanced and consensus-based outcome.

Australia and Malaysia both have important and rapidly growing services sectors in our economies. However our approaches to the WTO Doha round services negotiations differ. Malaysia has advocated an Emergency Safeguard Mechanism (ESM) for services. This would enable provisions to be implemented where domestic service providers become threatened by outside suppliers. Other WTO members, including Australia, have suggested that the practicability of an ESM in the services context needs to be carefully considered. As agreed by WTO members in the July Package, Australia is considering revision of its own initial offer and will work closely with Malaysia and other Members towards having as many improved offers as possible on the table by the May 2005 deadline.

Malaysia's approach to the Doha round is understandably influenced by its position as a developing country. Malaysia has been an active proponent of recognition of the special needs and circumstances of developing countries in the Doha round. Australia understands these concerns, and is working with Malaysia and developing country WTO members to find a way forward in all sectors of the negotiations which addresses developing country interests while also meeting the ambition of the mandate agreed by all WTO Ministers at Doha.

APEC

Australia and Malaysia are foundation members of APEC and work co-operatively in this forum. Our approach to APEC's trade and investment agenda is largely complementary, and Australia and Malaysia are both committed to the forum's trade and investment liberalisation and facilitation agenda and achievement of the Bogor Goals of free and open trade and investment in the region by 2010 for developed economies and 2020 for developing economies. Malaysia and Australia also work cooperatively on APEC capacity building initiatives and recently co-hosted a workshop on corporate governance in Kuala Lumpur.

AFTA-CER CEP

The year 2004 marks the 30th anniversary of Australia's dialogue partnership with ASEAN. On the trade and economic front, the relationship between Australia and ASEAN has continued to strengthen and mature through important initiatives in the AFTA-CER CEP. The AFTA-CER CEP provides a practical demonstration of Australia's commitment to encouraging economic growth and lowering business costs in the ASEAN region.

In April 2004, ASEAN Economic Ministers announced their support for a free trade area with Australia and New Zealand. In September Ministers from Australia, New Zealand and ASEAN recommended to Leaders that negotiations on an FTA commence in 2005 and be concluded within two years On 30 November 2004, Prime Minister John Howard, together with his ASEAN and New Zealand counterparts, announced that an FTA would be negotiated between Australia, ASEAN and New Zealand. The first round of negotiations began on 21 February 2005.

Meeting in Laos, the 12 leaders agreed the FTA would be comprehensive, covering trade in goods and services, and investment, and that it should build on individual members' commitments in the WTO. The leaders also agreed to complete the FTA negotiations within two years and to implement the Agreement fully within 10 years. An FTA with ASEAN will complement our bilateral FTAs with Singapore and Thailand, as well any new FTA with Malaysia. It will also contribute to the strength of Australia's engagement with South-East Asia.

Since 2002, the AFTA-CER Business Council (ACBC) has met with ASEAN, Australia and New Zealand Ministers to discuss options to improve trade and investment between the two regions. ASEAN and CER Ministers have instructed officials to work closely with the ACBC to ensure that an FTA reflects business priorities for deepening regional economic integration. Since 2002, Malaysia and Australia have worked closely in this forum as chair and vice-chair. The chairing of the ACBC was transferred from Malaysia to Australia in April 2004.

IOR-ARC

The Indian Ocean Rim Association for Regional Cooperation (IOR-ARC) launched in Mauritius in 1997, comprises 18 member states, including Australia and Malaysia. The Association aims to expand and facilitate trade and investment in the Indian Ocean region and disseminates information on various regimes, with a view to helping the region's business community to understand better the impediments to trade and investment within the region.

<u>Private Sector Cooperation</u>

The Australian Government has encouraged and supported an active group of institutions which are keen to promote the bilateral relationship and maintain people-to-people links.

The Malaysia Australia Business Council (MABC) and the Australia Malaysia Business Council (AMBC) are key bodies coordinating commercial linkages and conducting regular dialogues with both Governments, including participating in the Joint Trade Committee. The MABC has 275 members and the AMBC has approximately 155 members. Among other responsibilities, the Councils assist with business delegations, especially those accompanying Ministerial visits, and coordinate commercial events to coincide with such visits. The Councils are an important source of information and advice for businesses active in Australia and Malaysia and play an important role in promoting strong business networks.

The Malaysia-Australia Foundation (MAF) and Australia-Malaysia Foundation (AMF) are initiatives of the private sectors in Australia and Malaysia. The MAF was established in 1994 and includes prominent Malaysians – mainly from business and government – and contributes to the relationship through its programs of educational, cultural and people-to-people linkages. The MAF hosted the first Australian Alumni Convention in Malaysia in October 1996. The AMF was formally launched in 2001.

The Malaysian Australian Alumni Council (MAAC) is a national organisation for Malaysian Alumni Associations of Australian Universities, with strong links to the Australian High Commission in Kuala Lumpur. Building on the spirit of the

Colombo Plan, the Malaysia Australia Colombo Plan Commemoration Scholarships provide for two-way exchange of scholars between Australia and Malaysia.

A number of private sector bodies and institutions have also established close links with the Malaysian federal and state governments through the signing of Memorandum of Understandings covering cooperation in a range of areas including health, agriculture, and information and communications technology.

Institutional Cooperation and Legislative Framework

The high levels of bilateral commercial activity operate against the backdrop of an established institutional and legislative framework, including a *Double Taxation Agreement* which entered into force in June 1981. Bilateral air services arrangements were revised in early 2003. In addition, a bilateral *Cultural Agreement* signed in 1975 provides a framework for greater cultural, educational, scientific and technical cooperation.

Many rules and regulations governing business in Malaysia are similar in nature to Australian legislation and regulations. In some circumstances, Malaysia has drawn upon Australia's system as a model for their own. For example, Malaysia's companies legislation closely follows developments in Australian company law and the underlying principles are the same (the Malaysian Companies Act (1965) was based originally on the Australian Uniform Companies Act (1961)). Malaysia's Contract Act (1950) and Contract Amendment Act (1976) are also similar to Australian legislation and Australian cases, for example, on tax and company laws, have significant influence in Malaysian courts. Malaysia uses the Torrens land title system and Common Law, which is the Australian system. In Malaysia, traditional Islamic law is applied to Muslims only in respect of personal status matters.

Securities law in Malaysia is also very similar to Australia's regime. A Memorandum of Understanding (MoU) between the Malaysian Securities Commission and the Australian Securities and Investments Commission (ASIC), signed in July 1998, establishes a framework for assistance and cooperation. Both parties facilitate the exchange of information to enforce and ensure compliance with the securities and futures laws in each country. Mutual cooperation is also evident in terms of enforcement and surveillance of capital market laws. Both countries follow International Accounting Standards (IAS) and each country has an independent board (Malaysian Accounting Standards Board and the Australian Accounting Standards Board). These standards are accorded legal status and Malaysia considered the Australian model closely when establishing its financial reporting framework in 1997.

Bursa Malaysia and the Australian Stock Exchange also consult closely, including in several developmental areas, while the Reserve Bank of Australia and Bank Negara (Central Bank of Malaysia) also have avenues for cooperation and information exchange.

Chapter 3. The Impact of Preferential Liberalisation

Although much of the merchandise trade between Australia and Malaysia is carried out at zero or modest tariffs, significant tariff peaks and non-tariff barriers continue to impede trade. Australia's services trade with Malaysia is affected by substantial restrictions, ranging from equity limits, to problems with the recognition of qualifications and impediments to the movement of service providers. Consumers and firms in both countries would expect to benefit substantially from more open access provided to the other.

From Australia's perspective, major barriers to trade and investment are in the services sector and in parts of agriculture, metal-based manufactures and elaborately transformed manufactures where tariffs remain high or very high. A free trade agreement which addressed these barriers would provide solid and worthwhile benefits for Australia. A free trade agreement with Malaysia would also be consistent with the broader policy which Australia has pursued for several decades, of strengthening its engagement with East Asia. It would provide a stronger basis for cooperation with Malaysia which could yield important benefits over time.

Malaysia, for its part, would expect to benefit from preferential access to the fourth largest economy in the region, with output around three quarters of all the ASEAN economies combined. This access would help to protect its markets in Australia from erosion under the preferential free trade agreements which Australian has negotiated with Singapore, the United States and Thailand. An FTA should also attract increased Australian investment to Malaysia. The commercial and government-to-government links which an FTA would develop would assist Malaysia to move towards its goal of becoming a knowledge economy and achieving developed country status. It would also help Malaysia to promote its specific development objectives in sectors such as agriculture and tourism.

Both countries would expect to gain from the greater certainty that a bilateral agreement would provide for both trade and investment. Both countries are also likely to gain from progressively increasing the scope of the agreement over time.

3.1 Broader Foreign Policy and Strategic Implications

Closer engagement with Asia has been an enduring theme of Australian foreign and trade policies. In part, this reflects the economic importance of the region to Australia. Broadly defined, Asia accounts for around 60 per cent of Australia's export markets and seven of the top ten export destinations. Australia also has strong security and defence interests in close engagement with the region. These interests have become increasingly important in the more complex environment which has followed the end of the Cold War and the growth of international terrorism and trans-national crime.

Although Australia's largest markets in the region are in North East Asia, South East Asia is also of key economic importance. ASEAN economies account for around one sixth of Australia's exports. The dynamism of many of the South East Asian economies suggests that Australia's trade and investment ties with the region are likely to grow strongly over time. Our proximity to the region and its importance for the communications and maritime links vital to our trade interests means that Australia has a strong stake in this region's stability, as well as a powerful interest in close and cooperative relations with its governments.

Australia's bilateral relationships with countries in the region are typically growing more complex as trade, investment and other links develop, and as countries in the region focus on challenges as varied as international terrorism, people and narcotics smuggling and controlling the spread of disease. This underlines the importance of steps to continue to develop strong cooperative relationships with countries in the region, including Malaysia.

Australia's relationships with South-East Asia's economies have grown strongly in recent years. Australia and ASEAN economies have commenced negotiation of an ASEAN-Australia and New Zealand Free Trade Agreement, as agreed in November 2004. This agreement to negotiate an FTA builds upon the ASEAN Free Trade Area (AFTA)- Closer Economic Relations (CER) Economic Partnership (CEP) which has been in place since 2000. It also builds upon the separate bilateral free trade agreements which Australia has negotiated with Singapore and Thailand.[14]

A free trade agreement with Malaysia would be a further important step forward in developing a framework of complementary regional and bilateral ties with ASEAN economies. Malaysia is one of the most dynamic economies in South-East Asia, with a well-developed capacity to negotiate and implement a free trade agreement. The strength of the Malaysian economy, the importance of the bilateral relationship – particularly the economic linkages - and the leading role which Malaysia plays in regional forums suggests that it is a logical candidate for a bilateral free trade agreement with Australia.

3.2 The Implications for Australian Exports

Malaysia's economy has remained highly open to trade in spite of the substantial shocks it has faced in recent years. In 2004, Malaysia's simple average applied tariff was 8.6 per cent (up from 7.8 per cent in 1997), and the import weighted average tariff was 2.6 per cent (down from 4.1 per cent in 1997). However, the bound tariff, which covers about two thirds of Malaysia's tariff lines, is considerably higher than the applied tariff, suggesting there is significant scope for the authorities to raise tariffs.

As Chart 3.2.1 indicates, tariff protection is uneven. Fifty eight per cent of Malaysia's tariff lines were duty-free in 2004, but 14 per cent of tariffs were above 20 per cent.[15] Tariffs and the dispersion of tariff rates are much higher in some areas. For transport equipment (which includes automotive products), the Chart shows the average tariff as almost 37 per cent, but some tariffs are much higher and additional protection is conferred though a range of non-tariff barriers. There are many products where import duties are still high enough to exclude all but small quantities of imports.

[14] The Singapore-Australia Free Trade Agreement entered into force in July 2003. The Thailand Australia Free Trade Agreement entered into force in January 2005.

[15] In practice, the figure is likely to be higher, since tariff lines with specific rate duties are not counted as among those with over 20 per cent tariffs.

Tariffs on products originating in ASEAN and covered by the Common Effective Preferential Tariff are significantly lower than most favoured nation (MFN) tariffs. The simple average tariff rate for Malaysia's Inclusion List for the Common Effective Preferential Tariff was only 1.9 per cent in 2003. This covered over 97 per cent of tariff lines. In line with agreements reached in ASEAN, Malaysia would be expected to eliminate duties on items coved by the Inclusion List by 2010. Malaysia has agreed to transfer 218 lines on automotive products from the Temporary Exclusion List to the Inclusion List by 2005.

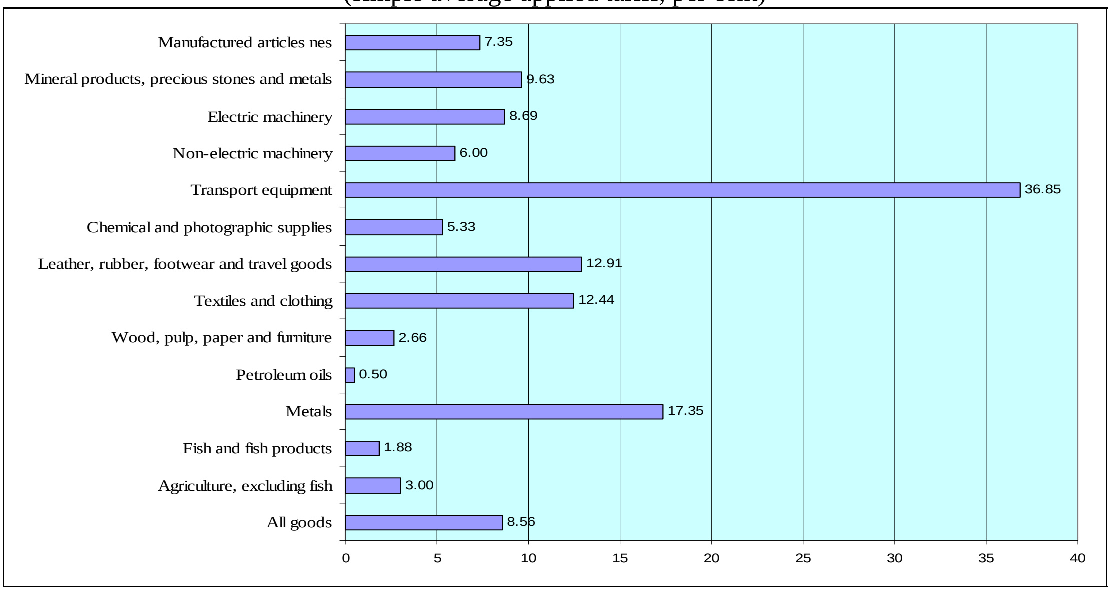
Free trade agreements involving ASEAN are similarly likely to lead to tariff reductions by Malaysia as these are negotiated. ASEAN's free trade agreement with China, for example, requires the elimination of most Malaysian tariffs on the "normal track" by 2010 or at the latest by 2012.[16] Another agreement of this kind is being negotiated with India, and negotiations will commence soon for ASEAN-wide agreements with Japan and the Republic of Korea. Taken together, these agreements and any bilateral agreements entered into by Malaysia with third countries have the potential to erode the competitive position of Australian suppliers unless Australia itself obtains freer access.

Although the tariff is the main instrument of protection in Malaysia, non-tariff barriers are also significant. For example, discretionary import licensing applies to a large number of products, partly with the aim, according to the authorities, of "developing certain important infant and strategic industries as well as to promote greater forward and backward linkages". Rice is purchased through a sole importer (Bernas). Australian industry has also noted a lack of uniformity in the application of the Malaysian tariff – itself an important non-tariff barrier. As discussed below, there are also significant non-tariff barriers in the automotive sector.

Chart 3.2.1

Malaysian Tariffs Barriers Applying to Australia

(simple average applied tariff, per cent)



[16] Sensitive and highly sensitive items are subject to much slower liberalisation.

Malaysia's APEC 2004 Individual Action Plan. Tariffs in the transport sector do not take into account reductions in automobile tariffs which came into effect in January 2005 (see Chapter 4).

A review of Malaysia's tariffs undertaken for this study shows that many of Australia's major exports to Malaysia enter at zero or low tariffs. However, there are a number of areas where tariff and non-tariff barriers could affect Australia's trade appreciably and where significant gains could be made from improved access.

Table 3.2.1 shows Malaysia's simple average applied tariff rates on selected Australian merchandise exports to Malaysia ordered at the broader 2-digit HS (Harmonised System) level. However, assessing the impact of preferential trade calls for a more detailed look at the composition of Australia's exports and barriers to these exports.

In the agricultural sector, the Table shows tariffs as zero for sugar and cereals, which account for a substantial part of Australia's agricultural exports to Malaysia. However, both of these sectors could gain from an FTA. With cereals, for example, Australia is a major supplier of wheat to the Malaysian market and has duty free access to its market. But the industry would benefit from having current applied tariffs bound bilaterally through an FTA. Sales of rice are also affected by the fact that Bernas, a government corporation, has the sole right to import.

Table 3.2.1

Malaysian Tariffs on Selected Australian Exports by Sector

HS	Description	Average Tariff rate (%)	Australian exports(A$m) 2003-2004
17	Sugars and sugar confectionery*	0.0	249.0
74	Copper	3.4	238.3
04	Dairy	5.3	189.1
76	Aluminium	20.3	188.3
27	Mineral fuels, mineral oils	0.5	120.2
30	Pharmaceuticals	0.0	120.2
10	Cereals*	0.0	120.1
84	Machinery**	6.0	97.3
02	Meat	0.0	61.4
79	Zinc	6.4	59.9
72	Iron and steel	16.0	49.6
85	Electrical machinery	8.8	44.3
01	Live animals	0.0	38.0
08	Fruit and nuts	6.0	36.2
07	Edible vegetables	1.0	35.9
48	Paper	11.0	29.9
39	Plastics	15.0	17.8
90	Optical equipment	0.8	17.3
22	Beverages***	Specific	16.3
51	Wool	0.0	13.8

DFAT STARS database; Malaysian tariff data.

* 2003 Calendar year.

** Some items under this category also attract specific duties applied on volumes.

*** Specific duties apply to 89 per cent of lines.

For a number of other agricultural and processed food exports, there are moderate or high tariffs in areas where Australia could supply competitively. For example, tariffs on flavoured yoghurt and flavoured butter milk powder are 25 per cent, and those on processed cheese, 10 per cent. Tariffs on many fruits and vegetables are significant. For example, apples attract a tariff of 5 per cent, some beans 10 per cent and some fruits have mixed (ad valorem plus specific) tariffs. A variety of processed foods attract very substantial tariffs. There would be good prospects for expanding Australia's exports in these areas under a free trade agreement. The potential growth areas are discussed in further detail in Chapter 4.

For industrial goods (including minerals and manufactures), tariffs vary considerably. Malaysia is a major market for aluminium, for example. Much of the product which Australia supplies is in the form of aluminium ingot which enters Malaysia duty free (again, there would be value for industry in bilaterally binding this applied duty at zero). However, more elaborately transformed aluminium manufactures, which Australia might competitively supply, attract higher rates of duty, often of 20 to 30 per cent. A similar position applies in the case of copper, where unwrought and refined copper enters at zero duty, but copper bars and rods attract a tariff of 18 per cent and wire 25 per cent.

In the manufacturing sector, there are some areas with extremely high tariffs, where Australia might expect to gain significantly from improved access. In the case of iron and steel products, for example, tariffs on flat rolled steel products, such as galvanized plate, are typically 50 per cent, a rate which effectively makes imports prohibitive. For automobiles, tariffs on completely built up (CBU) motor vehicles are 50 per cent, with an excise of up to 250 per cent. Tariffs on automotive components are also still very high. For example, tariffs on seat belts are 30 per cent, brake linings for passenger motor vehicles 30 per cent, and gear boxes for these vehicles 25 per cent. There are also substantial non-tariff barriers in Malaysia's automotive sector, which include the rebate of excise taxes for national car manufacturers.

Table 3.2.2.
Other Malaysian Tariff Barriers on Exports from Australia

HS	Description	Average Tariff rate (%)	Australian Exports (A$m) 2003-2004
8703	Motor cars and other motor vehicles	Up to 50*	4.3
7208	Flat rolled products of iron or non-alloy steel	48.8	2.3
7606	Aluminium plates, sheets, strips, foils, tubes and pipes	30.0	38.4
3210	Paints and Varnishes (including enamels and lacquers)	25.0	1.4
7408	Copper wire	10.0	2.1
1805	Chocolate and other food preparations containing cocoa	10.0	6.6

DFAT STARS database; Malaysian tariff data.
*Rate applies to CBU passenger motor vehicles. There is also an excise of up to 250 per cent on CBU vehicles.

There are many areas where tariff liberalization between Australia and Malaysia would lead to new patterns of supply. Table 3.2.2 lists at the 4-digit HS level a few examples of items where Australia's exports to Malaysia are currently small, but which it would expect to export to Malaysia in greater quantities under an Australia-Malaysia Free Trade Agreement.

A free trade agreement would also provide opportunities to address some non-tariff barriers to trade which could have important implications for Australian exports. Industry consultations have suggested that there would be scope to streamline arrangements for the halal certification of food products exported to Malaysia. There may similarly be scope to address sanitary and phytosanitary (SPS) certification requirements of food products such as chicken, liquid milk and eggs through consultations under the framework of a free trade agreement. Various technical barriers to trade (such as safety and environmental regulations) could also be addressed, along with the scope for greater cooperation on government procurement. These issues are addressed in Chapter 5.

Services Exports

Unlike merchandise trade, Malaysia's services trade regime remains relatively protected. Cross-country quantitative work by the Productivity Commission shows Malaysia as among the most protected of the countries for legal and accountancy services. Other studies put Malaysia in a highly restricted category for financial services.[17]

The specific barriers to services trade vary appreciably by sector. Restrictions on commercial presence apply to a number of areas. Malaysia's GATS Schedule notes that foreign acquisition of a Malaysian corporation requires approval in a number of general circumstances, including where it would involve a single foreign interest acquiring 15 per cent or more, or an aggregate interest of 30 per cent or more of the voting rights of a Malaysian corporation. Requirements to reserve a minimum level of Malaysian (including Bumiputera) equity are also commonplace. There are also restrictions on the movement of services providers into Malaysia. Malaysia has left this mode of delivery unbound in many GATS sectors (although companies are allowed to bring in senior managers and two specialists or experts per organisation, with additional experts subject to a market test and training Malaysians).

[17] See D. Nguyen-Hong, *Restrictions on Trade in Professional Services*, Productivity Commission Discussion Paper No. 1638, AusInfo, Canberra, August 2000; G. McGuire and M. Schuele, "Restrictiveness of International Trade in Banking Services", in C. Findlay and T. Warren (eds.), *Impediments to Trade in Services: Measurement and Policy Implications*, Routledge, London and New York, 2000, pp. 201-214.

Table 3.2.3.
Barriers in Specific Services Sectors

Sub-Sector	Principal Barriers
Legal services	To be admitted in Malaysia, lawyers must be Malaysian citizens or permanent residents and pass a Malay language exam (unless exempted). Foreign lawyers are permitted to provide legal advisory services in foreign law and offshore corporations law of Malaysia through GATS Modes 1 and 2. However, foreign law firms cannot establish operations in Malaysia except in the Federal Territory of Labuan to provide limited legal servies to other offshore corporations established in Labuan. The Attorney-General has the power to issue a Special Admission Certificate under special circumstances.
Telecommunications	Under the WTO Basic Telecommunications Agreement, Malaysia made limited commitments on most basic telecommunication services and partially adopted the reference paper on regulatory commitments. Malaysia guarantees market access and national treatment for these services only through acquisition of up to 30 per cent of the shares of existing licensed public telecommunications operators, and limits market access commitments to facilities-based providers. Value-added service suppliers are similarly limited to 30 per cent of foreign equity. Investments exceeding the 30 per cent limits are sometimes allowed, but the circumstances in which this occurs are not clear.
Accounting	Foreign accounting firms can provide accounting and taxation services only through affiliates. Accountants must register with the Malaysian Institute of Accountants (MIA) before they can apply for a licence which allows them to provide auditing and taxation services. Registration with the MIA requires proof of citizenship or permanent residency.
Architecture	Foreign architects cannot be licensed in Malaysia, but can be involved in Malaysian firms. Only licensed architects can submit architectural plans. Foreign architectural firms can only operate as joint ventures in specific projects with approval of the Board of Architects.
Engineering	Foreign engineers can work on specific projects under license from the Board of Engineers and must be sponsored by the Malaysian company undertaking the project. The Malaysian company must demonstrate that they are unable to find a Malaysian engineer. Foreign engineering companies may collaborate with a Malaysian company, but the latter is expected to design the project and is required to submit the plans.
Education	Recognition of qualifications from foreign education providers can be a problem. For example, the Malaysian Public Services Department (JPA) currently recognises qualifications on a course-by-course and a needs-required basis. Foreign educational institutions must be invited by the Government to establish a commercial presence and are subject to a number of limitations when they do so.
Insurance	Foreign shareholding exceeding 51 per cent is permitted only with Malaysian Government approval. New entry by foreign insurance companies is limited to equity participation in locally incorporated insurance companies and aggregate foreign shareholding in such companies may not exceed 30 per cent.
Banking	Foreign banks currently operate under a grandfathering provision and no new banking licenses have been granted to foreign banks for some time, with the exception of three new Islamic banking licenses. Foreign banks must normally operate as locally controlled subsidiaries.

The barriers to services trade have remained in place despite evidence of significant inefficiencies as a result of industry protection. In the case of banking services, one study found that the effect of non-prudential restrictions applying to foreign banks was to lift the price of banking services by over 60 per cent. Another study found that barriers to foreign suppliers of engineering services raised the price of these services by 12 per cent. In the distribution sector, the cost impact of foreign barriers to establishment has been estimated at over 8 per cent.[18]

The authorities envisage that the services sector will be gradually opened over time. In the case of financial services, for example, the Financial Sector Master Plan (FSM) and the Capital Market Master Plan (CMM) released in 2001 envisage liberalisation through staged reforms. Malaysia's ambition to develop its services exports in areas like education, health and construction should encourage it to open its own services sectors, both to improve their efficiency and to secure concessions from other countries in areas of interest to it.

Specific barriers of interest to Australia are set out in Table 3.2.3. The extent to which Malaysia would be willing to liberalise these sectors is unclear at this stage. There are some factors which may encourage Malaysia to agree to liberalisation of these sectors in the context of an FTA with Australia. Australian firms, even in a more liberal trading environment, would be small players in the Malaysian market and they would not, therefore, present the threat to Malaysian firms that larger multinationals, for instance, might. Moreover, in some of the professional services sectors (such as accountancy, architecture and legal), many of the Malaysian practitioners have been trained in Australia and are comfortable with its procedures and accreditation arrangements. For example, both countries follow International Accounting Standards while CPA Australia has about 8000 Malaysian members.

The impact of a free trade agreement on Australia's exports of services are explored in more detail in Chapter 4. However, possible benefits could cover each of the four basic "modes of supply" identified in the GATS[19] and include:

- an increase in investment opportunities in Malaysia in a variety of service sectors, flowing from greater transparency in investment regulations, or improved access. Areas where Australian investment could increase include telecommunications, legal services (where at least some Australian legal firms might take advantage of improved access to establish a commercial presence in the market), and banking and insurance services (where Australia already has a small presence). Increased investment is likely to be reflected ultimately in improved flows of income to Australia, and in new opportunities for other Australian firms;
- an increase in opportunities for Australian services providers, including consultants, academics, medical personnel and others, to seek short term employment in Malaysia;
- an increase in the number of Malaysian students studying in Australia or studying via distance or online education, flowing from greater recognition of Australian

[18] See K. Kalirajan, G. McGuire, D. Nguyen-Hong and M. Schuele, "The Price Impact of Restrictions on Banking Services", in C. Findlay and T. Warren (eds.), *Impediments to Trade in Services: Measurement and Policy Implications*, Routledge, London and New York, 2000, pp. 215-230; D.Nguyen-Hong, *op. cit.*, and K. Kalirajan, *Restrictions on Trade in Distribution Services*, Productivity Commission Staff Research Paper, AusInfo, Canberra, August 2000.

[19] The four "modes of supply" are discussed further in Chapter 4.

educational qualifications. This could also assist Australian branch campuses in Malaysia as could more streamlined procedures (such as more improved accreditation procedures and more flexible provisions regarding the enrolment of foreign students) ;

- a modest boost to the number of Malaysian tourists coming to Australia as a result of an improved relationship.

3.3 The Implications for Australian Imports

In Australia's case, applied tariff barriers are low. Most tariff lines are zero or 5 per cent, with the simple average applied tariff only 4.3 per cent. Moreover, because Australia offers Malaysia tariff preferences[20] on all tariff lines except PMV and TCF items, the average applied tariff applicable to Malaysia is a little lower at 3.9 per cent.

There are two sectors where Malaysia faces tariffs of higher than 5 per cent in the medium term. In the passenger motor vehicle sector, applied tariffs on motor vehicles are 10 per cent (since January 2005). They will remain at this level until 2010, when they will fall to 5 per cent. In the textiles, clothing and footwear industry, a more complex liberalisation of tariffs is occurring, with:

- tariffs on clothing and certain finished textiles now 17.5 per cent;
- tariffs for cotton sheeting, woven fabrics, carpet and footwear now 10 per cent; and
- tariffs on sleeping bags, table linen and some footwear parts now 7.5 per cent.

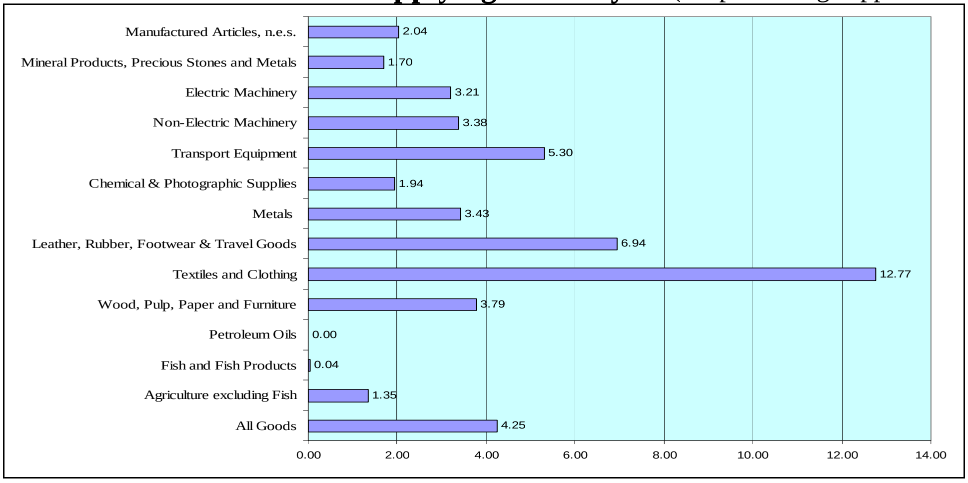
Australia has made preferential concessions in these sectors in the case of other bilateral free trade agreements. Under the Australia-U.S. Free Trade Agreement (AUSFTA), for example, tariffs on finished passenger motor vehicles from the United States are to be phased down to zero by 2010. Under the Thailand-Australia Free Trade Agreement (TAFTA), Australia eliminated tariffs on all passenger motor vehicles, off-road vehicles, goods vehicles and other commercial vehicles of Thai origin on the Agreement's entry into force. Tariffs on a number of automotive parts and components fell to 5 per cent on TAFTA's entry into force in January 2005 and will remain at that level until elimination in 2010.

In the TCF sector, tariffs have been eliminated for products which meet relevant rules of origin under the Singapore-Australia Free Trade Agreement (SAFTA). AUSFTA will see tariffs on textiles and apparel phased to zero by either 2010 or 2015. TAFTA will similarly provide a significant margin of preference to Thailand. For example, tariffs on clothing and certain finished textiles fell to 12.5 per cent on the Agreement's entry into force, and will be phased to 5 per cent in 2010 and zero in 2015.

[20] In some cases, these are developing country preferences and in other cases, preferences which apply specifically to Malaysia.

Chart 3.3.1

Australian Tariff Barriers Applying to Malaysia (simple average applied tariff, per cent)



Australia's 2004 APEC Individual Action Plan. Note: The above table reflects 2004 tariffs. As discussed, duties for motor vehicles and textiles clothing and footwear were reduced in January 2005.

In most sectors, where tariffs are zero or 5 per cent, the impact on imports would be limited – and certainly less than those arising from medium term fluctuations in exchange rates. At the same time, the margin of preference which Malaysia might receive under a free trade agreement would be valuable in its efforts to further expand its exports to the Australian market, particularly in a context in which other competitor countries such as Singapore and Thailand have obtained preferential access.

Australia's motor vehicle imports from Malaysia have remained modest in recent years. They were $25 million in 2003. However, Malaysia remains keen to capture a share of Australia's motor vehicle market with its Proton and distribution agents for its national car manufacturer are putting renewed emphasis into marketing the car in Australia. Australia is also a rapidly growing market for auto parts, with imports from Malaysia now $155 million. In the other major sector where Malaysia faces substantial barriers – textiles, clothing and footwear – Australian imports were valued at $73 million in 2003. There would be useful gains for Malaysia from preferential access in these sectors, but only modest implications for the domestic industry in Australia.

Table 3.3.1 shows Australia's simple average applied tariff rates on selected imports from Malaysia ordered at the 2-digit HS level. It confirms that Australian tariffs on major imports from Malaysia are limited, and that the adjustment issues for Australian industry in most of these areas are likely to be modest.

Table 3.3.1
Australia's Tariffs on Selected Malaysian Imports by Sector

HS	Description	Average Tariff rate (%)	Australian Imports ($ million) 2003-2004
27	Mineral fuels and oils	0.1	1,233.4
85	Electrical machinery	2.8	935.5
94	Furniture	4.6	192.8
44	Wood	2.6	132.2
99	Confidential and Miscellaneous		123.6
40	Rubber	5.7	116.6
15	Fats, oils	1.5	111.1
39	Plastic	5.1	107.5
90	Clocks, watches	1.2	58.1
73	Iron/steel products	3.9	56.3
31	Fertilizers	0	44.7
48	Paper	3.3	43.9
69	Ceramics	3.6	40.1
72	Iron and steel	1.5	39.6
29	Organic chemicals	0.7	38.9
87	Vehicles	5.8	37.3
18	Cocoa	2.3	33.0
38	Miscellaneous chemicals	2.3	25.9
76	Aluminium	3.8	24.4
16	Prepared meat	1.4	20.3

DFAT STARS database; Trade Negotiations Analysis System (TNAS).

Table 3.3.1 focuses on items which currently dominate Malaysian exports to Australia. They therefore do not take account of protection levels applying to other items that Malaysia may wish to export in greater quantities in the future. Based on Malaysia's leading exports to the rest of the world and other key sectors, Table 3.3.2 lists some examples of items at the 4-digit HS level that Malaysia may export to Australia in greater quantities following a Malaysia-Australia FTA, and gives Australia's simple average applied tariff rate in those sectors.

Table 3.3.2
Other Australian Tariff Barriers on Imports from Malaysia

HS	Description	Average Tariff rate (%)	Australian Imports ($ million) 2003-2004
5407	Woven fabrics of synthetic filament yarn	10.0	3.3
8703*	Passenger motor vehicles	6.3	3.5
7113	Articles of jewellery	5.0	0.8
5402	Synthetic filament yarn	4.4	0.1
7306	Tubes, pipes and hollow profiles	4.0	21.5
3823	Industrial monocarboxylic fatty acids	4.0	3.8

DFAT STARS database; TNAS.

* Covers only vehicles designed principally for the transport of persons. The average tariff excludes the specific rate tariff on used vehicles.

Australia's non-tariff barriers are not a major factor in merchandise trade. There are virtually no tariff quotas and few core non-tariff barriers of any kind. As at the end of November 2004, only two products from Malaysia were subject to anti-dumping measures. These were high density polyethylene (where anti-dumping measures applied to several countries) and certain types of A4 ring binders.

Australia has a rigorous, science-based quarantine (sanitary and phytosanitary) regime. Australia is, nevertheless, a substantial importer of agricultural products, such as fresh vegetables and fruit. In our FTAs with Thailand and the US we have augmented our WTO rights with advanced bilateral consultative mechanisms. There would also be long-term gains to Malaysia, as well as Australia, from efforts to address technical barriers to trade. These issues are explored in further detail in Chapter 5.

Australia has a relatively open and transparent services regime. It made substantial commitments covering a broad range of services sectors during the negotiation of the General Agreement on Trade in Services (GATS), including for business and professional services; telecommunications; construction and engineering; distribution; education; financial; recreational, cultural and sporting; tourism and transport. Australia has since made further GATS commitments in the financial and telecommunications sectors.

The scope for further opening in these sectors is therefore limited. However, Malaysia's exports of tourist services to Australia might increase (that is, more Australians might visit Malaysia) under a free trade agreement because of the "head-turning" effect and improved relations which appears to be associated with such agreements. There would also be scope for Malaysia to seek concessions in areas of particular interest to its service industries – as Thailand was able to do under TAFTA.

3.4 The Impact on Investment and Private Sector Linkages

As Chapter 2 has indicated, two-way investment flows are much lower than one might expect on the basis of the substantial trading relationship. Australian direct investment into Malaysia is very low. The implications of a free trade agreement for increasing Australian direct investment into Malaysia are likely to be of keen interest to Malaysia. Australia, for its part, has a strong interest in further developing both inward and outward direct investment links with Malaysia.

A free trade agreement would increase investment flows in four main ways. First, there will be the negotiated removal of, or reduction in, existing barriers to investment by both countries. The extent of any reductions will be for the parties to decide and will depend on the overall balance of commitments across the whole agreement.

Secondly, investment flows will be affected by specific provisions in a free trade agreement relating to improved transparency (not only of the measures themselves, but also of processes for granting approvals and the like) and the protection of investments. Here, there are a range of matters to consider, including the method of listing exceptions to the substantive treatment provisions in the agreement, provisions on compensation in the event of expropriation, methods of settling disputes, and repatriation of funds.

Third, the provisions of the agreement on trade in goods and services would themselves have certain dynamic implications for investment. Freeing up trade in goods, for example, would bring in its wake new flows of foreign investment as firms adjusted to a different economic environment and changes in economic incentives. It would be increasingly possible for firms to operate as though Australia and Malaysia were a single market, with distance and transport costs the main impediment to locating activities in areas best able to supply competitively. It would also add to the attractiveness of Australia and Malaysia in servicing third country markets. These changes would affect not only flows of investment between Australia and Malaysia, but also flows of investment from other countries.

Fourthly, a free trade agreement could be expected to influence investment through its impact on market perceptions. Negotiation of an agreement would be accompanied, in both Australia and Malaysia, by a heightened awareness of opportunities in the other market and on the strength of the bilateral relationship. This “head-turning” effect could be expected to lead to new interest by business in opportunities in the other country. This would mainly be expected to contribute to increased flows of Australian investment to Malaysia, but increased interest in both countries by other international investors could also occur in this way.

Anecdotal evidence tends to suggest that the prospect of an improved bilateral trade and economic relationship with Malaysia is already promoting increased interest in investing in Malaysia on the part of Australian companies. A move to negotiate and conclude a free trade agreement would be expected to add impetus to this. Sectors in Malaysia that might benefit from a free trade agreement range from agriculture, processed foods and mining (where Australian companies have strong firm-specific advantages) to manufacturing and services, including education. There might, for example, be scope for Australian automotive components manufacturers to develop investment links with their Malaysian counterparts for some products.

The prospects for increased investment in Malaysia would to some extent depend on the degree to which Malaysia was prepared to undertake the necessary regulatory reforms to liberalise its services sector. As Section 3.2 of this Chapter has already indicated, there are significant barriers to commercial presence in this area. Industry consultations undertaken in Australia have also indicated there is uncertainty in Australia about the application of the rules which govern foreign investment in this sector. Some firms have expressed a concern that taking a foreign investment stake in services sectors may involve risks if it involves access which goes beyond what is bound in the WTO. These are issues which a free trade agreement could address. The stimulus to investment would depend on the degree of ambition of the agreement and the extent to which it delivers greater business certainty to investors.

3.5 Rules of Origin Issues

The impact of a free trade agreement between Australia and Malaysia would be affected by the preferential rules of origin (ROO) under it. Rules of origin are used to determine whether a good qualifies under a free trade agreement for concessional entry. They are necessary to restrict the benefits reciprocally negotiated under an FTA to the parties to that FTA. At a minimum such rules should ensure that goods that are transhipped or subject to only minimal processing in the FTA parties do not qualify for tariff preferences under the FTA.

Generally, a good is taken to originate in a given country if it was *wholly obtained* (that is, wholly produced or manufactured) in that country. Wholly obtained ROO apply to raw materials and agricultural and fishing products, grown and harvested in the country. Origin is also conferred where some inputs to production come from outside the FTA area or where some part of the production process took place outside of the FTA area, if the good resulted from *substantial transformation* in that country. "Substantial transformation" can be defined either across all products or on a product-by-product basis, by applying one of the following methods or a combination of these:

- C*hange in tariff classification (CTC) method*: under this method, a good after production is required to be classified under a different tariff classification from that of its component materials.
- V*alue added method:* under this method, a minimum percentage of the value of a good must have been added within the country or preferential area for which origin is being claimed.
- Specified *process or manufacture operations method:* under this method, the origin is based on the country in which a specified manufacturing or processing operation for a specific product is undertaken.

Australia has a number of different ROO regimes under various trade agreements and other preferential arrangements. These ROO regimes can be broadly classified into two main groups.

The first, based on factory cost and last process of manufacture, is a variant of the value added approach and has been adopted, with some variations, in Australia's free trade agreements with New Zealand and Singapore, as well as in other preferential agreements with Papua New Guinea, the Forum Island Countries and the Australian Generalised Tariff Preference (AGTP) system for developing countries and the duty-free preference for Least Developed Countries. Australia's trade agreement with Canada also uses a variant of this ROO.

The second approach, using product-specific ROO based on change of tariff classification are employed in Australia's FTAs with the US and Thailand. These ROO require imports to undergo a specified change in tariff classification, supplemented in some cases (textiles, clothing, footwear, automotive products and parts and machinery and electronic equipment) by a regional value content (local content) requirement.

Malaysia's preferential trading arrangements with other ASEAN economies currently use ROO which confer origin if 40 per cent of the value of its content originates in any of the Member States.

Box 3.5.1

Rules of Origin in Australian Free Trade Agreements

The rules of origin Australia has traditionally used in free trade agreements is a variant on the value added approach. It has a two-fold requirement for conferring origin:

- the last process in the manufacture of the goods must be undertaken in the territory of the Party; and
- 50 per cent of the 'factory cost' of producing the finished goods must be allowable costs, representing local content, incurred by the manufacturer of the goods.

There are variations in the way this ROO is applied. For example, the FTAs with New Zealand and Papua New Guinea apply the factory cost ROO with no major change, while that with Singapore allows a lower 30 per cent of factory cost on some electrical and electronic goods and goods not made in Australia. As noted in the text, Australian and New Zealand Ministers agreed in December that CER would move to a change of classification ROO.

The product-specific ROOs based on change of tariff classification is used in Australia's FTAs with the US and Thailand are broadly similar. One major difference concerns textiles and clothing, where the US agreement has a 'yarn forward' ROO based on change of tariff classification, which requires most finished textile and clothing goods to be sourced from within the Parties from the yarn (and sometimes fibre) onwards. The Thai agreement has a simpler transformation requirement for textiles and clothing, based on change of tariff classification, with an additional 55 per cent regional value content requirement. Up to 25 percentage points of the 55 per cent can come from materials that are the origin of other developing countries provided that it undergoes the specified transformation.

Another difference concerns the calculation of the regional value content. Australia's FTA with the US uses three methods to calculate regional value content.

- 'build down' which is calculated as the share of non-originating content to the free on board price of the finished good. The content level under this method ranges from 35 to 65 per cent.
- 'build up' which is calculated as the share of local *materials* to the free on board price of the finished good. The content level under this method ranges from 30 to 65 per cent.
- 'net cost' which is calculated as one minus the share of non-originating materials to the 'net cost' of producing the finished good; the net cost is roughly analogous to the factory cost. The net cost method only applies to automotive and automotive part goods. The content level under this method is 50 per cent.

The Australia-Thailand FTA uses the 'build down' method only. The required content level ranges from 40 to 55 per cent.

Rules of origin are negotiated separately for each free trade agreement in accordance with the specific circumstances of the parties involved. Within Australia, attitudes have shifted on rules of origin, with many now preferring the change of classification approach as a simpler method providing greater certainty as to what constitutes substantial transformation, with lower transaction costs for business than the factory content approach previously used by Australia. At the Australia New Zealand CER Ministers' Meeting held on 10-11 December 2004, Ministers agreed that CER should move to a change of tariff classification approach.

In the context of any agreement with Malaysia, these issues would need to be addressed further, both through additional consultations with Australian industries which might be affected and in detailed negotiations with Malaysia.

3.6 The Overall Economic Impact on Australia

Estimating the economy-wide impact of a free trade agreement is a difficult analytical exercise. A general equilibrium model which can capture the interactions within different sectors of each economy, as well as those between the parties to the agreement and third countries, is often used to obtain such estimates. Chapter 6 of this study presents the results of an analysis of this kind with two widely used and highly respected modelling frameworks – the G-Cubed Asia Pacific (APG-Cubed) Model and Global Trade Analysis Project (GTAP) models. Both suggest modest, but worthwhile gains to Australia and Malaysia from a free trade agreement. This section reviews some more general arguments which are qualitative in nature, but which point to the same conclusion.

The costs and benefits of free trade agreements involving goods have traditionally been examined in terms of whether they lead to trade creation or trade diversion. Trade creation arises when liberalisation between the parties to the free trade agreement leads a member to increased specialisation and trade in products for which it is a low cost producer. Trade diversion, by contrast, arises when trade liberalisation between the parties to the trade agreement results in low cost production from third countries being replaced by less efficient production in a member economy. Agreements where trade creation predominates are expected to lead to positive economic and welfare gains, whereas those where trade diversion is the stronger factor may result in economic and welfare losses. Similar arguments also apply to investment creation or diversion.

There are other important sources of economic gains from liberalising trade in goods.[21] The larger market generated by a free trade agreement may lead to economies of scale, resulting in more efficient production in both economies. Stronger competition in a larger market, involving a larger number of firms, may lead to more efficient production. These "scale and competition" effects of a trade agreement are typically expected to have a positive impact on economic activity and welfare in each economy. They are expected to be particularly strong if negotiation of the free trade agreement leads to regulatory changes which strengthen competitive

[21] See World Bank, *Trade Blocs*, World Bank Policy Research Report, Oxford University Press for the World Bank, New York, 2000, especially Chapter 3 for an excellent survey of these effects.

forces in each economy. The impact of a trade agreement on policy reform is another important factor and may of itself lead to very substantial gains.

The assessment of this report is that an Australia-Malaysia FTA would involve significant trade and investment creation. The two economies are substantially different in terms of their comparative advantage, suggesting that liberalisation of trade between the two would lead to stronger complementary trade flows and increased two-way investment. Australia's strengths lie in temperate and some tropical agriculture, minerals, metals and metal-based manufactures and some capital and skill-intensive manufactures, and services. Malaysia's areas of comparative advantage include tropical products and manufactured goods, especially electronic and electrical products, for which it is now a major world exporter. It has growing potential in services sectors, notably in tourism-related areas.

Table 3.6.1

Economic Gains from a Malaysia-Australia Free Trade Agreement

Source of Gain	Impact on Australia
Market Access: Goods	Important gains in a wide range of areas, particularly in areas where tariff peaks apply. Significant gains from binding tariffs bilaterally, even where they are low or zero already.
Market Access: Services	Gains from greater tourism and education-related exports to Malaysia. Depending on the scope of the agreement, opportunities for greater supply via commercial presence and movement of personnel.
Increased efficiency from trade creation	Gains to efficiency from trade creation are likely to outweigh costs due to diversion of imports to more costly sources of supply.
Other gains to economic efficiency	Limited gains from stronger competition in the Australian market. Economies of scale may be possible in some sectors.
Increased investment opportunities in Malaysia and Australia	Substantial gains are possible, but will depend on the scope of the agreement on investment, the extent of negotiated reductions to existing barriers to commercial presence, transparency provisions and increased investor protection.

"Scale and competition" effects are likely to be appreciable as well. As Chapter 2 has suggested, a Malaysia-Australia FTA would, for Australia, add another economy around one fifth its own size to the Australian market. For Malaysia, it would add an economy around five times its own size. There would be important opportunities for scale economies in areas like auto parts, where both economies are substantial producers. Malaysia, in particular, would have opportunities to gain from stronger competition, including in areas ranging as widely as dairy production and automobiles. But Australia would be expected to realise some gains of this kind itself.

Chapter 4 of this study looks in greater detail at these issues in relation to particular sectors.

The economic costs of trade diversion are likely to be modest for Australia in a Australia-Malaysia FTA. In Australia’s case, tariff barriers are already low in most sectors. The risk of diverting imports from more efficient sources is therefore likely to be small. It has been made smaller by the fact that Australia has free trade agreements already with New Zealand, Singapore, the United States and Thailand.

For Malaysia, too, the risk of trade diversion is likely to be outweighed by the benefits of economic reform, including substantial reductions in tariff peaks. A substantial proportion of Malaysia’s imports already enter at minimal tariff rates, either from other ASEAN economies under the Common Effective Preferential Tariff, under arrangements which provide tariff exemptions, or increasingly, under the free trade agreement ASEAN has negotiated with China. The fact that Australia is a highly open economy also minimises the risk that Malaysia’s imports from Australia will be high cost imports, at prices out of line with those in the global market.

In the services sector, Australia is likely to gain from increased exports of both tourist and education-related travel services, as well as income gains from greater opportunities to establish a commercial presence in Malaysia. But there are likely to be only limited gains to the efficiency of the domestic Australian services sector, which is already highly open by international standards. Malaysia, by contrast, has a much more closed services sector, as Section 3.2 has indicated. Therefore, there are likely to be appreciable efficiency gains for Malaysia from further opening its services sector under a free trade agreement, particularly in areas like education, legal services, telecommunication services and financial services, where Australia has strengths and is well placed to supply on a competitive basis.

The overall economic gains for Australia are summarised in Table 3.6.1. They suggest solid and worthwhile gains. This overall picture is confirmed in the detailed case studies in major sectors in Chapter 4, in the work on possibilities for greater cooperation in Chapter 5 and in the modelling work carried out by the Centre for International Economics and reported in Chapter 6.

Chapter 4. The Implications of Liberalisation by Sector

An FTA between Australia and Malaysia would eliminate tariffs on substantially all trade and be expected to achieve broad-based liberalisation in services trade. This chapter highlights the opportunities from a free trade agreement by sector for agriculture, minerals and fuels, manufacturing and services. In the case of the manufacturing sector, particular attention is accorded to motor vehicles and components in view of the significant barriers to trade in this sector in both Australia and Malaysia. In the services sector, it highlights educational services, professional services, telecommunications and financial services and tourism in view of their current or potential significance to trade between the two countries.

The analysis indicates that a free trade agreement will generate gains to both Australia and Malaysia in each of the major sectors. These gains are likely to be especially evident in some parts of manufacturing (including motor vehicles and components) and in services (where Malaysia, in particular would gain from a more open regime and where Australia is well-placed to supply competitively). They would also be assisted by relaxation of restrictions on investment, in particular Australian investment, in Malaysia.

Constraints on competition in some sectors of Malaysia's economy – including through the absence of a national competition law and the presence of the Malaysian government as a shareholder of prominent companies in key sectors (especially manufacturing and services) – may also affect access to Malaysian markets for Australian products and service providers as well as incentives for investment.[22] A further issue is that the Malaysian Government exercises price controls on a number of staple foodstuffs, fuels, cement and some steel products, which may well have implications for returns to importers and investors in those sectors.

Competition issues are discussed in more detail in Chapter 5. Opportunities for further liberalisation and enhanced government-to-government cooperation on foreign investment are also discussed in Chapter 5. Some investment issues relevant to specific sectors are discussed below.

4.1 Agriculture

Australia's and Malaysia's agricultural production and trade are broadly complementary. Australian agriculture is already very outwardly-focused, with low applied tariffs and with more than 60 per cent of its output exported. In general, Australian agricultural products do not face sizeable barriers in the Malaysian market, but there are significant exceptions. Malaysia is an important Asian market for Australian agriculture – Australia's principal export market for sugar and among Australia's top 5 markets for dairy, horticulture and wheat. Agricultural and food account for about 40 per cent of Australia's total exports to Malaysia. (see Table

[22] Despite some divestment the Malaysian Government retains a stake (not necessarily a majority holding) in a large number of listed companies. In 2004 the Malaysian Government oversaw 40 listed companies, accounting for 34 per cent of the total market capitalisation of the Bursa Malaysia. They include the five largest listed companies which span electricity, telecommunications, banking, energy, manufacturing, oil palm and rubber production, motor vehicle distribution and trading activity. In addition, the energy giant Petronas Nasional Bhd, an unlisted GLC, is Malaysia's largest company.

4.1.1). Wheat exports are confidential.[23] Milk and cream, wheat, meat, citrus, wool, grapes, wine and selected vegetables are also prominent. Total Australian food and beverage exports to Malaysia were worth around $800 million in 2003. Australia is the second largest supplier of food to Malaysia.

Table 4.1.1
Major Agriculture Items in Australia's Exports to Malaysia, 2003

HS	Item	Value ($ million)
1701	Raw cane sugar	247.4
9999	Confidential items	235.2
0402	Milk and cream (mainly milk powders)	138.6
0102	Live bovine animals	39.6
0204	Meat of sheep or goats	21.7
0202	Meat of bovine animals, frozen	16.9
0805	Citrus fruit, fresh or dried	16.4
5101	Wool, not carded or combed	15.4
0806	Grapes, fresh or dried	14.6
2204	Wine of fresh grapes	14.5
0706	Carrots, turnips, etc	14.5

Source: DFAT Stars database

The modernisation of Malaysia's agriculture, including the development of the processed food sector, is an objective of Malaysia's 2005 Budget. Australia is already a significant supplier of raw materials to Malaysia's food industries. Preferential liberalisation of trade and investment would allow an enhanced role by Australia's agriculture and processed food sectors in the development of Malaysia's agrifood industries.

Tariffs

Malaysia's agricultural trade regime is relatively open and has enabled Australian agricultural exporters to maintain levels of exports at between $764-1083 million in the last six years. Many key commodities already enjoy zero or low applied tariffs (including zero for wool, meat, cereals, oilseeds and animal feed and 5 per cent for milk powders), although some products face higher applied tariffs (up to 30 per cent).

However, as tables 4.1.2 and 4.1.3 illustrate, many bound tariffs for Malaysia are much higher than the tariff rates currently being applied. As such, negotiations on tariff reductions should be based on current applied tariffs. Products where WTO bound rates significantly exceed applied rates include pork (applied rate free, bound rate nearly 140%), preserved meat (applied free, bound 168 per cent), milk and cream (applied free, bound 54.5 per cent), wheat flour, rice, some horticultural items, coffee, cereal and dairy preparations.

[23] Malaysia's imports of wheat from Australia in 2003 were reported as $114 million, though this may understate their value, as imports through Singapore would not be recorded as being from Australia.

Box 4.1.1

Opportunities in the Halal Market

Western Australian abattoir Hillside Tender Meats has joined with the Wheatbelt Growers Cooperative Ltd (WGCL), based in the state's south-west, to fast-track a joint Australian/Malaysian push into the global halal foods market. This follows the announcement by Australian and Malaysian Trade Ministers in 2002 to undertake a joint Halal Food Production and Marketing Initiative which involved both Governments working closely with industry to meet internationally recognised standards and produce high quality halal products for the global market. Malaysia plans to establish itself as a regional halal hub, providing opportunities for Australian companies in meat supply and expertise.

In 2004, the WGCL moved towards forming a joint venture with Malaysia's Perak State Development Corporation (PSDC) with a view to accessing the multi-million dollar, "farm to customer" halal foods market. As a result of the move, the WGCL recognised the need for additional expertise in abattoir management, meat processing and marketing/distribution and established an ongoing relationship with Hillside. The West Australian abattoir already has halal certification for Malaysia and has delivered a number of sample meat shipments into Malaysia.

The food products produced by the joint venture will comply with internationally accepted standards in areas such as food safety, quality and halal certification, with all products to carry the halal logo issued by the Department of Islamic Development, Malaysia (JAKIM). The WGCL was created to build supply capacity, facilitate technological exchange and act as a trading entity on behalf of its members, who have high-level expertise in grain growing and meat animal production. The two groups came together following a series of exchange visits over an 18-month period to form the halal foods joint venture. It will focus initially on Malaysia and then on several neighbouring countries, aiming to become a leading international player in the integrated growing, value adding, manufacturing, packaging and distributing of halal foods.

While the majority of Australian agricultural exports to Malaysia face very low or zero applied tariffs, there are some notable exceptions which could be addressed in FTA negotiations. Examples are set out in Tables 4.1.2 and 4.1.3. Items facing tariffs in the range of 5-30 per cent include dairy products, some horticultural products, processed meat, and some seafood. Specific rate tariffs with a higher ad valorem incidence apply to some tropical fruits and to alcoholic beverages (notably wine).

Malaysia was Australia's second most valuable dairy export market in 2003, importing $171 million of Australian dairy products. Most of this was powdered milk, which enters at a tariff of 5 per cent butter and butter oil (valued at about $13 million) enter at 2 per cent. Exports of cheese, which were valued at about $9.5 million, face a tariff of 5 per cent or 10 per cent for processed cheese. Unsweetened condensed milk enters at 5 per cent. More minor export items are yoghurt, subject to a 25 per cent duty for flavoured product and ice cream, which is subject to 5 per cent. Casein glues are subject to a 25 per cent duty. Liquid milk, which is a relatively minor export (valued at $2.8 million in 2003) has been entering Malaysia free of duty, but the quantity has been limited under import licensing. There is also a tendency towards tariff escalation[24] in the food sector. Many processed food products, such as chocolate, yeast, sauces and condiments and soups, face tariffs ranging from 19 to 25 per cent. Australian processed foods have a presence in Malaysia, but in general face higher tariffs and other protective measures than the more basic commodities. These measures restrict the ability of the Australian processed food industry to compete in the Malaysian market.

Tariff Rate Quotas

Malaysia retains the right under its WTO commitments to apply tariff rate quotas (TRQs) on poultry products, pork products, fresh milk, cabbage, coffee, flour and sugar. The over-quota tariff on these products is currently applied at zero, however, so the TRQ restrictions do not apply. In an FTA, these tariffs would be expected to be bound at the current applied tariff rate of zero. While the applied tariff on these products is zero, most of them continue to require import licences (see below).

Non-Tariff Measures

A range of agricultural products remain subject to import licences whose conditions vary by product. These include rice and rice products, sugar, unmanufactured tobacco, milk, cabbage, coffee, and cereal flours (including wheat). In some cases (e.g. liquid milk) the conditions act to limit the volume of trade. Livestock imports are subject to import licensing in addition to a requirement for veterinary certificates. This means that market access is potentially subject to change.

Import licences for white sugar are reported to be available only to Malaysian sugar refiners, who only import raw sugar, effectively closing the market to imports of white sugar. Centralised purchasing arrangements within Malaysia limit returns to Australian exporters of some commodities. MITI oversees imports and negotiates long-term contracts for raw sugar. As noted in Chapter 3, a government corporation, Bernas, is the sole authorised importer of rice.

Malaysia's food standards and labelling regime has been the subject of some concern from Australian food exporters, especially the halal trade regime. The latter is the subject of on-going work between Australian and Malaysian authorities through existing bilateral mechanisms. A key issue is the accreditation of Australian abattoirs. The Malaysian Department of Islamic Affairs (JAKIM) does not recognise Australia's halal approval and accreditation program for meat. This has led on occasions to the deregistering of abattoirs and the need to re-register. Halal accreditation is also seen as a source of uncertainty for exporters of some processed foods. Australian wine exporters to Malaysia are required to include labelling (of alcohol content) in Bahasa, which adds to costs. Wine imported into Malaysia is also subject to testing for alcohol content.

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[24] As the OECD has noted, "Tariff escalation imposes a trade bias towards raw materials and semi-processed products due to higher tariffs on finished products." OECD, *Post Uruguay Round Tariff Regimes- Achievements and Outlook,* 1999, quoted in G. Maguire, *Barriers to Trade in Indian Ocean Rim Countries*, a study prepared for IOR-ARC, Commonwealth of Australia, Canberra, 2003, p. 37.

An FTA could explore further options for co-operation on halal and other food regulatory issues, in order to streamline procedures/requirements, including certification, inspection and reduce the costs of doing business. This is discussed in more detail in Chapter 5.

Customs Issues

Cost issues can arise for Australian exporters from the processing time and consistency of approach during Customs entry. There may be room to improve outcomes through cooperation. These issues are discussed in more detail in Chapter 5.

Preferential Liberalisation

Economic modelling suggests that preferential liberalization could see some increase in Australia's exports of dairy products, some meat products, other processed foods and beverages. Exporters of a wide range of agricultural products could also benefit from the improved certainty that would result from binding current duty free entry, the removal of licensing requirements and enhanced cooperation on food standards and SPS issues.

Binding of existing tariff treatment across a range of agricultural products and the replacement of existing import licenses by quota-free entry, including for pork products, would remove uncertainty about the continuation of current market access for both Australian exporters and Malaysian importers.

Modelling indicates that under preferential liberalization Malaysia could achieve increased exports of some food products. However, as almost all Australian agricultural tariffs are currently applied from 0-5 per cent, tariff elimination under an FTA with Malaysia would be unlikely to have a significant impact on Australian industry. Malaysia's key agricultural export is palm oil, which enters duty free. Other agricultural imports from Malaysia include seafood ($25 million), and small quantities (each less than $5 million) of cereal foods, fruit and vegetables, bakery products, non-alcoholic beverages, and other processed foods. All of these products already enjoy low tariffs. However, Malaysian exporters of those agricultural products would gain useful improvements in market access to Australia from the removal of tariffs.

Table 4.1.2
Key Tariff Barriers to Australia's Exports to Malaysia: Meat, Dairy Products, Fresh Fruit and Vegetables

HS	Item	Maximum Applied Tariff (%)	Max WTO Bound, Ad Valorem(%)	Max WTO Bound, Specific RM/unit
52.01,03	Cotton	10-15		
Meat				
0201	Bovine Meat, fresh or chilled	0	15	
0202	Bovine Meat, frozen	0	15	
0203	Pork	0	138.6#	
0204	Sheep or Goat meat, fresh, chilled or frozen	0	15	
0206	Offal of beef, pork, sheep, goats	0	15	
0207	Poultry	0	85#	
0210	Preserved meat	0	167.87#	
Dairy				
0401	Milk & Cream	0	54.4 (liquid)#	8.82RM/100kg *SSG
0402	Milk powder/other solid form	5	5	41.89/100kg (condensed)
0403	Yoghurt (flavoured)	25	10	
0405	Butter & butterfats	2	5	
0406	Cheese	5-10	10	
Honey				
0409	Natural honey	2	5	0.55/kg
Vegetables				
0710	Frozen vegetables	(sweet corn)8	5	
0711	Preserved vegetables	7	20	
0712,0713	Dried vegetables	5	15	9.84/kg
0714	Cassava & sweet potatoes	5	5	31/kg
Fruit				
0804.30	Pineapples	5		608/tonne
0804.40	Avocados	5	16	
0804.50	Mangoes	5+220.45/t	5	224.70/t
0805	Citrus	5-10	20	various
0806	Grapes	5	20	
0807	Melons & pawpaws	5+661.40/t	5	661.40/t
0808	Apples & pears	5	20	
0809	Apricots, cherries, peaches & plums	10	20	661.40/t
0810	Berries & other fruit	5-30	20	661.40/t
0813	Dried fruit, mixed nuts or fruits	20	20	1322.77/t

Notes:
#Tariff Quota applies
*SSG Special Safeguard applies
Where an item is identified in bracket e.g. (liquid) it refers to the specific product within a class which attracts the maximum rate.
Maximum tariff rate for each HS code is shown (there may be lower rates some tariff lines within a code).
If both ad valorem (%) and specific (RM) tariffs, rate may be whichever is the higher, both %+RM, or refer to different tariff lines within an HS item.
WTO bound tariffs are final rates by 2004, applied tariffs as at Sept 2004.
Where maximum applied rate is higher than bound rate further investigation is required (eg 2202 & 0403).
Sources: WTO Uruguay Round Schedule XXXIX, Malaysian Government *Budget Papers* 2004, DFAT Trade Negotiations Analysis System and DFAT, *Agrifood Globalisation and Asia*, Vol. IV, pp.97-100.

Table 4.1.3
Key Tariff Barriers to Australian Exports to Malaysia: Selected Processed Foods, Beverages

HS	Item	Maximum Applied Tariff (%)	Max WTO Bound Ad Valorem (%)	Max WTO Bound, Specific RM/unit
1516	Processed animal/vegetable fats/oils	5	20(almond)	88.18/t (groundnut)
1517	Margarine	20	30(liquid)	198.92/t
1601	Sausages and similar products	15	15	
1602	Other prepared meat	15	15	
1701	Cane or beet sugar#	0	15	385.45/t
1702	Other sugars & sugar syrups	15	20	369.3/kg
1704	Sugar confectionery	15	30	
1806	Chocolate & cocoa preparations	15	15	2/kg
1901	Cereal & dairy preparations	7	31	44.85/kg
1902	Pasta	8	20	
1905	Bread, pastry, cakes & biscuits	6	15	
2001	Veg./fruit/nuts preserved by vinegar	8	20	
2002	Tomatoes prepared/preserved	8	20	14.96/kg
2004	Frozen/preserved vegetables	20	20	14.96/kg
2005	Other prepared vegetables, not frozen	20	20	14.96/kg
2008	Fruit or nuts otherwise prepared	20	20	744/kg (pineapples)
2009	Fruit juices	30	20	
2103	Sauces & condiments	20	20	
2104	Soups	20	20	
2105	Ice cream and other edible ice	5	5	
2106	Other food preparations	20	20	
2201	Waters	20	20	
2202	Sweetened or flavoured drinks	20	15	
2203	Beer	5/l		150/decalitre
2204	Wine	23/l		1200/ decalitre

Notes: As for Table 4.1.2

In the longer term, and unrelated to an FTA, Malaysia's efforts to become a more efficient producer of food products may lift their competitiveness, relative to some Australian industries, such as horticulture (see also Chapter 5).

Upgrading of the ongoing bilateral cooperation on Customs issues could reduce the incidence of costs incurred by some Australian exporters of agricultural products, food and beverages by reducing the processing times for Customs clearance and enhancing the consistency of administration. Upgrading of the ongoing bilateral cooperation on labelling and standards (particularly halal certification) could also reduce the costs incurred by Australian processors and exporters.

Investment

Trade liberalization, along with closer cooperation on investment, would facilitate the two-way flow of investment in the agriculture and food sector.

The increased two-way flow of investment could assist development of the Australian processed food industry, which is increasingly subject to regionalization and globalization. It could also promote the development of the Malaysian processed food industry, an area specifically targeted in Malaysia's 2005 Budget, along with development of aquaculture and livestock production.

Australia is already a significant supplier of agricultural products including live cattle and food (dairy, wheat, raw sugar and red meat) much of which is further processed in Malaysia. Malaysia's aim to become a regional hub for halal food processing may provide opportunities for increased Australian investment in Malaysia's food processing industries. Australian investment in agrifood activity in Malaysia could also bring with it technology transfer and increased research and development capacity.

The modernisation of agriculture is one of the key policy goals of the Malaysian Government. The Government's intention is that this will include greater commercial orientation, wider adoption of new technologies and modern management systems and greater participation by the private sector. Foreign investment in agriculture certainly has potential to contribute to modernisation. For instance, initiatives to encourage investment in downstream processing industries, including for halal products, would benefit supply chain management and productivity in agriculture more generally. There are, however, limitations on foreign ownership in agriculture in Malaysia, including in relation to the ownership of rural land.[25] For example, most land designated for agricultural use comes under State jurisdiction or is reserved for Malays only.

4.2 Minerals and Fuels

Most mineral products, including all metal ores and concentrates, enter Malaysia free of duty. Exports of unprocessed minerals to Malaysia in 2003 were around $8 million, accounting for less than 0.3 per cent of Australia's total merchandise exports to Malaysia in that year. The main minerals exports were natural magnesium carbonate ($2.8 million), tin ores and concentrates ($2.4 million) and pumice stone ($2.3 million).

Malaysia's mineral resources include tin, petroleum, copper, iron ore, natural gas and bauxite. The main mineral imported from Malaysia, which is also the largest merchandise import, is crude petroleum, which is free of duty. Imports were $774

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[25] Requirements for notification and approval, by the Foreign Investment Committee (FIC), apply to mergers and acquisitions and to the purchase of property, including all types of land. State control over land matters has led to restrictions on land acquisitions and in some cases to delays to land transfers. See Arumugam Rajentheran, *Malaysia: An Overview of the Legal Framework for Foreign Direct Investment,* Institute of Southeast Asian Studies, Economics and Finance, No. 5(2002), p.17.

million in 2003. Other minerals imports were minor: $4.7 million of Portland cement and $1.5 million of limestone flux. Both these items are also duty free.

Australia's exports of fuels to Malaysia are larger than its minerals exports. Fuel exports in 2003 were $115 million, accounting for 5.5 per cent of total exports to Malaysia. The main goods in this group were coal ($98 million) and refined petroleum ($16 million). Coal enters Malaysia duty free, but refined petroleum is subject to a 5 per cent duty. Refined petroleum imports were $109 million of which $100 million was enriched crude which enters duty free. There was about $8.4 million of diesel fuel, subject to an excise of $38/39 cents per litre, equivalent to 85 per cent ad valorem. However a by-law provides for an exemption. Most bilateral trade in minerals is relatively open.

Under the terms of the Petroleum Development Act of 1974, the upstream oil and gas industry is controlled by Petronas, which is the sole entity with legal title to Malaysian crude oil and gas deposits. Foreign investment takes the form of production sharing contracts. Foreigners can hold up to 100 per cent equity in any new venture involving extracting, mining or processing mineral ores, but mergers and acquisitions would be subject to FIC approval.

Preferential liberalisation of minerals and fuel trade could increase Australian exports of refined petroleum to Malaysia. It would also add greater certainty to existing trade in cases where WTO bound rates are above those applied. Relaxation of existing foreign investment approval requirements for mergers would encourage investment.

4.3 Manufactures

Modelling suggests that under preferential liberalisation there would be an increase in Australian exports of motor vehicles and other transport equipment, ferrous metals, metal products, chemical rubber and plastic products, textiles and paper products. Malaysia would be likely to increase exports of electronic equipment, other machinery and equipment, motor vehicles and parts, metal products, wood products, chemicals, rubber and plastics and textiles and other manufactures.

As noted in Chapter 3, Malaysia's tariffs on industrial goods vary considerably. Australian tariffs on manufactured goods also vary, though over a narrower range. There are some areas of high or very high Malaysian tariffs where Australia might expect to gain from improved access. There are also some areas of manufacturing where Australia maintains significant tariffs and Malaysia might expect to benefit from preferential liberalisation.

A significant part of Australia's manufactures exports to Malaysia are base metals which are manufactured from Australian minerals. With some exceptions, these enter Malaysia at low or minimum rates. However, for more complex products (such as coated steel, some aluminium products and motor vehicles) there is significant escalation in Malaysia's tariffs.

Malaysia is a significant exporter of manufactured products, especially electrical and electronic goods. Information and communications technology equipment generally enters Australia duty free from all sources, as do selected consumer electronic goods not made in Australia. Examples of major Malaysian manufactures which face tariffs into Australia include furniture (4.6 per cent simple average applied tariff), plastics (5.1 per cent), iron and steel products (3.9 per cent), ceramics (3.6 per cent), aluminium (3.8 per cent), paper (3.3 per cent), woven fabrics of synthetic yarn (15 per cent), motor vehicles (10 per cent for passenger motor vehicles from 1 January 2005, 5 per cent for other motor vehicles) and jewellery (5 per cent). Tariffs for rubber products vary from 0 to 25 per cent.

While the level of Australian investment in Malaysia is relatively low, a diverse range of manufacturing activity is already being undertaken by Australian firms in Malaysia, such as the making of electrical and electronic products, automotive components, coated steel products, building materials and wood products.

As noted in Chapter 2, the Malaysian Government relaxed investment guidelines for manufacturing, in 2003, including allowing 100 per cent foreign equity for all investments in new manufacturing projects and for investments in expansion/diversification projects by existing companies. The 2003 reforms also included a doubling of the threshold value requiring Foreign Investment Committee approval for acquisitions of existing property or business, to RM10 million.

The 2003 changes were a positive development for potential manufacturing investment. Nevertheless, as detailed in Chapter 2, significant foreign investment guidelines apply to manufacturing operations set up before June 2003. The Foreign Investment Committee handles foreign and domestic manufacturing proposals, or proposals relating to manufacturing-related services, on a case-by-case basis. Approval depends on factors such as investment size, export-orientation, required financing, technology transfer, infrastructure requirements and the existence of a product market.

The different product specialisations of Malaysia and Australia suggest that preferential liberalisation under an FTA would facilitate increased two-way trade. In this regard, it is instructive to consider three examples, namely, motor vehicles and parts, steel and aluminium, and textiles, clothing and footwear.

Motor Vehicles and Components

Automotive production is a significant part of both the Australian and Malaysian economies. The Malaysian and Australian motor vehicle industries are comparable in scale of operation, although the Australian market for passenger motor vehicles is about twice the size of the Malaysian market. There are significant opportunities for the Malaysian and Australian economies to benefit through increased two-way trade in this sector.

As Table 4.3.1 shows, current automotive trade is mainly from Malaysia to Australia (in the ratio 15:2). Most of Malaysia's exports are components. This reflects the greater size and openness of Australia's vehicle market and Malaysia's higher tariffs on vehicles and parts.

The Asian financial crisis has also had a lasting effect on Malaysian automotive imports. Australia's motor vehicle and parts exports to Malaysia were over $90 million in 1997. By 2003 they were down to around $29 million.

Table 4.3.1
Australia's Automotives Trade with Malaysia ($ million)

	1999	2000	2001	2002	2003
Exports: components	10.12	13.66	21.14	17.01	11.50
passenger motor vehicles	23.28	20.42	17.08	8.86	17.73
Total exports	33.39	34.08	38.22	25.87	29.24
Imports: components	81.51	112.28	126.73	124.64	155.07
passenger motor vehicles	19.96	30.39	17.53	10.55	25.11
Total imports	101.47	142.67	144.26	135.19	180.18

Source: DFAT Stars Database

The Australian Motor Vehicle Market

As Chart 4.3.1 shows, the Australian motor vehicle market has been growing steadily for the last decade with over 909,800 new vehicles (including 589,000 passenger motor vehicles) being sold in 2003. Sales for 2004 were 955,000 (including 590,000 passenger motor vehicles). The ratio of motor vehicles registered to the resident population has been increasing consistently over a long period. The growth in demand for motor vehicles in Australia has been facilitated by improvements in vehicle affordability and value for money. Over the 10 years to 2003, the price of imported vehicles fell by 10 per cent. In contrast, in real terms, the average price of an Australian-produced vehicle is about the same as a decade ago. However, "significant improvements in vehicle quality and specifications mean that purchasers are getting better value for money."[26]

Australia's Tariffs

Australia's general tariffs on imports of passenger motor vehicles were phased down from 45 per cent in 1988 to 15 per cent in 2000, and 10 per cent from 1 January 2005. They will remain at 10 per cent until 1 January 2010, when they will be reduced to 5 per cent. Tariffs on commercial vehicles and four wheel drive vehicles are 5 per cent. Imports now account for 70 per cent of the Australian market, and a higher proportion of the 4 cylinder vehicle sector.

The Australian Industry

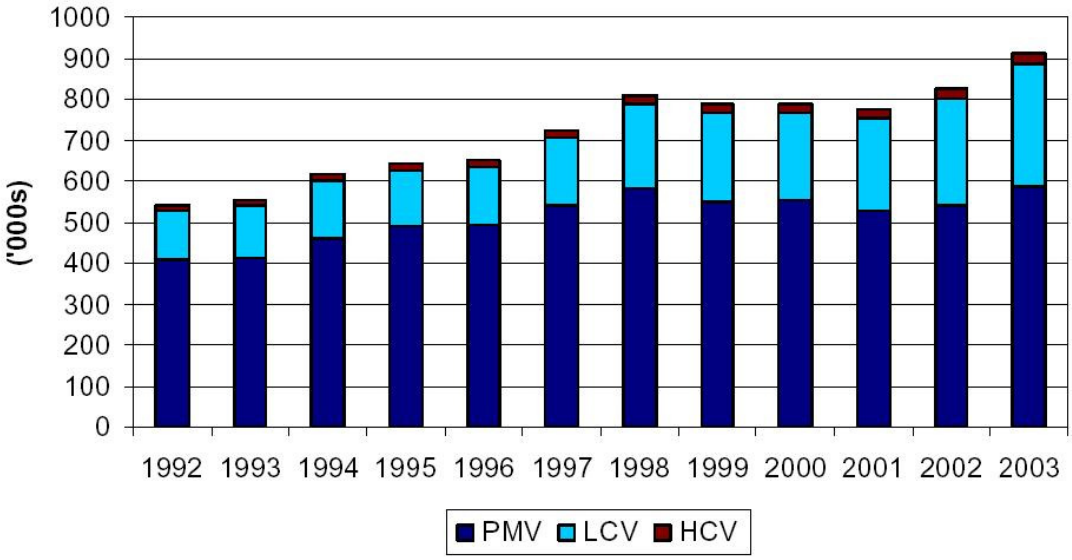
Australia has a substantial motor vehicle industry which produced just over 407,000 vehicles, including over 365,000 passenger vehicles, in 2003. Australian vehicle production is concentrated in the medium to large size vehicles, most of which have 6 cylinder engines. Of the four Australian manufacturers (Holden, Toyota, Ford and

[26] APEC, *Automotive Profile – Australia*, APEC Automotive Dialogue, 2004, at www.apecsec.org, p.2.

Mitsubishi), Toyota is the only one which now produces a four cylinder vehicle. Holden produces a four cylinder engine, which it exports to Korea. Exports of six cylinder engines are expected to increase from the third quarter of 2005 following Holden's investment in an enlarged six cylinder engine line, which will produce V6 engines of 2.8 litres and 3.6 litres capacity for export.

Chart 4.3.1

New Motor Vehicle Sales: Australia



PMV: Passenger Motor Vehicles, LCV: Light Commercial Vehicles, HCV: Heavy Commercial Vehicles.
Department of Industry, Tourism and Resources, *Key Automotive Statistics 2003*, October 2004

Australia's components industry is highly internationalised. Many companies are wholly or partly foreign owned and components are exported to many countries. Major exports include braking systems to the USA, mirrors to North America and Japan, anti-theft systems, propeller shafts and heating, ventilation and air conditioning products to North America and China.

Australia's open market encourages its automotive industry to remain competitive and seek export opportunities. This has meant that during the period of steadily falling tariffs, the Australian vehicle industry has expanded production, chiefly through niche exports. The research and development capability of the Australian carmakers and components companies has been an important element in successfully targeting export niches.[27]

[27] *Ibid.*, p.7. "The expertise and flexibility acquired in engineering platforms and modifying production techniques to cater for the requirements of the small domestic and has imbued the industry with the capacity to identify niche market opportunities and to respond to them and cost effectively. … Hence while small scale has long been regarded as an inherent weakness of the domestic industry in some contexts it has emerged as an important strength."

Malaysia's Motor Vehicle Market and Industry

Total sales of passenger motor vehicles in Malaysia in 2003 were around 320,000 units, predominantly small to medium vehicles with 4 cylinder engines. This pattern of demand is encouraged by Malaysia's road tax and excise rates, which are based on engine displacement. There is a significant and growing market for larger/luxury vehicles.

Total car sales in Malaysia fell sharply in 1997-98, but have been rising steadily since that time. The rate of car ownership is expected to continue to increase in line with increasing per capita incomes.

Two national car makers, Proton[28] and Perodua, which manufacture vehicles primarily in the mini, small and medium passenger car segments, accounted for about 90 per cent of sales of passenger vehicles in 2002. Proton's sales are about double those by Perodua. However sales of non-national cars expanded by more than 50 per cent in 2003. Non-national cars are sourced mainly from the local assembly of imported completely knocked down (CKD) packs, predominantly of Japanese, European and Korean vehicles.[29] A small number of fully assembled (CBU) vehicles, including some from Australia, are imported under license. Tariffs and a differential excise make other CBU imports prohibitively expensive.

There are more than 300 component manufacturers in Malaysia, including some Australian companies. In 2003, Proton replaced imported Mitsubishi engines in some vehicles with an engine of its own manufacture. Most components companies have a close relationship with Proton and Perodua, but exports, including to Australia, are also significant, particularly for the larger companies.

Malaysia's Tariffs and Non-Tariff Measures

Development of Malaysia's motor vehicle industry has been part of the transformation of Malaysia from a predominantly rural to a manufacturing economy. However the motor vehicle industry has been supported by very protectionist policies and, perhaps as a consequence, is less export-oriented than other manufacturing sectors in Malaysia. Malaysia's tariffs and excises for passenger motor vehicles are shown in Table 4.3.2.

In 2004 and 2005, Malaysia implemented tariff reductions on motor vehicles. However, the tariff reductions were offset by increases to excise, on which the national cars received a 50 per cent rebate. From January 2005, a tariff rate of 20 per cent applies to CBU vehicles from the ASEAN countries and 50 per cent for other countries. The excise on imports ranges from 90 per cent (vehicles with engines under 1800 cc) to 250 per cent (vehicles over 3000 cc). Because the 2005 changes involve increases in the excise paid on Malaysia's national cars they will reduce the

[28] Proton has recently been discussing a strategic alliance with Volkswagen, following the sale of Mitsubishi's equity in Proton.
[29] Before 2002, there were some Australian exports of CKD packs to Malaysia. These exports ended following changes to Australia's Automotive Industry Assistance Arrangements which wound up the export facilitation scheme.

overall level of protection enjoyed by the national carmakers. However, the protection will remain very high – over 150 per cent for larger vehicles. In addition the Malaysian Government announced in December 2005 that it would extend to the automotive industry "similar fiscal incentives that have been provided to other sectors of the economy".

It is arguable whether the application of a differential excise to imported vehicles is consistent with Malaysia's WTO obligations and doubts have been expressed that it can be a long-term measure.

Table 4.3.2

Malaysia's Tariffs and Excise# on Imported Passenger Motor Vehicles

CBU Vehicles

	ASEAN				Non-ASEAN			
	Tariff %		Excise %		Tariff %		Excise %	
	2004	2005	2004	2005	2004	2005	2004	2005
Engine Size cc								
<1800	70	20	60	90	80	50	60	90
1800<2000	90	20	70	120	100	50	70	120
2000<2500	110	20	80	150	120	50	80	150
2500<3000	180	20	90	200	160	50	90	200
>3000	190	20	100	250	200	50	100	250

CKD Vehicles

	ASEAN				Non-ASEAN			
	Tariff %		Excise %		Tariff %		Excise %	
	2004	2005	2004	2005	2004	2005	2004	2005
Engine Size cc								
<1800	25	0	60	90	35	10	60	90
1800<2000	25	0	70	120	35	10	70	120
2000<2500	25	0	80	150	35	10	80	150
2500<3000	25	0	90	200	35	10	90	200
3000	25	0	100	250	35	10	100	250

Proton and Perodua receive a 50 per cent rebate on excise. Tariffs on most imported components are 25 per cent.

It is likely that Malaysia's automotive sector will gradually become more open, at least within ASEAN, as a result of Malaysia's AFTA commitments. Malaysia is due to implement a 5 per cent tariff on CBU vehicles from ASEAN countries in 2008.

Sales of national vehicles are subsidised by concessional loans, at interest rates as low as 2.99 per cent, which are available from the national car companies, their distributors and banks.

Implications of an FTA for the Australian and Malaysian Automotive Industries

Economic modelling suggests that both Australia and Malaysia would increase exports of automotive products under a free trade agreement. Australian exports of larger vehicles and components to Malaysia are likely to increase. Malaysia is likely to increase its exports to Australia of smaller vehicles and components.

An FTA has the potential to provide motor vehicle and component manufacturers in both Australia and Malaysia with a very useful preferential margin in each other's markets. While the Australian market is clearly the larger of the two, Malaysia's market has significant growth potential.

Under preferential liberalisation, there are unlikely to be significant adjustment costs for either the Australian or Malaysian local vehicle manufacturers.

Under an FTA the Australian carmakers would have an opportunity to increase their exports to Malaysia of medium and large vehicles, particularly those with larger engine sizes. In that larger/luxury vehicle segment, Australian imports could potentially displace some CBU imports or assembly in Malaysia of imported CKD kits. Because of differences in products there would be little impact on Malaysia's national producers. Australian automotive components producers would also have opportunities to expand their exports.

The impact of preferential reduction of tariffs on the competitive position of Australian motor vehicle exports to Malaysia could, however, be moderated by the continuation of a number of benefits enjoyed by Malaysian vehicle builders and assemblers. These include production subsidies, the differential application of excise, duty drawback on imported components and materials not made in Malaysia and subsidised consumer finance.

Malaysian automotive exports to Australia do not face significant non-tariff barriers and would potentially have a 10 per cent margin of preference against imports from other countries. Malaysia's Proton is already gearing up for an expansion of marketing and sales in Australia, and is targeting the growing small car and light commercial segments. Because of their body size and engine capacity, increased sales by Proton and, perhaps, Perodua in Australia would be likely to be mainly at the expense of imports rather than local manufacturers.

Malaysia's automotive exports could therefore expand under preferential liberalisation. An FTA would increase the potential for greater specialisation in the components industries in both countries, which could promote two-way investment.

<u>Base Metals and Metal Products</u>

Metals

Australia's main metal exports to Malaysia are copper (valued at $220 million in 2003), aluminium ingot ($173 million) and unwrought zinc ($24 million) which all enter Malaysia duty free. Exports of unwrought and semi-manufactured gold, valued at $10 million in 2003, are also free of duty. The situation with metal shapes and articles is somewhat different. There is generally an escalation of the Malaysian tariff on metal products, with some peaks of up to 50 per cent.

In the iron and steel sector, Australian exports to Malaysia of pig iron, ferro alloys, waste and scrap (except remelting ingots which incur a specific rate tariff), granules, powders, and ingots of other forms (except high carbon steels which attract 10 per cent) and most semi-finished products of iron or non-alloy steel enter duty free. Most hot-rolled flat steel, including coated forms, is subject to a 50 per cent tariff. Bars and rods enter free if the carbon content is 0.6 per cent or higher, otherwise generally at 15 per cent. Hot-rolled steel sections enter at 20 to 30 per cent.

Many steel articles of HS Chapter 73 are subject to medium to high tariff rates when imported into Malaysia. Line pipe for oil or gas pipelines incurs tariffs of 30 to 50 per cent, drill pipe 30 per cent and pipe for hydro-electric conduits 30 per cent. Tube or pipe fittings tariffs range from 5 to 20 per cent and steel structures from 20 to 30 per cent.

Malaysia has suffered periodic shortages of steel in recent years, particularly in the building sector. In 2004, Malaysia instituted a six month ban on the export of building steel, while at the same time maintaining high tariff barriers.

As noted, aluminium ingot enters Malaysia duty free. However aluminium bars, rods and wire are subject to a duty of 25 per cent, plates sheets and strip 30 per cent, foil 25 to 30 per cent, tubes and pipes 25 per cent, structures (for example, door and window frames) 25 per cent, reservoirs and tanks 20 per cent and wire and cable 30 per cent. Australian exports of aluminium products in 2003 were about $32 million.

Zinc enters Malaysia duty free except for plates, sheets, strip and foil, on which the duty is 20 per cent. Tubes and pipe are duty free but guttering and other building components are 20 per cent and household articles 25 per cent. Unwrought zinc and zinc alloys accounted for more than 95 per cent of zinc exports. There were imports of about $240,000 of sheets and strip which would have entered duty free. There were no exports of structural zinc products. Exports of tin and articles thereof to Malaysia were about $5 million in 2003. Most exports were subject to a 25 per cent duty.

As noted, unwrought copper enters Malaysia free of duty. Most articles of copper also enter free of duty. The main exceptions are bars and hollows of refined copper (18 per cent), copper wire (25 per cent), stranded wire (25 per cent) and some household articles (25 per cent). Australian exports of bars, rods and profiles were about $7 million in 2003. Bars and rods are subject to an 18 per cent tariff. Exports of other copper and articles were low.

While Malaysia has some tariff peaks in the base metals and metal products sector, it should be noted that there is duty drawback for materials used in the manufacture of goods which are exported, or where equivalent materials are not made in Malaysia. Drawback for exports is important in view of the strong export orientation of much of Malaysia's manufacturing activity.

Imports

Imports of iron and steel from Malaysia were about $29 million in 2003. Imports from Malaysia receive developing country preferences and enter duty free, except for remelting scrap ingots, hot-rolled steel products of 7208.90, some hot-rolled strip of

7211.90, bars and rods of non-alloy steel of 7215.50.90, steel wire, stainless steel and other alloy steels, all of which are subject to a 4 per cent duty.

Imports of articles of iron and steel from Malaysia were valued at $45 million in 2003. A significant portion of these imports, including line pipe ($7 million), welded pipes and profiles ($9 million), structures and parts for structures ($4 million) and threaded screws and bolts and nuts ($7 million) were subject to a 4 per cent or 5 per cent duty. Leaf springs and leaves therefor ($4 million) are subject to the tariffs for motor vehicle parts (10 per cent from 2005).

From time to time steel imports from Malaysia are subject to complaints of dumping from the Australian steel producing sector.

Imports of aluminium products from Malaysia were about $26 million in 2003. Of this nearly half were bars, rods and profiles, which entered at 4 per cent duty. The other two main items were tube or pipe fittings ($3.6 million) and foil backed with paper or paperboard ($2 million), both of which entered duty free.

Imports of zinc and articles thereof were negligible. No duties apply to imports from Malaysia. Imports of tin and articles thereof from Malaysia were just under $16 million in 2003. They enter free of duty. Imports of lead were negligible. There is no duty on imports from Malaysia.

Imports of copper and articles thereof from Malaysia were about $6.5 million in 2003. The main items were tubes and pipes of copper alloys not elsewhere specified ($2.1 million), bars rods and profiles of refined copper ($2 million) and copper wire, 6mm or less in diameter, all of which are subject to a 4 per cent duty.

Preferential Liberalisation

Under preferential liberalisation, Australian exports of hot rolled steel, including line pipe, some steel products, some types of aluminium, aluminium products and some copper and zinc products to Malaysia could be expected to increase. Malaysia could also expect to increase its exports of steel and steel products and aluminium bars and rods, tubes and pipe fittings to Australia.

<u>Textiles Clothing and Footwear</u>

Textiles clothing and footwear (TCF) are relatively minor areas of trade between Malaysia and Australia. However there is potential for trade to increase under preferential liberalisation.

The simple average of tariffs applying to textiles and clothing imported from Malaysia in 2004 was 12.8 per cent. Australia's main imports of textiles clothing and footwear from Malaysia in 2003 were knitted apparel and clothing ($4.1 million), apparel and clothing, not knitted ($3.1 million) and footwear ($4.7 million).

As noted in Chapter 3, a number of tariffs on these products have been reduced from 2005. For example:

- Australian tariffs on clothing and certain finished textiles have fallen to 17.5 per cent;

- tariffs on cotton sheeting, woven fabrics, carpet and footwear are now 10 per cent; and

- tariffs on sleeping bags table linen and some footwear have fallen to 7.5 per cent.

Under the TAFTA and the AUSFTA tariffs on most TCF products will fall to zero by 2010 or 2015. Tariffs have already been eliminated under SAFTA. This and the limited value of existing imports suggest that preferential access for Malaysia to Australia's market is likely to involve only limited adjustment issues.

Australia's main TCF exports to Malaysia in 2003 were carpets and other textile floor coverings ($1.5 million), impregnated, coated, covered or laminated textile fabrics ($2.2 million) and other made up textile articles, mainly worn clothing and rags ($2.1 million).

Most carpets enter Malaysia at 20 or 25 per cent tariffs, impregnated fabrics at between 7 and 20 per cent, and worn clothing at nil or 5 per cent.

Preferential Liberalisation

Under preferential liberalisation, both Malaysia and Australia could increase exports to the other of specific TCF items. However liberalisation is unlikely to result in significant adjustment costs for either country.

4.4 Services

Services are becoming increasingly important in trade and investment worldwide. They are important, both directly as a prominent component of trade, and indirectly, by enabling or facilitating international business, including through travel, legal, financial and professional services, especially through commercial presence.

A liberal services sector brings economy-wide benefits by facilitating and encouraging innovation, efficiency and improved quality. When the services sector is also regulated according to sound, efficiency-enhancing principles, then a liberal services sector provides the best opportunity for increased economic growth.[30] An important dimension to this is the streamlined mobility of business people.

The variety of ways in which services can be delivered is captured in GATS Article I, which defines four modes of delivery of services. These are (i) cross border delivery (for example, a Malaysian resident, over the internet, may use an Australian stockbroking firm to buy shares), (ii) consumption of the service abroad (for example, when a Malaysian student studies at a university in Australia), (iii) delivery through a commercial presence (for example, when an Australian bank establishes in Malaysia

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[30] UNCTAD, *Trade in Services-Market Access Opportunities and the Benefits of Liberalization for Developing Countries*, New York and Geneva, 2002, p. 3.

and provides financial services to a Malaysian citizen) and (iv) through the presence of natural persons (as when an Australian engineer works in Malaysia).

Liberalisation of the services market implicates a broad range of regulation while opening up new areas of cooperation across all four modes of delivery of services. It can include issues as wide-ranging as the recognition of education degrees and other professional qualifications, regulations affecting foreign investment through to visa restrictions on the movement of professionals and business personnel.

Chapter 2 of this study highlighted the significance of services trade between Australia and Malaysia. It is anticipated that, as the Malaysian economy continues to develop, its demands for sophisticated services will increase, and that services exports will represent an increasingly significant proportion of both Malaysia's imports and exports. Services trade will therefore become an even more important part of Australia's bilateral relationship with Malaysia. An FTA can play an important role in encouraging and facilitating further liberalisation of the services sector with significant benefits to both economies.

Education Services

Australia and Malaysia have a long standing education relationship which dates back to the many Malaysian students who came to Australia to complete university studies under the Colombo Plan. This relationship has evolved into a mature partnership characterised by mutual benefit with collaboration extending across all the education and training sectors. Australian education institutions, including three Australian university branch campuses are playing a significant role in providing offshore education services to Malaysian students and contributing to capacity building in Malaysia. Australia estimates that the cross border provision of education services to Malaysia is worth approximately $556 million.

Education services can be classified according to the following five sectors: primary, secondary, higher/tertiary (vocational and university level), adult (community courses) and 'other' (including foreign language tuition, short courses, etc.). Education, like other services, can be delivered via the four modes of supply.

In the year to November 2004, approximately 20,000 Malaysian students had enrolled with Australian education providers to undertake studies in Australia. Onshore delivery of education services is currently the most significant form of delivery between Australia and Malaysia although offshore delivery is growing. In 1998, Monash University established the first branch campus in Bandar Sunway, Selangor. Since then, Curtin University and Swinburne University of Technology have followed suit, establishing branch campuses in Miri, Sarawak and Kuching, Sarawak respectively.

Many Australian universities have been involved in the growth of private educational institutions in Malaysia, largely through twinning arrangements, advance standing arrangements and programs to upgrade the qualifications of Malaysian academics. These arrangements may allow Malaysian students to undertake the early years of their courses in Malaysia and to complete part of their studies at an Australian campus. Further, more than fourteen Australian universities also have approval to provide full in-country degree programs with local Malaysian partners. Various Australian Registered Training Providers are understood to also be looking at increasing the provision of vocational education and training in Malaysia.

Box 4.4.1

Monash University Malaysia

Since the early 1960's, Monash University has had close involvement with Malaysia, welcoming students under the Colombo plan and private students. In 1998, Monash was the first foreign university to open a branch campus in Malaysia, Monash University Malaysia.

Monash University Malaysia campus in Bandar Sunway operates as a joint-venture between Monash University in Australia and the Sunway Group. Monash University Malaysia enjoys the same status as any other of the eight campuses of Monash, sharing the same admission standards, curriculum, and assessments. Over 2000 students are currently enrolled at the Malaysia campus.

The degree courses offered at Monash University Malaysia are selected to meet the demands of the students and the needs of society. They currently include courses in Business and Economics, Information Technology, Engineering, Arts and Science. From 2007, courses in Medicine, Nursing and Health Science will be offered. Monash University has links with government, business and the local community and contributes to Malaysia's development through education, research and philanthropic endeavours.

Issues in education services between Australia and Malaysia

Cross border supply

A potentially important growth area in the provision of education and training is learning by distance and online education. One of the benefits of this form of learning is its flexibility and that it allows access to education where it may otherwise not be possible. Currently, a significant barrier to the further growth of education in this area is Malaysia's lack of recognition of degrees earned via distance and online education. Where it can be demonstrated that online services are of the same standard as those delivered via face-to-face medium and are subject to the same quality assurance standards as those for face-to-face learning, recognition of degrees awarded through online education would facilitate the growth of this important area of education provision.

Consumption abroad

Approximately 20,000 Malaysian students have enrolled with Australian education providers to undertake Australian qualifications to November 2004.

An important issue that could be addressed in an FTA is the extent to which the Malaysian Public Services Department (JPA) fails to recognises degrees offered by Australian universities. It is understood that currently Malaysia's recognition of

Australian higher education qualification occurs on a course-by-course as well as an institutions by institution basis. Australian qualifications are accredited according to standards set by the Australian Qualifications Framework (AQF). There are 13 qualifications and are all supported by nationally agreed and documented guidelines. These guidelines define each qualification in terms of learning outcomes, pathways into and out of the qualification and those authorised to issue the qualification, such as universities. This provides common ground for qualifications across the sectors and those that are delivered in more than one sector. By connecting the major education and training sectors in a coherent single framework, the AQF aims to improve recognition of prior learning (RPL) and make credit transfer and flexible learning paths easier (this is relevant to the commitments Australia has made under the Memorandum of Understanding and Framework Agreement with Malaysia – discussed in more detail in Chapter 5).

Assessing Australian education qualifications on a course-by-course or institution-by-institution basis, reduces the range of courses that Malaysian students are prepared to undertake in Australia. This has resulted in significant compliance costs for Australian institutions. For example, Malaysia only recognizes fourteen of Australia's twenty nine Bachelor of law degrees, effectively excluding other universities from the Malaysian market.

It is important, should negotiation for an FTA go ahead, that further information be exchanged with Malaysia on the AQF with the aim of ensuring the assessment of Australia's qualifications and quality assurance measures is accurate.

The JPA's lack of recognition of the comparability of Australian degrees with those awarded by other foreign countries is a further issue which reduces the value of the qualification obtained by the student and disadvantages Australian providers. Currently, it is understood that recognition is based on the nomenclature of the degree awarded, rather than by the comparability in quality and course content. In particular, the JPA does not distinguish between the Australian Honours Bachelor degrees and the three-year Bachelor degree with Honours offered by other foreign universities such as those in the United Kingdom. The mainstream Bachelor degree in the UK is the Honours Bachelor degree, which is most commonly of three years' duration. By contrast, an Australian Honours Bachelor degree requires an additional year of independent specialist research following the completion of the Bachelor degree and only students obtaining a strong academic result are invited to undertake the additional Honours year.

Also Australia's three year bachelor degrees are currently recognised in Malaysia as a "pass" degree, comparable to a Higher Diploma or a two year course, whereas a three year Honours degree earned in the UK is recognised as such in Malaysia.

It is important to note that some Malaysian private providers and employers recognise the Australian three year bachelor's degree as comparable to the overseas three year honours degree (such as the UK model). For this reason it is recommended that Malaysia aim to streamline its recognition procedures in the JPA to equate with the private sector and consider the recognition of Australia's three year bachelor degree comparable with the overseas three year honours degree.

Commercial presence

In 2004, Australian education institutions exported education services to approximately 12,000 Malaysian students, either through branch campuses in Malaysia, or various other relationships, such as twinning and advance standing arrangements.

Delivery offshore of education services is an important growth area and can play an important role in contributing to capacity building and increasing the quality (through competition) of education available in a country. There are a number of barriers that limit the potential of this mode of supply. Improving access to each market for providers from the other under an FTA is desirable.

Currently, Malaysia imposes a limitation of one year on the period of advanced standing (recognition of prior learning) that foreign universities can offer to holders of non-Australian awards. For example, a Malaysian with a Diploma in Nursing plus appropriate experience can be given two years advance standing in Australia towards a Nursing degree, whereas the National Accreditation Board (LAN) imposes a maximum of 1 year's advanced standing for a Diploma.

Quality assurance is another important issue for both countries particularly where there are partnerships between institutions. It is important to have measures in place to assure the quality of institutions, both local and foreign. Australia has a well-established and robust quality framework and Australian education providers are subject to comprehensive quality assurance arrangements. For universities, this includes reporting to the Australian Government and regular institutional audits by the independent Australian Universities Quality Agency (AUQA). Audits include offshore operations and audit reports are made public. Australian universities are established through legislation. Use of the title 'university' and the award titles of bachelor, masters and doctoral degrees are also protected in legislation. Under the *Education Services for Overseas Students Act 2000* (ESOS), all providers offering courses to international students within Australia must be approved and registered on the Commonwealth Register of Institutions and Courses for Overseas Students (CRICOS). Protocols for higher education quality assurance for both Australia-based and offshore operations are set out in the National Protocols for Higher Education Approval Processes, and are enacted through legislation. With the rapid developments in transnational education, quality and quality assurance are the focus of increasing international attention, and quality in partnerships is one particular area of focus.

A further barrier which may impact on Malaysia's stated aim to become an international hub for education is the compulsory requirement for all undergraduate students, including foreign students, to study LAN subjects (Bahasa Malay, Malaysian Studies (Civics), Islamic or Moral Studies). This may be a disincentive for foreign students to study in Malaysia.

In Malaysia, student visas are issued on an annual basis and must be renewed annually subject to academic performance and class attendance. The renewal process can be lengthy and requires student to relinquish their passports thereby impeding the ability of a student to leave the country or undertake any other activity where passport identification is required. This further reduces the attractiveness to foreign students of studying in Malaysia.

Foreign providers encounter difficulties in altering their course structure to cater to market changes and students interests due to the requirement that a licence must be obtained for each course of study and that once a license is granted there is no scope to vary the program in any way.

In spite of these barriers, Malaysia has made progress in reforming its educational sector. Australia acknowledges recent positive steps taken by the Malaysian Government, especially with the establishment of an Education Envoy, to open its education sector to aspects of competition and collaboration with foreign partner educational institutes.

Presence of natural persons

Foreign academic staff frequently encounter lengthy delays and difficulties in obtaining visas and teaching licences for the purpose of teaching in Malaysia.

The Impact of Preferential Liberalisation

Although there is already extensive trade in educational services between Australia and Malaysia, a free trade agreement could provide a way of addressing remaining impediments to this trade such as those outlined above. Removal of these impediments would benefit both Australia, as a supplier of quality education services, and Malaysia, through the provision of services essential to developing an internationally competitive economy and the strengthening of local educational institutions as a result of institutional partnerships. Other areas where the liberalisation of the education and training relationship can be progressed through cooperation under an FTA are outlined in the following Chapter.

<u>Professional Services</u>

Malaysia's market for professional services is currently quite heavily protected from foreign competition. This affects both Australia's presence in the market and the way in which professional services are delivered. The major impediments to Australian firms and suppliers are set out below.

Legal Services

In the case of legal services, barriers include the need to be a Malaysian citizen or permanent resident, to pass a Malay language exam, prohibition on association with foreign firms and immigration restrictions on foreign lawyers. The Attorney-General has the power to issue a Special Admission Certificate under special circumstances. In addition, there are obligations on Malaysian law firms to employ only Malaysian citizens and restrictions on associations and profit sharing between Malaysian and foreign law firms.

Foreign law firms may establish as corporations in Malaysia's offshore financial services centre, the Federal Territory of Labuan, and provide legal services in their home country laws, international law and Malaysia's offshore corporations laws to other offshore corporations established in Labuan. Foreign lawyers and law firms are also permitted to provide legal advisory services covering categories of law identified above to clients in Malaysia through cross-border mode of service supply – that is through telecommunications and similar electronic networks from their home base.

Box 4.4.2

Legal Services Underpin Business

Legal business services underpin international trade and investment. Together with other business services like accountancy, management consultancy, and computer and information technology services, they are increasingly critical to the growth of trade and investment across borders.

Legal services enable and facilitate business activity by defining rights and responsibilities and processes for dispute resolution where commercial conflicts arise. Typically, they will involve professionals skilled in the business services of the countries or jurisdictions involved in the investment, trade or transaction – not just one country or jurisdiction.

Removal of unnecessary regulatory barriers to legal and other business services provides benefits to countries through increased efficiencies and economic growth. Users of legal business services benefit from more choice of suppliers, the availability of integrated business services, and the introduction of new technologies in the development and supply of such services.

Malaysia is understood to be giving consideration to liberalising its regulatory regime for legal services involved in trade and investment, particularly in respect of foreign lawyers.

Australia has a relatively open legal services market and is continuing to liberalise its regulation, particularly in relation to foreign lawyers.

There is an opportunity to explore through a possible FTA the benefits to both Malaysia and Australia of removal of unnecessary regulatory or other barriers to trade in legal and other business services between the two countries. Such barriers may presently include restrictions on joint partnerships and other forms of commercial association between local and foreign firms, scope of practice issues, ability of a law firm to employ local or foreign lawyers and to admit partners from other jurisdictions, minimum experience and/or post-qualification requirements, residency requirements and prudential requirements relating to professional indemnity insurance.

Malaysia currently recognises law degrees from fourteen of the twenty nine Australian University law schools. Fourteen of the 'unrecognised' law schools have submitted applications for recognition. However, the Malaysian Attorney General has indicated that he is keen to establish a common bar examination as a basis for admission to practise law in Malaysia for both national and foreign qualified law students. This could represent a positive development, provided that the eligibility criteria developed for the Bar examination do not discriminate against foreign qualified students or legal practitioners. Given the likely timeframe required to implement such an arrangement (possibly two to three years), an interim measure to address the outstanding applications by Australian law schools for degree recognition should be considered.

Accounting and Taxation Services

Foreign accounting firms are permitted to provide accounting and taxation services in Malaysia only through affiliates. All accountants who wish to provide auditing and taxation services in Malaysia must register with the Malaysian Institute of Accountants (MIA) before they may apply for a licence from the Ministry of Finance. Proof of citizenship or permanent residency is required for registration with the MIA.

Architectural Services

A foreign architectural firm may operate in Malaysia only as a joint-venture participant in a specific project with the approval of the Board of Architects. Malaysian architectural firms are not permitted to have foreign architectural firms as registered partners. Foreign architects may not be licensed in Malaysia but are allowed to be managers, shareholders, or employees of Malaysian firms. Only licensed architects may submit architectural plans.

Engineering Services

There are particular limitations on foreign engineers. They may be licensed by the Board of Engineers (Board) only for specific projects, and must be sponsored by the Malaysian company carrying out the project. This licence is only valid for the duration of the project. To obtain temporary licensing for a foreign engineer, the Malaysian company must demonstrate to the Board that they are unable to find a Malaysian engineer to do the job. In addition, foreign engineers are not permitted to operate independently of the Malaysian partners of the company, or serve as directors or shareholders of a consulting engineering company.

In order for a foreign engineer to become a registered as an engineer in Malaysia, he or she must be registered in his/her home country as a professional engineer, have a minimum of 10 years experience, sit the Malaysian Professional Assessment Examination (PAE) and have a physical presence in Malaysia for at least 180 days in a calendar year. Foreign engineering companies may collaborate with a Malaysian company, but the latter is expected to design the project and is required to submit the plans.

Malaysia also does not recognise Australian engineering qualifications. However, Australia is a member of the Washington Accord (which provides a mechanism for mutual recognition between signatory bodies of engineering education accreditation) and Malaysia is currently a provisional signatory to the Accord. It is expected that Malaysia will recognise Australian engineering degrees when it becomes a full member of the Accord.

The Impact of Preferential Liberalisation

Addressing the barriers to professional services in the context of an FTA would open up some new areas of opportunity for Australian suppliers. It would also provide significant benefits to Malaysian users of these services. Importantly, Australian firms in these areas are not so large as to present a significant challenge to their Malaysian counterparts. But they are likely to provide high quality services in niche areas which are important to Malaysia's economic development.

Australia's relatively open professional services market has brought important gains to the economy. For example, the opening of its legal market has encouraged the establishment of international law firms in Australia, exposing domestic lawyers to world's best practice. As an intermediate input, this has not only led to increased trade and investment, but has also strengthened the quality of the Australian legal market, and ultimately led to the export by Australia of legal services. Malaysia might similarly be expected to gain from steps to address its own barriers.

<u>Telecommunication Services</u>

Currently, there is only limited trade and investment in telecommunication services between Australian and Malaysia, suggesting that this is an area with significant potential for growth. One of the reasons for the limited investment is that the Malaysian telecommunications market for fixed line services is controlled by Telekom Malaysia through ownership of the lines. As a result, there are limited opportunities for Australian telecommunications providers to compete in the delivery of fixed line services. Access to the mobile phone market is also limited by the Malaysian Government's control over mobile phone licenses.

Malaysia has also only provided limited undertaking in its GATS Schedule for telecommunications. For example, its liberalization of its telecommunications market is limited by an investment cap of 30 per cent for an aggregate interest in a Malaysian telecommunications company.[31] The investment regime is also uncertain, because investment levels of up to 70 per cent are permissible with approval of the Economic Planning Unit. However, there are no guidelines on how these decisions are made and the potential for them to be reversed creates a significant disincentive to invest.

The Malaysian telecommunications market is regulated by the Malaysian Communications and Multimedia Commission (MCMC), pursuant to the Broadcasting Act of 1988. Malaysia, however, has only partially adopted the WTO Reference Paper on Basic Telecommunications Services[32] and there is only limited independent regulation by the MCMC of the Malaysian telecommunications markets. Decisions by MCMC are also subject to Cabinet override, further reducing the scope and certainty of regulatory decisions. These factors also discourage investment in Malaysia's telecommunications market.

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[31] A Malaysian telecommunications company includes a provider of Basic Telecommunications services, Value-added services and IT consultancy and Database services. Broadcasting services are excluded, but its definition in the Broadcasting Act 1988 makes it unclear whether this extends to Broadband and Mobile Content services.

[32] The Reference paper sets out a range of best-practice regulatory principles.

Malaysia has sought to encourage investment in the telecommunications market by channeling investment into the Multimedia Super Corridor (MSC). The types of investment that can achieve MSC status are those focused on research and development of new and innovative multimedia products. This precludes a large segment of the telecommunications market and therefore, the MSC has only a limited role to play in encouraging investments in the telecommunications market.

Other issues that create disincentives to investing in Malaysia's telecommunications market include its intellectual property regime and enforcement of relevant laws, the requirement that the companies have Bumiputera equity participation of 30 per cent, and the uncertain and lengthy procedures for acquiring the various licenses and permissions needed to operate in the telecommunications market.

Competition in the telecommunications market has the potential to dramatically decrease costs and increase the quality and range of services available to consumers. Due to the importance of telecommunications services in the production of other goods and services, access to more efficient and cost effective telecommunications services would strengthen the competitiveness of Malaysian firms. Steps to address barriers to the market would therefore be likely to benefit both Malaysia and Australia.

Financial Services

Restrictions to financial services in Malaysia have been significant, including the winding back of foreign access to the financial sector in response to the Asian financial crisis in the late 1990s. Malaysia has, however, subsequently sought to undertake a progressive (re)liberalisation of the financial services sector through a staged process of reforms. These reforms are outlined in the Financial Sector Master plan (FSM) and the Capital Market Master plan (CMM), which were released in 2001. There remains some opacity in the implementation timetables for FSM and CMM reform.

Banking

Australian banking institutions, including ANZ, NAB and Macquarie Bank have only a limited presence in the financial services sector in Malaysia. In the banking sector, Australian banks in Malaysia can only act as liaisons for their external customers, unable to conduct their own business. Instead, entry into the Malaysian market requires acquisition of shares in a domestic bank. As with the telecommunications sector, there is a formal cap of 30 per cent for aggregate investment. However, higher equity levels are possible with the approval of the Economic Planning Unit (EPU). A lack of clarity on the formal equity caps and the decision making processes of the Economic Planning Unit creates a disincentive to invest.

Banking licenses are issued by Bank Negara Malaysia (BNM), and the decision whether to issue a licence is also made by the Economic Planning Unit. As noted above, a lack of guidelines on how these decisions would be made creates uncertainty about investing in Malaysia's financial sector, which is a disincentive to investment.

There are also a variety of regulations that restrict the ability of Australian banks to compete in Malaysia. For example, Australian banks cannot offer finance company type products (e.g. car loans) and the requirement that thirty per cent of loans are to Bumiputera individuals or Bumiputera corporations also reduces the competitiveness of these banks in Malaysia and regionally. Financial institutions are also required to meet specific lending targets to SMEs and for low cost housing. The number of branches a foreign bank can open is also limited, and, for this purpose, ATMs are considered branches.

Implementation of the FSM could, however, liberalise the banking market by 2007, with foreign banks being permitted to acquire local institutions. In the interim, foreign banks will experience reduction in the restriction points of service. In particular, foreign banks will be allowed to have more branches and off-site ATMs (though limited to a shared foreign bank network).

Under its reform programme, Malaysia will also permit foreign banks to offer a broader range of services and liberalisation of product pricing. As per insurance services, Mode 4 quotas applying to the number of expatriate senior managers and specialists will be increased.

The Federal Territory of Labuan was established as an International Offshore Financial Centre in October 1990. Foreign investors receive preferential tax treatment for offshore banking activities, trust and fund management, offshore insurance and offshore-related businesses, and offshore investment holding business.

Investments in Malaysia’s financial sector would also be encouraged by harmonizing Malaysia’s prudential and regulatory standards applicable to financial institutions with Australia’s. Further, improvements in the transparency of Malaysia’s regulatory structure and decision making processes would also provide investors with additional certainty, thereby improving the investment climate.

Malaysia also retains various limits on its capital account, affecting the competitiveness of its financial sector. For example, while non-resident controlled financial institutions can borrow up to RM100 million without seeking permission, 60 per cent of the funds must be borrowed from a financial institution controlled by Malaysians. Permission is also required for residents to borrow over RM5 million from non-residents and for residents to make payments to non-residents for any spot or forward contract, interest rate swaps or futures not transacted at the Malaysian Futures Exchange. Payments to non-residents of over RM10,000 are subject to reporting requirements and approval is required for any transfer of funds between external accounts. Approval is also required for payments by residents to non–residents for any amount exceeding RM10,000 for the purpose of investing abroad. All settlements of exports and imports must also be made in foreign currency.

As with investment in the telecommunications sectors, uncertainty and delays in obtaining visas for senior or specialist personnel, and the need to rotate senior people through Malaysia due to these visa restrictions are impediments to doing business in Malaysia.

Insurance

Branches of foreign insurance companies were required to incorporate locally under Malaysian law by 30 June 1998, but the Malaysian government has granted individual extensions. Foreign shareholding exceeding 49 per cent is permitted only with Malaysian government approval but this cap was increased to 51 per cent as part of the 1997 WTO Financial Services Agreement.

New entry by foreign insurance companies is limited to equity participation in locally incorporated insurance companies and aggregate foreign shareholding in such companies may not exceed 30 per cent. This limit has, however, been subject to negotiation. Restrictions on insurance cross-shareholdings of 5 per cent or more may apply to both foreign and domestic insurance companies.

Malaysia's restrictions on the sale of insurance products are also scheduled to be removed as part of the FSM. The pricing of general insurance products, notably fire and motor insurance products, is to be deregulated and the reinsurance industry is to be opened fully to foreign competition.

Securities

Malaysia currently permits 49 per cent foreign ownership in stock brokers and a 30 per cent foreign equity in unit trusts. Although it was proposed, under the CMM, to allow foreign stocker brokers to purchase a limited number of existing stock brokering licences and take a majority interest in unit trust management companies, this has not occurred due to lack of interest in the Malaysian market. Fund management companies may be 100 per cent foreign owned if they provide services to foreigners, but are limited to 70 per cent foreign ownership if they provide services to both foreign and local investors.

Malaysia's further reforms under the CMM include: the removal of branching restrictions on stockbroking companies; the Malaysian stock exchange to open listings for foreign companies; and permitting foreign institutions to issue Malaysian Ringgit bonds.

The Impact of Preferential Liberalisation

The liberalization of Malaysia's financial services market would provide new opportunities for Australian financial service providers to enter that market and build on the currently very small amount of financial services trade between Malaysia and Australia.. Malaysia would gain substantially. Financial services are vital inputs for other firms in the economy. From Australia's experience over the last 20 years, liberalization under an FTA would promote greater competition and reduce interest margins, consequently delivering cost savings for consumers and reducing the cost of producing other goods and services for domestic use or for export. Liberalization would also introduce new expertise and technologies into the Malaysian market, particularly in areas such as corporate governance and risk management processes, increasing the attractiveness of Malaysia's financial sector to international investors.

Tourism

Malaysia is a significant source of tourists into Australia with 175,300 visitor arrivals in 2003-04, accounting for 3.5 per cent of all arrivals. The value of their contribution to the Australia economy has been estimated by Tourism Research Australia at $483.4 million.[33]

Malaysia is currently experiencing robust inbound tourism growth, partly fuelled by deregulation of airfares. This growth is reported to be generating benefits for Malaysia's economy and also creating interest by Malaysians in travelling abroad.

There is room to further increase Australia's share of the Malaysian tourism market. There is also likely to be some stimulus to the numbers of Australian tourists to Malaysia, for example through increased business travel resulting from increased trade and as a result of the "head-turning" effect of an FTA.

Health Services

Opportunities exist to significantly increase the provision of health services to Malaysians both in Malaysia and in Australia. This includes a diverse range of activities such as aged care, tele-medicine, hospital administration and medical education and training, including in specialist areas.

Malaysian consumption of Australia's health services (particularly specialist medical services) can be increased by developing networks between Australian and Malaysian doctors. This can be encouraged by providing opportunities for Malaysians to study medicine within Australia.

Within the overall context of a Free Trade Agreement there may be room to explore greater bilateral cooperation between Australia and Malaysia on health education.

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[33] Tourism Research Australia, Australia 2004.

Chapter 5. Cooperation in Other Areas

The free trade agreements to which Australia is a party address much more than tariff preferences. Like many other preferential agreements, they tackle a range of other impediments to the free flow of goods, services and investment. The Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), which seeks to harmonise measures ranging from customs issues to business law, has gone further in the direction of promoting “deep integration” between the parties than other agreements involving Australia. Recent agreements which Australia has negotiated with Singapore, the United States and Thailand are also wide-ranging in scope and are likely to lead to much deeper economic integration over time.

This chapter looks at possible areas of cooperation and further liberalisation under an Australia-Malaysia Free Trade Agreement, including customs procedures, industrial technical barriers to trade, food standards, investment, the movement of natural persons, education, electronic commerce, competition policy, intellectual property and government procurement. This is not intended to be an exhaustive list of the issues that might be addressed in a free trade agreement, but to suggest some possibilities for extending cooperation.

5.1 Customs Procedures

As a key link in the international circulation of commodities, custom procedures play an important role in facilitating trade. They have therefore been a priority for international economic cooperation, including in the WTO and, for more than a decade, in APEC. The additional costs arising from paperwork and procedures broadly defined have been estimated in some studies to be as high as 10 per cent of the value of goods traded, of which those arising from customs requirements form a part.[34] Consultations and submissions for this study indicate that they are important issues to consider in any free trade agreement between Australia and Malaysia.

Both Australia and Malaysia are members of the World Customs Organization, and are signatories to the WTO (Customs) Valuation Agreement and the International Convention on the Harmonized Commodity Description and Coding System. However, there are no formal customs bilateral arrangements in place between Australian Customs and Malaysia’s Royal Customs and Excise Department.

<u>Australia’s Customs Framework</u>

The Australian Customs Service (Australian Customs) is responsible for managing Australia’s customs framework. It works closely with industry to facilitate legitimate trade and travel, while detecting and deterring unlawful movement of goods and people across the Australian border.

The main roles of Australian Customs are:

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[34] See P. Dee, C. Geisler and G. Watts, *The Impact of APEC’s Free Trade Commitment*, Industry Commission, Staff Information Paper, AusInfo, Febuary 1996, especially pp.10-14, 21-23. Much lower estimates were adopted in *The Impact of Trade Liberalization in APEC: Report by the Economic Committee*, APEC, November 1997, pp.18-19.

- to facilitate trade and the movement of people across the Australian border while protecting the community and maintaining compliance with Australian law; and
- to collect customs revenue and merchandise trade statistics efficiently.

Australian Customs works closely with other Australian government and international agencies to manage the security and integrity of Australia's borders. Protecting the Australian community through intercepting illegal drugs and firearms is a high priority and sophisticated techniques are used to target high-risk air and sea cargo, postal items and travellers. This includes intelligence analysis, computer-based analysis and profiling, detector dogs and other technologies such as container x-rays and ionscans. Equally as important are Australian Customs' responsibilities for revenue collection, including Customs duties, and detecting attempts to avoid paying duty. Compliance checks of traders and collecting trade statistics are also essential roles.

Australian Customs derives its authority principally from the Australian Constitution, which provides for the levying of customs duties and for laws about trade and commerce. Australian Customs was established in its present form on 10 June 1985 by sub-section 4(1) of the *Customs Administration Act 1985*. The constitutional authority of Australian Customs is given legislative expression through the *Customs Act 1901*, the *Customs Tariff Act 1955* and related legislation. Australian Customs also administers legislation on behalf of other government agencies, in relation to the movement of goods and people across the Australian border.

Australia is a signatory to the World Customs Organization Revised Convention on the Simplification and Harmonization of Customs Procedures, which reflects the international trading environment and modern administrative practices of customs administrations.

<u>Malaysia's Customs Framework</u>

The Royal Customs and Excise Department (Malaysian Customs) administers Malaysia's customs laws. Malaysian Customs states its core business as revenue collection and its mission is to collect duties and taxes efficiently and to promote the development of trade and industrial sectors through customs facilitation, as well as to ensure compliance with legislation to safeguard economic, social and security interests.

Malaysia is not a signatory to the World Customs Organization Revised Convention on the Simplification and Harmonization of Customs Procedures, but it has engaged the assistance of signatory countries, including Australia, through the APEC Sub-Committee on Customs Procedures to prepare it for accession to the Revised Convention.

<u>Opportunities for Increased Co-operation</u>

Customs cooperation in a possible free trade agreement would assist to expedite trade between Australia and Malaysia. Areas that could be reflected in the text of a free trade agreement, particularly in the absence of a formal bilateral customs agreement, include:

- commitment to cooperate to improve the efficiency of customs processes;
- commitment to maintaining customs procedures that are transparent and reflect international standards;
- agreement to advise one another of changes in relevant customs laws and procedures;
- establishment of contact points in both countries to respond to customs-related inquiries;
- commitment to exchange of information on technical customs matters such as domestic customs legislation, relevant technologies and examination methods;
- cooperation on providing advance rulings on the tariff classification of goods being imported into one country from the other;
- cooperation on implementing paperless trading initiatives;
- more formal cooperation on issues such as commercial fraud and drug trafficking;
- improved channels for information exchange on intelligence issues, including more timely provision of information for the prevention, investigation and combating of customs offences;
- working together to encourage cooperation with other regional customs administrations, including actively supporting the World Customs Organization; and
- promoting increased dialogue between Australian and Malaysian Customs administrations and business to improve communication and understanding between the customs administrations and business.

5.2 Industrial Technical Barriers to Trade

Differing standards on industrial goods, unnecessary technical regulations and overly complex procedures for assessing conformity also need to be addressed if the gains from trade liberalisation are to be fully realised. Although empirical evidence is difficult to obtain, there are a number of studies which point to very substantial costs as a result of the need to acquire information on standards in other countries, adapt local production to those requirements and provide evidence that they have been met.

<u>Australia’s Approach</u>

Under Australia’s federal constitutional system legislative, executive and judicial powers relating to technical regulations (mandatory standards) are shared between the Commonwealth (the Australian central government) and the constituent State and Territory Governments. Technical regulations are developed within these arrangements in respect of food, pharmaceuticals and therapeutic goods, safety and emission requirements for vehicles, and mandatory safety and information standards for selected consumer goods. The National Measurement Institute is responsible for primary measurement standards, legal metrology and pattern approval as a result of the merger of the former National Measurement Laboratory and the National Standards Commission.

Standards Australia International (SAI), the peak non-government standards writing body, is responsible for the formulation and publication of voluntary standards. In addition to Standards Australia, there are, at least, 16 private sector bodies that prepare industry standards, codes and guides. Two of these bodies, the Australian Gas Association (AGA) and the Australian Communication Industry Forum (ACIF), are accredited by SAI's Standards Accreditation Board to prepare Australian Standards in specific areas. In addition to Standards Australia and the Australian Communications Authority, the ACIF, AGA and the Australian Forestry Standard Steering Committee, three non-governmental standardising bodies, have accepted the Code of Good Practice annexed to the WTO Agreement on Technical Barriers to Trade (TBT).

Standards enforcement is the responsibility of different regulatory agencies, including the Therapeutic Goods Administration, the Australian Quarantine and Inspection Service, the Department of Transport and Regional Services and bodies accredited by the National Association of Testing Authorities (NATA), and the Joint Accreditation System of Australia and New Zealand (JAS-ANZ). NATA accredits the competence of calibration and testing laboratories and inspection bodies; and JAS-ANZ accredits the competence of certification bodies for the certification of management systems, products and personnel.

<u>Malaysia's Approach</u>

Malaysia has a comprehensive framework for addressing standards and conformance issues. The Department of Standards Malaysia (DSM) has overall responsibility for national standards. It operates within the framework of the Standards of Malaysia Act 1996. DSM's functions include developing and promoting national standards and representing Malaysia in international and regional activities on standards. It is also responsible for accrediting organisations engaged in conformity assessment. DSM is supported in some of these functions by SIRIM Berhad, a government-owned company appointed by DSM to coordinate standards development activities and participate in international and regional discussions. There are a number of advisory bodies relating to standards, of which the most important is the Malaysian Standards and Accreditation Council.

Both mandatory and voluntary standards are in use in Malaysia. Goods subject to technical regulations include transport equipment, fire safety and protection equipment, electrical products and accessories, consumer safety products and telecommunications equipment. Like Australia, Malaysia aims to align Malaysian standards with international standards. At September 2004, some 50 per cent of Malaysian standards were so aligned. Malaysia plans to gradually increase the percentage of standards aligned with international standards as these are reviewed.

<u>Opportunities for Increased Cooperation</u>

International cooperation on standards issues has been developing steadily over the past decade as the significance of these issues has been increasingly recognised and as standards themselves have proliferated under the impact of new concerns on issues like health and the environment. At the multilateral level, the WTO Agreement on Technical Barriers to Trade has provided a broad framework which governs the preparation and application of technical regulations, standards and conformity assessment by governments, with the aim that these not create unnecessary obstacles to international trade.

Although it has encouraged members to apply international standards, the WTO Agreement has left a vast agenda at the regional and bilateral level for states to agree on mutual recognition of particular standards or to recognise other countries' arrangements for conformity assessment. As WTO members, both Australia and Malaysia are bound by the WTO Agreement on Technical Barriers to Trade. In addition, both countries are actively involved in the development of international standards through bodies such as the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC).

At the regional level, both Australia and Malaysia have significant links in relation to technical regulations and standards, particularly in the APEC and ASEAN-CER contexts. We should explore the scope to build on this work.

A free trade agreement would offer further opportunities to develop closer cooperation on standards and conformance issues between Australia and Malaysia. Closer cooperation could include adherence to common transparency principles by standards setting bodies and regulatory agencies in Australia and Malaysia, closer alignment with international standards and mutual recognition of conformity assessment procedures. Both Australia and Malaysia could seek recognition of the adequacy of testing and certification procedures in respect of goods of particular interest to their own economies.

5.3 Food Standards and Related Issues

Malaysia and Australia both have quarantine regimes in place to minimise the risk of entry, establishment and spread of exotic pests and diseases that could damage human health, animal or plant life or the environment. In accordance with WTO rules, especially the Agreement on the Application of Sanitary and Phytosanitary Measures (the SPS Agreement), decisions on quarantine and food safety matters are made on the basis of scientific assessments of the risks involved in the commercial movement of animals and plants and their products.

<u>Australia's SPS Regime</u>

Australia adopts a conservative, scientifically-based, managed-risk approach to quarantine controls that are the least trade-restrictive possible, underpinned by a transparent, science based import risk analysis process.

Australia is free of many of the serious pests and diseases affecting other countries and gives a high priority to maintaining that status, which underpins many of our export industries.

Where appropriate, Australia bases its quarantine measures on international standards, including those developed by the World Organisation for Animal Health (OIE), the International Plant Protection Convention (IPPC) and the Codex Alimentarius Commission (Codex). However, in some cases international standards do not exist or do not deliver the level of protection required by Australia to protect its disease-free status. In such cases, the Australian standard is based on a rigorous risk assessment.

Australia's import risk analysis (IRA) process is science-based, open and transparent. It is consistent with WTO rights and obligations and specific guidelines and standards on risk analysis developed by the OIE, IPPC and Codex. All interested parties, including other countries, if they wish, are kept informed of developments via regular stakeholder notification procedures. The process is clearly documented, including through the Internet. When a number of countries request access for a similar commodity, a generic examination looking at all potential sources may be undertaken rather than examination on a country-by-country basis.

Australia's approach to managing pest and disease risk is set out in the Import Risk Analysis Handbook. It is designed to keep the risk of entry, establishment and spread of exotic pests and diseases to an appropriately low level, in the least trade restrictive way.

In terms of the administration of Australia's quarantine system:

- the Department of Agriculture, Fisheries and Forestry (DAFF) is responsible for plant and animal quarantine and has a role in food safety;
- the Australian Quarantine and Inspection Service (AQIS), as an operating group within DAFF, is responsible for implementing and administering strict quarantine controls at Australia's borders, to minimise the risk of exotic pest and disease incursions; and
- Biosecurity Australia, an independent agency within DAFF, is responsible for undertaking Australia's import risk analyses, usually in response to requests from other countries for import into Australia of animals, plants and/or their related products. The IRA process is a key element in Australia's strategy for ensuring that pests and diseases of concern do not enter Australia.

<u>The Australian Food Regulatory System</u>

Food Standards in Australia and New Zealand are governed by Food Standards Australia New Zealand (FSANZ), which is an independent statutory authority with appropriate scientific and technical expertise to develop food standards in the two countries. The overriding goal of the system in both countries is to maintain and strengthen the protection of public health and safety in regard to food. Other key bodies are a Ministerial Council comprising Government Ministers from the relevant portfolios in Australia and New Zealand and a Standing Committee on Food Regulation.

FSANZ is responsible for developing domestic (Australian and New Zealand) food standards, including primary food production standards (Australia only), having regard to Ministerial Council policy guidelines and consistent with the objectives, principles and procedures set out in the FSANZ Act. Once developed and approved by the FSANZ Board, new standards and variations to standards are notified to the Ministerial Council. The Ministerial Council may seek up to two reviews of any standard notified to it by FSANZ and ultimately has the power to reject or amend proposed new standards or amendments.

The FSANZ Act sets out FSANZ objectives in developing or reviewing food regulatory measures and variations of food regulatory measures. These objectives are (a) the protection of public health and safety; (b) the provision of adequate information relating to food to enable consumers to make informed choices; and (c) the prevention of misleading or deceptive conduct.

In developing or reviewing food regulatory measures and variations of food regulatory measures, FSANZ must also have regard to (a) the need for standards to be based on risk analysis using the best available scientific evidence; (b) the promotion of consistency between domestic and international food standards; (c) the desirability of an efficient and internationally competitive food industry; (d) the promotion of fair trading in food; and (e) any relevant Ministerial Council policy guidelines notified to FSANZ.

Imported food must also meet the requirements of the *Imported Food Control Act 1992* (the IFC Act) for matters relating to food safety. The Australian Quarantine and Inspection Service (AQIS) administers the IFC Act and has regulatory responsibility for monitoring of imported food through the imported food inspection scheme (IFIS) at the point of entry. FSANZ is responsible for the setting of food standards that apply to imported food and food for sale on the domestic market with the States and Territories Health departments coordinating domestic food inspection. The IFIS aims to ensure that imported food is safe for human consumption and complies with the requirements of the Food Standard Code.

Imported food may need to undergo a quarantine inspection to ensure it satisfies all quarantine requirements before undergoing an imported food inspection.

<u>The Malaysian SPS and Food Standards System</u>

Malaysia applies strict sanitary and phytosanitary measures to trade in plants, forest products, food, and animal and seafood products. The legislative and regulatory framework on which these measures are based includes:[35]

- the Plant Quarantine Act of 1976 and Rules of Plant Quarantine 1981, which "aims to protect Malaysia's agricultural sector from foreign diseases and pests, and ensures that Malaysian plant product exports are free from infection";
- the Animal Ordinance 1953 and associated rules and orders;
- the Fisheries Act 1985, which covers the distribution and marketing of live fish and related organisms; and
- the Food Act 1983 and Food Regulations 1985, covering the preparation, sale and use of food.

[35] The information is from the Malaysian External Trade Development Corporation, www.matrade.gov.my accessed 10 December 2004.

Malaysian food standards and regulations include requirements that food be processed, stored and handled in a sanitary manner, with these requirements applying to both domestic and imported products. The authorities have sought to harmonise food standards with those used internationally, including the relevant Codex standards. Malaysia has also contributed to the development of Codex Standards for certain products such as palm olein and anchovies. There are nutritional labelling requirements for certain food products, including cereals, breads, milk, various canned foods and fruit juices, soft drinks and salad dressings.

Malaysia has played a leading role in the development of halal certification, reflecting the objective of the Government of developing the country as a hub for Halal food products. Responsibility for issuing Halal certificates lies with the Department of Islamic Development Malaysia (JAKIM). Its certification is widely recognised. Malaysian standards in this area were further strengthened in July 2004 through new guidelines issued by the Department of Standards Malaysia, which, among other things, apply Good Manufacturing Practices (GMP) to Halal foods.

<u>Opportunities for Increased Cooperation</u>

Australian exporters have raised some issues in relation to the operation of the Malaysian quarantine regime. These include issues of transparency, relevance, and uniformity of decision making processes. A free trade agreement would provide the opportunity to acknowledge our commitment to the WTO SPS Agreement as well as to strengthen exchange of information and cooperation between our two quarantine systems, including at a technical level. It would also provide an opportunity to seek ways to streamline existing control, inspection and certification and approval procedures.

A bilateral forum for cooperation in the agriculture sector, the Malaysia Australia Agricultural Cooperation Working Group (MAACWG), has existed for some years and is currently being revamped. MAACWG could form part of an enhanced consultative mechanism covering agricultural issues, including SPS issues and food standards. Australia and Malaysia also commenced bilateral plant quarantine technical discussions in 2003. MAACWG has identified a number of potential bilateral projects in the area of quarantine. These range from education in techniques used in Australia to the implementation of a Hazard Analysis Critical Control Point (HACCP) inspection programme. Other free trade agreements to which Australia is a party have included mechanisms to strengthen cooperation. For example, SAFTA provides for cooperation on food standards and TAFTA establishes a consultative mechanism on sanitary and phytosanitary measures and food standards.

As Chapters 2 and 4 have noted, Australia and Malaysia are already cooperating closely on Halal food production and marketing. However, consultations carried out for this study have suggested that there needs to be greater understanding of the Halal certification and registration process (both veterinary and religious) for Malaysia. Closer consultation with the relevant authorities through the MAACWG and/or any enhanced consultative mechanisms established under an FTA would assist resolution of these and other concerns regarding food standards and labelling.

5.4 Investment

An FTA between Australia and Malaysia would provide both countries with opportunities to attract more foreign investment from each other and from third countries. Improvements in our investment environments could be achieved through reducing foreign equity participation limits, liberalising pre-establishment investment screening regimes, providing greater certainty in decision making processes and ensuring that investors have access to appropriate legal protection.

Australia is currently a party to three FTAs that include investment chapters: AUSFTA, TAFTA and SAFTA. In addition, Australia is a party to 19 Bilateral Investment Treaties (BITs) that have come into force. Malaysia is a party to the ASEAN Investment Area and more than 30 BITS that have come into force. There is currently no BIT between Australia and Malaysia.

Australia and Malaysia both maintain some equity limits on foreign investment. In Australia, foreign equity participation is limited in only a small number of sectors (international aviation services and airports, newspapers, broadcasting services and Telstra Corporation Ltd). By contrast Malaysia requires that foreign investments take the form of joint ventures with Bumiputera interests in all but exempted categories.

Regulations that require foreign investors to operate in joint ventures artificially distort the corporate structure of investments. Flexibility in the choice of corporate structure is necessary to provide appropriate compensation and safeguards for the foreign investor's contribution of capital and the burden of risk that they carry. In a joint venture, even if the capital contribution is split evenly between foreign and domestic partners, conditions imposed generally imply the foreign partner is likely to carry more risk. There are also costs associated with finding the right joint venture partner and there may be insufficient joint venture partners in any particular sector. As equity restrictions impose costs on foreign investors that are disincentives to investment, they should only be applied when they provide benefits that outweigh these costs.

The Malaysian Government has exempted foreign investment in the manufacturing sector and Multimedia Super Corridor status companies from the equity limits. Other exemptions can be granted by various government agencies, but the basis for these is currently unclear. Expanding the scope of these exemptions from foreign equity constraints would benefit Malaysia economically, as it would introduce innovation from efficient foreign firms and increase employment and competition. Australian companies, particularly service providers, would also benefit through increased investment opportunities.

Australia and Malaysia operate pre-establishment screening regimes for foreign investment. Australia's Foreign Investment Review Board (FIRB) administers the *Foreign Acquisitions and Takeover Act 1975*, related regulations and policy instruments. Malaysia's Foreign Investment Committee (FIC) administers the Guidelines on the Acquisition of Interests, Mergers and Take-Overs by Local and Foreign Interests. An FTA could address aspects of our respective regimes that are identified as deterring foreign investment. These could include:

- reducing or removing the burden of seeking foreign investment approval for small and medium size businesses;
- ensuring decision making processes are consistent, widely understood and rules-based; and
- processing applications efficiently.

Australia and Malaysia have both continued to liberalise their foreign investment regimes. Most recently, under the AUSFTA Australia has significantly raised the threshold above which US investors must seek approval for acquisitions of significant interests in Australian businesses and prescribed corporations in non-sensitive sectors, as well as developed commercial real estate, from $50 million to $800 million. Furthermore, new ‘greenfields’ investments by US investors in non-sensitive sectors do not need to be notified to the FIRB. In other FTAs Australia has bound its existing threshold effectively guaranteeing that while our treatment of foreign investors from the partner countries may become more liberal, it cannot be made more restrictive.

In the administration of our respective foreign investment regimes, Australia and Malaysia should endeavour to minimise the costs imposed on applicants. This requires easily understood, rules-based decision-making processes to reduce the burden of uncertainly faced by foreign investors. Furthermore, applications should be dealt with in an efficient and confidential manner. An FTA would provide opportunities to discuss and make commitment on these issues.

BITs and the investment chapters of FTAs typically include commitments to provide post-establishment national or Most Favoured Nation (MFN) treatment for foreign investors from the partner country. This gives greater legal certainty to foreign investors once they have received approval for their investments. Investor State Dispute Settlement (ISDS) provisions are also typically included in FTAs. TAFTA and SAFTA both included ISDS provisions as do the BITs that Malaysia and Australia have signed.

5.5 Movement of Natural Persons, Business Mobility

International trade and investment often relies upon ready access to qualified managers and professionals. Facilitating the mobility of business people is therefore an important means of promoting international trade and investment. An FTA can therefore address issues such as slow, opaque and burdensome administrative arrangements and complicated and costly visa processes that unnecessarily restrict this mobility and thereby also limit opportunities for increased trade and investment.

<u>Australia’s Temporary Entry Framework</u>

Each year, more than 10 million people travel to and from Australia. This includes Australian citizens travelling overseas as well as migrants, tourists, temporary residents, working holiday makers, overseas students and diplomats.

Box 5.5.1

Australia's Temporary Entry Arrangements

Australia's principal visa options are as follows.

Subclass 456 Short Stay Business Visa: People intending to visit Australia on business for three months or less may obtain a Subclass 456 Short Stay Business Visa. This Visa is for business people who wish to:

- explore business opportunities in Australia;
- conduct business negotiations, site visits, equipment inspections;
- sign business contracts; and/or
- attend conferences or meetings in relation to their field of employment.

APEC Business Travel Card (ABTC): Frequent Business Visitors who are citizens of participating APEC economies, may be eligible to apply for an ABTC through their own government.

- ABTC entry and stay conditions are identical to those of the subclass 456 visa;
- no separate visa application is required; and
- no visa label is required in the ABTC holder's passport.

Subclass 457 Business Temporary Entry Visa: People intending to enter and work in skilled employment in Australia for periods of up to four years may obtain a subclass 457 Business Temporary Entry Visa. Under this visa, arrangements have been streamlined, including offshore processing and a single application process, to ensure entry procedures are efficient, expeditious and transparent and to reduce the barriers to business people and companies associated with delays and entry costs. This visa is based on sponsorship by the employer, who will be responsible for their nominee. Malaysia-based companies are able to sponsor personnel to establish an operation in Australia. Australian companies are able to sponsor professional and skilled personnel (trade and higher level occupations) as needed. The subclass 457 Business Temporary Entry Visa provides permission to enter and work for an initial period of up to four years. Australian businesses may apply for further periods of up to four years at a time. Under this visa, spouses and dependants are granted automatic work rights. There is no upper limit for the number of subclass 457 Business Temporary Entry Visa granted. Australia has put in place a number of streamlining measures for skilled temporary entrants including:

- development of e-business solutions for processing applications for long-term temporary business entry where sponsored by Australian businesses;
- implementation of a simple regime involving a minimum salary level (average annual salary) and minimum skill thresholds;
- increased assistance and access to comprehensive information on regulations and procedures relevant to entry and stay. Measures include the establishment of business centres in each region, the development of website and printed information packages, including industry-specific information.

The *Migration Act 1958* and the Migration Regulations are administered by the Department for Immigration and Multicultural and Indigenous Affairs (DIMIA). The Department is responsible for maintaining the integrity of Australia's borders by ensuring that only those foreign nationals who have authority are allowed to enter and stay in Australia. Australia has a universal visa system, requiring all non-citizens to have a visa for entry and stay in Australia.

By using new systems and technology with the universal visa system, Australia has developed a very sophisticated electronic entry processing system, which enables immigration clearance for most passengers to be completed in less than a minute. DIMIA is responsible for action against people who try to enter Australia unlawfully and those who fail to comply with the terms and conditions of their visas. It locates people who have overstayed their visas and become "unlawful non-citizens" and ensures that they depart Australia if there is no legal reason for them to remain.

Australia has a broad range of visa options available for the temporary entry of Malaysia’s citizens seeking to enter for business purposes. The three key visa options for business people are outlined in Box 5.5.1. The Department of Employment and Workplace Relations (DEWR) works closely with DIMIA on the parameters of various temporary migration arrangements to ensure that they do not affect adversely Australia’s objectives of promoting employment and training opportunities for Australian jobseekers and comply with Australia’s standards and conditions of employment.

Malaysia’s Approach

Visitors who wish to travel to Malaysia for business purposes do not typically require a visa, and those from most Commonwealth countries, including Australia, are eligible to stay without a visa for up to three months. Entry for business purposes is defined to include, for example, the entry of company owners or representatives to attend meetings or examine company accounts, or investors or business persons seeking business opportunities. Holders of an APEC Business Travel Card can stay under a 2 month pass.

Employment of foreign personnel for business purposes can be more problematic. Most foreign firms face restrictions in the number of expatriate workers they are allowed to employ. Although there has evidently been some liberalisation of guidelines for hiring expatriates in the manufacturing sector, there remain significant restrictions for services.

In the services sector, the process of recruitment and renewal of permits for Intra-Corporate Transferees (ICTs) is subject to considerable bureaucratic red tape and subject to approval from multiple Ministries. A company director has to be present personally in order to submit foreign labour applications and to receive approval. Malaysia currently imposes a cap on the number of specialists (currently 2) that are allowed to enter and stay as ICTs. Spouses of ICTs are not permitted to work in Malaysia. Foreign owned firms are not permitted to obtain expatriate work permits unless the firm has a 30 per cent Malaysian shareholding.

Opportunities for Increased Cooperation

Generally speaking, Australia and Malaysia could seek to explore the opportunity for generous entry, work and stay provisions, establish arrangements to ensure quick and timely granting of entry visas for business people employed by enterprises and organizations of the two countries and to increase the application of electronic methods, especially the internet, in managing business entry. Streamlining procedural arrangements for visa applications, processing and granting of visas and/or temporary entry rights and ensuring their transparent administration in a timely and uniform manner would also contribute to improved business person mobility. The FTA negotiations also provide an opportunity to establish service standards for short and long-term entry and stay.

As noted already, Malaysia's process for ICTs is subject to approval from multiple Ministries. FTA negotiations could explore ways of simplifying processes for granting ICTs. For instance, an FTA could include facilitation of movement of business people by requiring authorities to publish on the internet all information on its regulatory visa regime, including application forms. Mechanisms could also be established to enhance communications between the relevant authorities of each country.

FTA negotiations could also address restrictions on the number of specialists allowed to enter as ICTs, as well as visa conditions for the immediate families of ICTs. The prospects for spouses and dependents of primary applicants who are not ICTs receiving work rights could also be explored.

It would also be possible for FTA negotiations to look at ways to enhance the cooperation and coordination on the APEC Business Travel Card scheme and other mechanisms to facilitate the mobility of business people. Australia and Malaysia could seek to ensure that contractual service suppliers and skilled people of an enterprise of one party of the possible FTA are granted entry to allow them to enter, stay and work in the other party for a reasonable period of time. Multiple entries within the period of stay could also be considered.

5.6 Education

Australia and Malaysia have a positive and cooperative bilateral education relationship, facilitated by strong government to government links and institutional cooperation. Australia is the largest overseas provider of education services to Malaysia and is an important source market for students, ranking as Australia's fifth largest source country for international students enrolments in 2003.

Chapter 4 of this study discusses trade in educational services between Australia and Malaysia and the current impediments or barriers to trade. There is considerable scope for an FTA to not only remove existing barriers, but also to facilitate cooperation between each country's respective government agencies and educational institutions. For example, increased recognition by Malaysia of Australian degrees and their equivalence with degrees awarded by other foreign universities would be an important step towards ensuring Malaysian students have a valuable and recognisable qualification and to increasing the competitiveness of Australian education providers in Malaysia.

The Malaysian-Australian Memorandum of Understanding on Cooperation in the Field of Education, and the Framework Agreement on the Recognition of Academic Qualifications, underpin and formalise our education relationship. The Framework Agreement includes a statement on the comparability of the Bachelor degree awarded by a public university in Malaysia and a Bachelor degree awarded by an Australian university. In June 2002, the Agreement was amended by a Supplementary Arrangement to recognise Bachelor degrees awarded by seven private Malaysian universities.

Australia-Malaysia Joint Working Group (JWG) meetings and the Vocational Education and Training (VET) Dialogue meetings also facilitate and strengthen Australia's bilateral relationship with Malaysia. The meetings provide a forum to acknowledge the considerable activity which occurs between the two countries, to share valuable information on recent developments in education and training and to explore new opportunities for further collaboration.

An FTA could facilitate policy dialogue and collaboration between Australian and Malaysian education authorities. It could, for example, lead to increased involvement by Australian institutions in the Malaysian education market, the exchange of academic staff and students and encourage collaborative research and training. An FTA could provide an opportunity to give this Framework Agreement greater weight or broader initiatives.

5.7 Electronic Commerce

E-commerce refers to trade in goods and services for which electronic communication is central to the transaction or delivery process. This form of trade has enabled new and important business models and opportunities, although it has also presented a number of policy challenges. Both Australia and Malaysia recognise the potential and growing importance of e-commerce and associated high-technology industries. Both also recognize that electronic commerce is emerging as an important aspect of trade relationships between countries.

Free trade agreements are becoming an important mechanism to cement bilateral cooperation agendas to make the most of opportunities presented by e-commerce and to increase the effectiveness of policy responses to the challenges that it creates.

<u>Australia's Approach to E-Commerce</u>

The Australian Government has seen the growth of e-commerce, and the transformational effects of information and communications technology (ICT), as primarily private sector driven, but with clear beneficial effects for the economy and citizens generally. In putting in place relevant regulatory settings, the Government has focused on removal of unnecessary barriers to e-commerce, while regulating specific aspects, such as content, on their merits as required by the public interest.

Australia has developed legislation, the *Electronic Transactions Act 1999*, to remove legal obstacles to the use of electronic materials. The legislation was developed in consultation with the States and Territory Governments because a national approach is essential to the success of electronic commerce in Australia. It deals with Commonwealth law, but is complemented by similar legislation in the States and Territories to have similar effect in those jurisdictions.

The Act allows individuals to deal with Commonwealth departments and agencies electronically and makes clear the general principle that a person can enter into contracts electronically. The Electronic Transactions Act 1999 is part of the Australian Government's strategic framework for developing the information economy in Australia. The strategic framework reflects the Government's commitment to ensuring that all appropriate Government services are available online. The Act is based on the United Nations Commission on International Trade Law Model Law on Electronic Commerce.

The Act creates a "light touch/facilitative" regulatory regime for using electronic communications in transactions. It facilitates electronic commerce in Australia by removing existing legal impediments that may prevent a person using electronic communications to satisfy legal obligations under Australian Commonwealth law. The Act gives business and the community the option of using electronic communications when dealing with Government agencies (though it allows agencies to specify certain requirements for an electronic communication to be legally valid).

The Act provides that any other laws that deal specifically with the use of electronic communications to satisfy writing, signature, production or retention requirements will be preserved. It is not the intention of the Act to override any existing or future laws that deal specifically with these matters.

The Act is based on the key principles of technological neutrality (the legislation does not prefer one form of electronic signature technology over any other) and functional equivalence (paper documents and electronic transactions should be treated equally).

Malaysia's Approach

The Malaysian Government has also been active in promoting the use of the internet and associated high technology industries. Its overall objective has been to develop Malaysia as a competitive knowledge-based economy. The Government has undertaken a number of regulatory reforms intended to accelerate uptake of the internet and promote the use of e-commerce. Through the Multimedia Super Corridor, it has sought also to develop a nucleus of high technology industries which will strengthen Malaysia's competitiveness in information and communications technology (ICT). Government measures to promote the use of ICT in trade and the manufacturing sector include a variety of grants as well as training programmes.

According to MITI, the value of e-commerce in Malaysia doubled in 2003, rising to RM10.3 billion, driven by increases in both business-to-business and business-to-consumer e-commerce. A 2003 survey undertaken by Malaysia's MITI suggests strong use of information technology in the manufacturing sector.[36] The Government has reported significant progress in allowing permits and documentation to be submitted electronically. For example, shipping documentation can now be submitted electronically at all major ports.[37]

Opportunities for Increased Cooperation

At its most basic level, e-commerce draws on the potential of communication and computer systems to deliver information on a larger scale, at a lower cost and more quickly than has been possible in the past. For this to be commercially useful, however, a number of conditions must be fulfilled. For example, it requires systems to be in place to receive the information at the other end. It also requires the identity and intentions of the sender of the information to be trustworthy. On the other side of the coin, effective e-commerce requires that nuisance, malicious and fraudulent uses of the systems be minimised. Australia and Malaysia are currently considering cooperation in ICT under of proposed Memorandum of Understanding (MoU) under the Australia-Malaysia Joint Trade Committee process.

An FTA could build on and formalise cooperation being considered under the Joint Trade Committee. There are a number of areas where cooperation might prove to be of value:

- *Trade Administration Documents and Customs.* In most instances it will be the responsibility of commercial operators to have systems in place to receive, process and send the electronic messages necessary for e-commerce, and the market is often best-placed to drive this uptake of technology. However, a major concentration of government involvement (where market signals are missing), and an area of great significance to trade is in trade administration, and customs in particular. An FTA could add impetus to efforts to standardise customs data and encourage the creation and acceptance of electronic trade administration documents.
- *Customs duties moratorium.* An FTA can be used to agree to maintain the current practice of not imposing customs duties on electronic transmission, the subject of a rolling moratorium in the WTO.
- *Electronic Transactions: Basic Framework.* It is important to have guidelines governing the use of electronic materials. As noted above, Australian legislation has sought to achieve this, in part, by removing existing legal impediments that may prevent a person using electronic communications to satisfy legal obligations under Australian law. It would be possible for cooperation under an FTA to extend this to e-commerce between the two countries. In particular, an FTA could clarify the use of United Nations Commission on International Trade Law (UNCITRAL) based model laws for e-commerce used in Australia and Malaysia. An FTA could also seek to explore the cross-jurisdictional relevance of electronic transactions across borders. Efforts are being made via the E-ASEAN strategy to harmonise and create frameworks or to utilise existing electronic transactions acts for cross border transactions. An Australia-Malaysia FTA could build on this

[36] See Ministry of International Trade and Industry, Malaysia, *Malaysia, International Trade and Industry Report 2003*, Kuala Lumpur, 2004, p.169.
[37] *Ibid.*, pp. 170-174.

work and pilot test cross-border e-transactions, which may be government-to-government transactions, such as customs.

- *Authentication.* In attempting to establish the authenticity of undertakings and participants in an e-commerce transaction – a vital prerequisite to successful e-commerce – mechanisms that can be used include digital certificates and electronic signatures. An FTA could facilitate mutually recognisable versions of these tools, and encourage the use of international standards in specifications.
- *Privacy and on-line data protection.* It is important to ensure the privacy of information used in electronic transactions. It is useful to have guidelines to set out the stages of processing personal information and standards for the collection, use, disclosure, quality and security of such information. They could also set out the requirements of access to such information. An FTA could contain a commitment to ensuring the privacy of information used in electronic transactions.
- *Consumer protection.* Measures to ensure consumer protection are essential to promoting confidence in online transactions. An FTA could promote cooperation on mechanisms to ensure consumer protection for electronic transactions.
- *Spam.* There has been an increasing proliferation of unsolicited electronic material known as spam. It is important to achieve a balance between permitting responsible direct marketing and other business activities while allowing a strong and effective response to spamming. An FTA could be a vehicle to promote cooperation on combating spam.

5.8 Competition Issues

A sound competition regime can ensure that the benefits derived from market liberalisation mechanisms such as Free Trade Agreements are not undermined or frustrated by anticompetitive and unfair practices within a domestic economy such as price fixing; market sharing; bid rigging; misuse of market power (monopolisation) including predatory pricing; resale price maintenance; tied-selling; refusal to deal; exclusive dealing; or misleading and deceptive practices. There are also structural arrangements that can provide opportunities for anti-competitive conduct and the maintenance of government enterprises or entities that are immune from pro-competitive laws.

Competition policy can contribute towards the sound economic development of an economy by putting in place mechanisms that promote independent rivalry, lead to more product research and innovation, ensure truthfulness of product claims, improve price and quality of products and services and enhance the efficiency of distribution systems, with the associated benefits flowing to consumers. An effective competition policy can also contribute to more favourable perceptions on the part of international investors and thus promote increased foreign direct investment.

<u>Australia's Competition Regime</u>

In Australia, microeconomic reforms undertaken by the Federal, State and Territory Governments since the early 1990s led to an increased focus on adopting a nationally coordinated approach to reform. This focus led to the Council of Australian Governments (COAG) agreeing in October 1992 to establish an independent

Committee of Inquiry into a National Competition Policy for Australia. The Inquiry made a series of recommendations on various aspects of competition, including extending the scope of *the Trade Practices Act 1974* to all business activities; a review of Federal and State legislation which restricted competition; and ensuring fair and reasonable access by third parties to nationally significant infrastructure. In 1995 Australian Governments established the National Competition Policy (NCP), the aim of which was to promote competition resulting in businesses adopting effective resource usage, reducing prices and adopting other practices that benefit consumers.

The National Competition Council (NCC) was established in November 1995, as an independent body funded by the Federal Government but answerable to COAG. The creation of the NCC provided a means by which Australia can independently assess and encourage progress in implementing national competition policy. Incentives for reform are provided to the Australian State and Territory Governments by the Federal Government in the form of competition payments. Such payments represent the States' share of the additional revenue raised by the Commonwealth as a result of effective competition reform, to date worth around $3.4 billion. Payments to jurisdictions may be reduced where the NCC recommends penalties for lack of progress with competition reforms.

In 1995, the Federal Government also established the Australian Competition and Consumer Commission (ACCC) by a merger of the former Trade Practices Commission and the Prices Surveillance Authority. As an independent regulator, the ACCC is charged with enforcing the primary piece of competition law in Australia, the *Trade Practices Act 1974* (the TP Act), and is also involved in compliance and outreach activities. The ACCC also regulates national infrastructure services. Its primary responsibility is to ensure that individuals and businesses comply with the TP Act which includes provisions relating to competition, access to essential infrastructure, fair trading and consumer protection.

Competition reforms in Australia have delivered significant benefits to the country, including enhanced export competitiveness due to lower domestic production costs. The Productivity Commission has estimated that export volumes would be 3.4 per cent higher as a result of NCP reforms than would otherwise have been the case.[38]

In its 2002-03 economic survey of Australia, the OECD also noted that "the implementation of Australia's ambitious and comprehensive National Competition Policy over the past seven years has undoubtedly made a substantial contribution to the recent improvement in labour and multifactor productivity and economic growth. In 1999 the Productivity Commission estimated that Australia's GDP would be 2½ per cent higher than it would otherwise have been as a result of competition policy."[39]

Competition policy ensures the promotion of competitive markets, and ensures that market access improvements obtained through multilateral or bilateral arrangements are not frustrated by over or under regulation in the domestic economy. Australia has included competition policy chapters in its Free Trade Agreements with Singapore, Thailand and the United States.

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[38] Productivity Commission, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Report Number 8, AusInfo, Canberra, 1999, p. 299.
[39] OECD, *OECD Economic Surveys, 2002-2003 Australia*, Paris, 2003.

Australia's competition framework takes account of international factors with respect to mergers. When assessing mergers pursuant to section 50 of the TP Act, the ACCC considers the actual and potential level of import competition in the market. In deciding whether to grant authorisation to a merger, the ACCC is required to regard as a public benefit significant import substitution and a significant increase in the real value of exports. In certain circumstances Australia's merger policy extends to cover acquisitions that occur outside Australia, in which cases significant import substitution and a significant increase in the real value of exports are considered.[40]

Malaysia's Competition Regime

Malaysia does not presently have a national competition law, although the Ministry of Domestic Trade and Consumer Affairs has been working on formulating Malaysia's policy approach to competition policy and undertaking an educative process within the domestic economy. Only two areas of Malaysia's economy are currently covered by any type of competition-specific regulation - the communications and multimedia sector under the *Communication and Multimedia Act, 1998* and the energy sector under the *Energy Commission Act 2001* - which make competition regulation a function of the sector's regulator.

Since 2000, the Communications and Multimedia Commission has released guidelines covering competition which seek to clarify definitions such as rivalries, market dominance, anti-competitive conduct and also to detail the actions which may be taken by the agency to investigate alleged breaches under the Communication and Multimedia Act.

Price regulation under various pieces of legislation occurs in other sectors of the Malaysian economy such as in the distribution, road transport, railways and ports sectors but in general, sectoral regulation is aimed at economic regulation (such as market entry) rather than at promoting or protecting competition. Other legislative instruments such as the *Trade Descriptions Act 1972*, the *Hire-Purchase Act 1967*, the *Weights and Measures Act 1972*, the *Direct Sales Act 1993*, the *Money Lenders Act 1951* and the *Consumer Protection Act 1999*, also afford protection to consumers by identifying their rights and detailing unethical and illegal business activities.

Malaysia's eighth five-year economic plan (2001-2005) contained reference to the implementation of competition policy stating that efforts would be made to foster fair trade practices that contribute to greater economic efficiency and competitiveness. The plan called for a fair trade policy and law to prevent anti-competitive behaviour such as collusion, price fixing, market allocation and the abuse of market power.

Consideration by the Malaysian Government of a competition policy regime was accelerated in 2001 by WTO discussions in the Doha Development Agenda. Malaysia has taken a cautious approach given the absence of a national regime in the country. It has expressed concerns over how a multilateral instrument may affect its (and other developing countries') ability to shield industries and firms from competition from multinational corporations and to pursue measures to promote the growth of strong domestic corporations. It also considers that the development and

[40] Matters of this nature are considered by the Australian Competition Tribunal, not the ACCC.

implementation of a competition policy regime in Malaysia will need to accommodate its long-term socio-economic policies.

In July 2004, WTO Members agreed that competition policy should not form part of the Doha Round. Nevertheless, Malaysia is continuing with its efforts to pursue a national competition regime that could be expected to take the form of a Fair Trade Act, if implemented.

Opportunities for Increased Cooperation

As mentioned earlier, Australia's experience in adopting a national competition regime suggests a number of challenges will be faced by Malaysian authorities including legislative change to sector-specific regulations, policy coherence, obtaining political support and implementing modalities associated with the possible creation of a Fair Trade Commission. These challenges represent opportunities for Australia to share its experience of implementing a national competition regime and cooperate with Malaysia on capacity building. Australia and Malaysia may also wish to consider creating mechanisms for future collaborative arrangements and information sharing, particularly with respect to enforcement assistance and cooperation.

The Australian Treasury is responsible for competition policy in Australia and would have primary responsibility for taking forward such consultations, with the ACCC also likely to be involved. The ACCC, as Australia's competition enforcement agency, would have prime responsibility for taking forward any consultations on enforcement matters, with Treasury also likely to be involved.

Inclusion of a competition chapter in any free trade agreement with Malaysia could provide for consultations and informations sharing between Australia and Malaysia on matters of competition policy. These could cover, for instance, the application of competitive neutrality disciplines to government-owned businesses and regulatory cooperation and mutual assistance. Consideration could be given to creating a mechanism to explore ongoing agency-to-agency, treaty level and other cooperative arrangements as the Malaysian competition regime develops.

This area would need to be reviewed (for example, under any review mechanism built into the agreement) should Malaysia move to enact a generic competition law or to establish an over-arching competition policy regulator.

5.9 Intellectual Property

Intellectual property (IP) law protects the property rights in creative and inventive endeavours and gives creators and inventors certain exclusive economic rights, generally for a limited time, to deal with their creative works or inventions. Both Australia and Malaysia recognise that it is a vital component in creating the conditions in which creativity can flourish. Both also recognise that it is an important condition for the growth of international trade in goods and services, and for the growth of foreign direct investment.

Australia's Intellectual Property Regime

Australia is a signatory to a variety of international IP conventions. These provide mechanisms for registering Australian patents, trade marks, and plant varieties in other signatory countries. International protection for copyright is achieved under the conventions through the principle of 'national treatment'. Broadly speaking, each convention member country gives the same rights to the nationals of other convention countries as it gives to its own nationals. The laws of members of the treaties must conform with the minimum standards specified in the treaties.

Two Commonwealth government departments carry primary policy and administrative responsibility for IP. Responsibility for policy development and administration of the patent, trade mark, design and plant breeder's systems rests with IP Australia. The Attorney-General's Department is responsible for policy development and the administration of the *Copyright Act* and the *Circuit Layouts Act*.

Australia has specific laws covering patents, trade marks, designs, plant breeder's rights, copyright and circuit layouts:

- The *Patents Act 1990* establishes a legislative framework for granting and registering patents. Registered owners have exclusive rights to commercially exploit inventions for generally the 20 year life of the patent.
- The *Trade Marks Act 1995* establishes a legislative framework for registering and granting rights to exploit trade marks. A trade mark can consist of, for instance, words, symbols, pictures, sounds and/or smells, or any combination of these, used to distinguish the goods and services of one trader from another. Initial registration lasts 10 years, but registration may be renewed for successive periods of 10 years on payment of the renewal fee.
- The *Designs Act 2003* establishes a legislative framework for registering and rights to commercially exploit designs. Registration protects the visual appearance of designs which have an industrial or commercial use. Registered owners have exclusive rights to commercially exploit designs. Initial registration lasts for 5 years, but registration can be renewed for one further 5 year period.
- The *Plant Breeder's Rights Act 1994* establishes a system for registering plant varieties. New varieties of all plant, fungal, algal species and transgenic plants are eligible for protection. In tree and vine varieties, the right to exploit plant varieties continues for 25 years from the date of granting, and in all other varieties, for 20 years.
- The *Copyright Act 1968* provides copyright owners with certain exclusive rights in relation to original artistic, dramatic, musical and literary works (including computer programs), films, broadcasts, performances and sound recordings. Literary, artistic, dramatic and musical works are generally protected for the life of the author plus 70 years.
- The *Circuit Layouts Act 1989* provides protection to owners of the layout-designs of integrated circuits (also known as computer chip designs or semi-conductor chips) against unauthorised copying. The maximum possible protection period is 20 years.

- The *Australian Wine and Brandy Corporation Act 1980* provides the legislative framework for protection and administration of geographical indications (GIs) for wine in relation to regions and localities in Australia.

Some types of IP do not have special statutory protection. Confidential information and trade secrets are protected through contract and the common law action for breach of confidence. Business reputation and goodwill in unregistered trade marks or trade names may be protected by the common law action of passing off or an action for misleading or deceptive conduct under the *Trade Practices Act 1974* or equivalent State or Territory legislation.

Enforcement of intellectual property rights (IPR) refers to the mechanisms used to assert or defend a right or to test its validity. IPR are enforced through a variety of mechanisms, including opposition processes, warning letters, commercial negotiations, alternative dispute resolution, customs seizures and litigation.

Australia provides a well developed system for enforcing IPR through both administrative and judicial processes.

- Administrative authorities such as the Commissioner for Patents, the Registrar of Trade Marks and Registrar of Designs may make various decisions as to the granting of patents, trade marks and designs. The Copyright Tribunal is a specialist administrative body which handles disputes in relation to statutory licences. Administrative decisions can be appealed to the Administrative Appeals Tribunal (AAT) or the Federal Court. Appeals from decisions of the AAT can also be made to the Federal Court.
- Courts determine substantive disputes regarding IPR. Proceedings under IP legislation may be commenced in any State or Territory court or in the Federal Court of Australia. Copyright proceedings can also be brought in the Federal Magistrates' Court. It is most common for proceedings to commence in the Federal Court of Australia. The High Court of Australia will hear appeals on IP matters that, on its determination, raise particularly important issues of law. The Federal Government has developed *IP Access*, a web-site offering an integrated access point for information relating to IP and accessible at http://www.ipaccess.gov.au.

The Malaysian Government's Intellectual Property Regime

Malaysia's intellectual property regime is intended to protect patents, trademarks, industrial designs, copyright, geographical indications, and layout designs of integrated circuits. Its approach is shaped, in part, by its membership of a number of international organizations and conventions, including the World Intellectual Property Organization, the Berne Convention for the Protection of Literary and Artistic Works and the Paris Convention for the Protection of Industrial Property.

The principal agency responsible for policy development and administration is the Intellectual Property Corporation, which on its establishment in 2003, assumed the functions of the Intellectual Property Division of the Ministry of Domestic Trade and Consumer Affairs. The Corporation operates under a framework set out in a number different Acts of Parliament, including, for example, the *Trade Marks Act 1976, the Copyright Act 1987, the Industrial Designs Act 1996, the Layout Designs and Integrated Circuit Act 2000* and *the Geographical Indications Act 2000*.

Copyright protection in Malaysia provides for protection of literary, musical or artistic works for 50 years following the death of the author, while patents, consistent with TRIPS, provide a protection period of 20 years from the date of filing an application. Trade marks are protected for a period of ten years, but this period can be renewed.

The authorities have made determined efforts to improve the enforcement of intellectual property in Malaysia. But piracy remains a significant problem, as it does in many other East Asian economies. The International Intellectual Property Alliance, which represents US copyright-based industries, estimates piracy levels in Malaysia in 2003 at 50 per cent for motion pictures, 45 per cent for records and music and 90 per cent for entertainment software.[41] Enforcement of intellectual property has also been raised in consultations carried out by the Department of Foreign Affairs and Trade for this scoping study.

Opportunities for Increased Cooperation

The overall objective for an intellectual property chapter in any Free Trade Agreement with Malaysia would be to increase the benefits from trade and investment between the parties through the protection and enforcement of intellectual property rights.

In order to enhance cooperation on intellectual property issues, the Agreement could usefully consider elements such as the following:

- an agreement, subject to available resources, to reaffirm and strengthen:
  - cooperative arrangements between respective government agencies, educational institutions and organisations concerning intellectual property rights;
  - information exchanges (including the enhancement of online resources and public education and awareness activities) to assist in developing a greater understanding of the operation of their respective IP systems;
- an agreement to establish any necessary additional cooperative arrangements to foster dialogue on intellectual property issues and to develop an action plan to address those issues. Subject to available resources, this could be done through the establishment of working groups on relevant topics, such as enforcement;
- a statement acknowledging each Party's commitment to and obligations under the various multilateral intellectual property treaties and organisations to which they are a party (eg World Intellectual Property Organization (WIPO), WTO TRIPS and the APEC Intellectual Property Rights Experts Group (IPEG));

[41] International Intellectual Property Alliance, *2004 Special 301 Report on Global Copyright Protection and Enforcement*, p.341, at www.iipa.com accessed on 10 December 2004.

- an agreement to accede to or ratify other relevant international intellectual property agreements within a specified period from date of entry into force of the FTA. The relevant treaties will need to be specified, but are likely to include the WIPO Copyright Treaty, the WIPO Performances and Phonograms Treaty, and the Patent Cooperation Treaty;
- an agreement to consider acceding to other relevant international intellectual property treaties. The relevant treaties will need to be specified, but could include the Madrid Protocol (concerning the international protection of trade marks);
- a commitment to implement any measures that Parties agree would enhance the effectiveness of their intellectual property regimes.

5.10 Government Procurement

Although precise estimates are difficult to obtain, both the Malaysian and Australian Governments are important purchasers of goods and services. Government procurement has been addressed in each of the free trade agreements to which Australia is a party.

Both Australia and Malaysia are members of the APEC Government Procurement Experts' Group (GPEG) which promotes transparency, value for money, open and effective competition, fair dealing, accountability and due process, and non-discrimination in government procurement.

The Australian Government Procurement Framework

Australian Government arrangements for the management and accountability of its entities distinguish between departments and agencies subject to *the Financial Management and Accountability Act 1997* (the FMA Act) and independent government authorities and companies subject to *the Commonwealth Authorities and Companies Act 1997* (the CAC Act).

The FMA Act covers all Australian Government departments of state, including legal departments and departments supporting Parliament, and their agencies. The FMA Act provides the framework for the proper management of public money and public property by the executive arm of the Australian Government. Public money and public property is money and property in the custody or control of the Australian Government.

The Minister for Finance and Administration, under Regulation 7(1) of the FMA Regulations, has the power to issue guidelines relating to procurement On 7 December 2004 the Australian Government released revised *Commonwealth Procurement Guidelines* (CPGs)[42] incorporating requirements from the recent Australia-United States Free Trade Agreement.

The procurement framework created by the CPGs follows the devolved resource management model of the FMA Act. That is, each Australian Government department or agency is responsible for managing their procurements, in terms of the

[42] Available through http://www.finance.gov.au/ctc/commonweath_procurement_guidel.html

processes and the outcomes, within a centrally prescribed framework of procurement policies as issued by the Minister for Finance and Administration.

This requires Chief Executives to apply the efficient, effective and ethical use of the Commonwealth resources for which they are responsible. Chief Executives mainly discharge this responsibility for procurement by ensuring that their officials have appropriate policies, procedures and guidelines in place to achieve 'value for money' in procurement processes, in an accountable and transparent manner and that the officials conduct procurements in an ethical manner.

'Value for money' is the core principle governing Commonwealth procurement, and is usually assessed on price and non-price criteria to ensure that the government gets the best performance outcome for what it buys. Officials buying goods and services need to be satisfied that the best possible outcome has been achieved taking into account all relevant costs and benefits over the whole of the procurement cycle.

Consistent with the core principle of 'value for money', the Australian Government procurement framework is generally non-discriminatory between domestic and foreign suppliers. Exceptions to this non-discrimination are specific policies to assist small and medium enterprises and, in limited circumstances, policies to assist indigenous Australians.

The CPGs now also apply to the procurement of a number of agencies governed under the CAC Act and listed in the Government Procurement chapter of the AUSFTA. These bodies are covered only in respect of procurements of over $400,000 in value (or $6 million in the case of construction services).

Departments and agencies covered by the FMA Act are currently required to publicly gazette all contract awards over $10,000 in value. For the financial year 2003-04, these departments and agencies gazetted over 184,000 contracts with a total value of $17.4 billion. Defence accounts for almost 60 percent of these contracts by value.

Australia is not a member of the WTO Agreement on Government Procurement. However, Australia is a party to a number of international bilateral trade agreements that feature a chapter on government procurement as a means of enhancing trade and reducing economic barriers.

While the chapters covering government procurement vary between these free trade agreements, Australia has sought to maintain several key features of its Government Procurement Framework, including:

- devolved responsibility for the management of procurement by the heads of agencies, in accordance with the FMA Act;
- the principles-based procurement framework, with value for money as the single most important principle;
- flexibility in procedural rules to enable efficient procurement processes across a diverse, and ever changing, procurement environment;

- recognition of agency accountability to the responsible Minister, to the Australian Parliament, to the Australian National Audit Office and to other external bodies; and
- the efficient, effective and ethical use of resources.

Australia has been able to retain these features in the Australia New Zealand Agreement on Government Procurement **(**ANZGPA**)**; the Singapore-Australia Free Trade Agreement (SAFTA); Australia-United States Free Trade Agreement (AUSFTA); and the Thai-Australia Free Trade Agreement (TAFTA). The way in which these agreements address government procurement is set out in broad terms in Box 5.10.1.

Box 5.10.1
Government Procurement in Australian Free Trade Agreements

ANZGPA:

Value for money is recognised as the key principle and is supported by non-discrimination requirements. The ANZGPA states the objective of creating and maintaining a single government procurement market to maximise opportunities for Australian and New Zealand suppliers. While not a treaty level agreement, all Australian Federal, State and Territory Governments and the New Zealand Government mutually agree to be covered by the ANZGPA.

SAFTA:

The Government Procurement chapter of this agreement is principles-based and consistent with the Australian Government procurement framework. The Chapter details requirements for non-discrimination, equal opportunity to bid for government tenders, the preservation of confidential information and intellectual property, and recognition of industry development policies. The Chapter places emphasis on transparency mechanisms and provides for a review by a competent authority where a supplier has a complaint in respect of alleged breaches of a procuring party's laws, regulations, procedures and practices. For Australia, only agencies governed by the FMA Act are covered.

AUSFTA

The Government Procurement chapter of AUSFTA generally follows the model of the WTO-AGP but with some important departures intended to maintain flexibility and efficiency in procurement. Like the WTO-AGP, the chapter is an agreement to provide non-discriminatory access to the government procurement market of each country with non-discrimination safeguarded through rules, procedures and transparency standards to be applied in the conduct of procurement. There are significant departures from the WTO-AGP template in respect of greater flexibility for procurement procedures, for example in regard to the use of select tendering.

TAFTA

At this stage, Australia and Thailand have agreed on an interim framework chapter covering government procurement. The chapter states that each Government will recognise the APEC non-binding principles of transparency, value for money, open and effective competition, fair dealing, accountability and due process, and non-discrimination. The chapter also states that no later than one month after entry into force, the parties will enter into negotiations to develop a government procurement chapter.

In Australia, State and Territory Governments have the power to set their own procurement frameworks in terms of processes, purchasing models and accountability. State and Territory Governments have the power to decide independently whether to participate in international agreements on government procurement.

The Government Procurement Framework in Malaysia

Government procurement in Malaysia aims to support national development goals and long-term socio-economic policies. Key objectives include promoting the growth of local industries; supporting the development of Bumiputera entrepreneurs; strengthening the capabilities of local institutions and industries through the transfer of technology; and promoting service-oriented local industries. Malaysian procurement principles do, however, also recognise such key principles as public accountability, value for money, and open and fair competition.

The Ministry of Finance is the principal Federal Government agency on government procurement issues. All goods and services tenders in excess of RM30 million and works (for example construction or engineering activities) over RM50 million must be referred to it for decision. Tenders below these thresholds can, however, be considered by Tender Boards in each Federal Government ministry. Local authorities and statutory corporations are generally bound by Federal Government regulations, but this is not the case for government companies operating as business ventures.

Bumiputera tenderers receive preferential treatment which varies from 10 per cent for contracts of RM100,000 to 2.5 per cent for contracts of RM15 million. There is no preference for Bumiputeras for contracts over this limit. Locally produced goods obtain a preference of 10 per cent for contacts below RM10 million, and up to 3 per cent for contracts above this value. These policies mean that international suppliers operate at a significant disadvantage in the Malaysian government procurement market. Submissions received in the course of this study have also highlighted significant administrative and other costs involved in registering with the Ministry of Finance in order to bid for contracts, or in finding Bumiputera partners.

The Malaysian government procurement market is a significant one. Data published by the WTO put its size at RM74.1 billion ($33.8 billion) in 2000, or which RM33.2 billion ($15.2 billion) was Federal Government expenditure on supplies and services, or development expenditure; and a further RM32.0 billion ($14.6 billion) was expenditure by statutory bodies or non-financial public enterprises.

Opportunities for Increased Cooperation

Australia and Malaysia should, as part of the negotiations for any FTA, explore interest in some form of agreement covering government procurement, noting that there are a variety of forms any such agreement can take. Neither Australia nor Malaysia are signatories to the WTO Agreement on Government Procurement (WTO-AGP) and therefore are not tied to that agreement as a model or reference. An initial exploration of attitudes would help to define the nature and scope of any provisions on government procurement which are likely to be acceptable to both parties. Issues which might be addressed in such discussions include:

- consultation mechanisms, for example, with regard to procurement laws, regulations, procedures and policies;
- suppliers' rights, for example, with regard to the protection of confidential information;
- principles of non-discrimination and their application, including the treatment of sensitive preference and offset policies;
- coverage of any agreement in terms of entities; and
- minimum procedure requirements in respect of procurement processes, including, for example, registration/qualification of suppliers.

Chapter 6. Modelling the Impact of an Australia-Malaysia Free Trade Agreement

For the purposes of this study, the Department of Foreign Affairs and Trade commissioned economic modelling on the benefits and costs of an Australia-Malaysia Free Trade Agreement. This work was carried out by an independent consultant, the Centre for International Economics (CIE). It confirms that a comprehensive agreement would provide solid and worthwhile benefits to both economies. For Australia, the increase in GDP is estimated at $1.9 billion in net present value terms for the period to 2027, 20 years from implementation of the agreement. Over the same period, Malaysia's GDP would increase by RM18.3 billion (around $6.5 billion). A decade out, Australia's real GDP is 0.03 per cent higher than would otherwise be the case, and Malaysia's is 0.20 per cent higher. A summary of the modelling results is given in Box 6.0.1.

These estimates use generally conservative assumptions about the impact of a free trade agreement. They do not take into account some important non-tariff barriers and the gains from greater cooperation in a wide range of areas (such as customs issues, standards and competition issues). Investment liberalisation is only taken into account in the services sector. The modelling assumes implementation of a comprehensive agreement. It does not take into account the impact of rules of origin. Welfare gains for Malaysia, in particular, are significantly smaller in the event of slower implementation. They are also reduced for Malaysia if its liberalisation involves only limited services liberalisation.

6.1 Models and Modelling Assumptions

The CIE was asked to assess benefits and costs of a WTO-consistent FTA and to assess the impact of preferential liberalisation for industrial and agricultural goods, as well as the impact of services liberalisation between the two countries. Although the focus of the study was on Australia, it was also to address the impact on Malaysia. In particular, the CIE was asked to:

- include analysis and estimates of the impact on output and economic welfare, as well as results for other key variables;
- identify short, medium and long–run outcomes;
- take into account "dynamic" effects and the impact of deeper integration;
- separately identify, to the extent appropriate, the impact of different types of liberalisation and cooperation (such as merchandise trade liberalisation, services liberalisation, and stronger two-way investment links);
- provide estimates of the implications for employment;
- provide key results (including output and employment) by sector and detailed analysis of the sectoral results;
- provide key results by Australian State and Territory;
- clearly identify the key assumptions underpinning the results of the modelling; and

- include key sensitivity analysis to ensure that the results were robust.

Box 6.0.1

Modelling Results in Brief

- Both Australia and Malaysia benefit from an FTA, with Malaysia deriving greater benefit, as the economy with higher trade barriers and a higher ratio of trade to GDP.
- In Australia, real GDP rises by $1.9 billion and real consumption by $1.4 billion for the period to 2027 (in net present value terms).
- Malaysia's real GDP rises by RM18.3 billion ($6.5 billion) and real consumption by RM18.2 billion ($6.4 billion) over the same period.
- For Australia, real GDP is relatively unaffected when liberalisation is phased over ten years, but real consumption is around 9 per cent lower than for immediate liberalisation. Malaysia's GDP gains fall by almost 25 per cent if the FTA is phased in over 10 years rather than immediately.
- The FTA could create an additional two thousand jobs in Australia at its peak impact in 2007. Real wages are expected to rise by 0.03 per cent in the long run.
- Australian industries which expand under an FTA include raw milk, dairy products, beverages, ferrous metals, motor vehicles and components, construction, (wholesale and retail) trade, and air transport. No industries experience a substantial decline in output.
- Malaysian industries which expand include dairy products, beverages, leather products, wood products, other mineral products, ferrous metals, metal products, motor vehicles and components, other transport equipment, machinery equipment and other manufactures. No industries experience a substantial decline in output.
- Australian global merchandise exports increase appreciably (in percentage terms) for dairy products, ferrous metals, wood products, other mineral products, vegetable oils and fats, metal products, paper products and motor vehicles and components. Exports of tourist and educational services also rise. However, exports decline in some industries.
- Malaysia's global exports increase appreciably (in percentage terms) for such industries as motor vehicles and components, dairy products, beverages and tobacco products, leather products, metal products, paper products and ferrous metals.
- Bilateral trade expands. Australia's exports to Malaysia increase by $198.3 million (5.5 per cent) and Malaysia increases its exports to Australia by RM760.4 million (6.3 per cent) or $258.1 million in the long run.
- All Australian States and Territories benefit from an FTA. The largest States, New South Wales and Victoria, gain the most in dollar terms, but percentage gains are fairly evenly spread across all States and Territories.

The CIE used two models for the study, both of which have been widely used in studies of trade liberalisation. The first, G-Cubed Asia Pacific (APG-Cubed), is a dynamic general equilibrium model. The model's features mean that it is well placed to estimate the macroeconomic impacts of free trade agreements and to track them over time. Strengths of the APG-Cubed model include its macroeconomic detail, its detailed treatment of the financial sector, and its explicit treatment of expectations (allowing it to account for the way in which future credible policy changes can affect economic activity at an early stage in their implementation). The version of the model used for this study identifies some 19 countries or regions and 6 different industry sectors (see Table 6.1.1).

Table 6.1.1
Economy and Industry Coverage of APG–Cubed

Countries/regions		*Industry sectors*
Australia	New Zealand	Energy
Canada	Non-oil developing countries	Mining
China	Oil exporting developing countries	Agriculture
Taiwan	Rest of OECD	Durable manufacturing
Hong Kong	Philippines	Non-durable manufacturing
India	Singapore	Services
Indonesia	Thailand	
Japan	United States	
Korea	USSR and Eastern Europe	
Malaysia		

The second model used in the study, the Global Trade Analysis Project (GTAP) model, is a comparative static general equilibrium model. It provides a "snapshot" of what economies in the model will look like in the long run, but no detail on how they arrive at that long-run position. Nor can it properly account for all the cumulative effects of a free trade agreement over time. GTAP's strength lies in its sectoral detail. The full version of the model identifies some 57 sectors of economic activity for 66 countries or regions. It is therefore a useful tool to examine the impact of trade liberalisation on specific sectors.

The simulations carried out for the study assumed that all tariffs were removed on a preferential basis between Australia and Malaysia. The modelling included estimates of the *ad valorem* equivalent of specific rate tariffs where these were important in trade between the two countries, although because of highly variable data on prices, some goods that had specific rate tariffs but very small trade flows were excluded. Certain non-tariff barriers on goods were excluded from the analysis, given that it was difficult to obtain quantitative estimates of them.

In the case of services trade, the modelling makes assumptions which vary according to the services sub-sector. Specifically, it *assumes*:

- a significant increase in Australia's exports of tourism services to Malaysia in the long run (flowing, for example, from the "head-turning" effect of an FTA and expanded business and other contacts), with Australia capturing a share of

Malaysia's tourism market comparable to that achieved in Thailand relative to major competitors;

- a modest increase of 4 per cent in Malaysian demand for Australian educational services provided through consumption abroad (that is, through Malaysian students travelling to Australia), with additional expenditure flowing from this; and
- reduction in estimated barriers which affect the prices or costs of firms or institutions providing services in Malaysia in sectors such as higher education, construction, financial services, insurance, and various business services (including engineering services, architecture, accountancy, and legal services).[43]

Estimates of services barriers for this purpose drew on detailed studies prepared as a result of a joint research programme involving the Australian National University, the University of Adelaide and the Productivity Commission. They include the effects of restrictions on the movement of service providers (for example, lawyers or architects) where this affected firms operating in Malaysia.

It is widely recognized that economic models can underestimate the gains from trade liberalisation by ignoring some important links to productivity, including those arising from greater competition. The modelling undertaken by the Centre for International Economics seeks to address this by assuming some of these "dynamic" gains. The assumptions adopted, which are conservative, assume that a 1 percentage point unilateral reduction in tariffs will lead to an increase in productivity of approximately 0.3 per cent. This is then adjusted down because liberalisation under consideration is on a preferential basis.[44] In Malaysia's case, these dynamic productivity gains rise as high as 0.4 per cent in the dairy sector, but are typically much lower. For Australia, they range as high as 0.1 per cent for wood products. Because dynamic gains are sometimes contested, the modelling has sought to separately identify them where possible.

A number of simulations were carried out in modelling the impact of a free trade agreement. In the case of APG-Cubed, the central simulation assumed immediate implementation of a free trade agreement between the two countries from 2007. This provides a useful benchmark for the kind of gains which can be achieved under other time frames. In two further simulations, liberalisation was phased in over five years and ten years respectively, beginning in 2007. With GTAP, one key simulation was undertaken, with additional simulations to explore the sensitivity of the results to varying the modelling assumptions.

6.2 Macroeconomic Impact of a Free Trade Agreement

The modelled macroeconomic impact of an Australia-Malaysia Free Trade Agreement on Australia is illustrated in Chart 6.2.1, which shows the results from the APG-Cubed model. The net present value of the increases in GDP under a free trade

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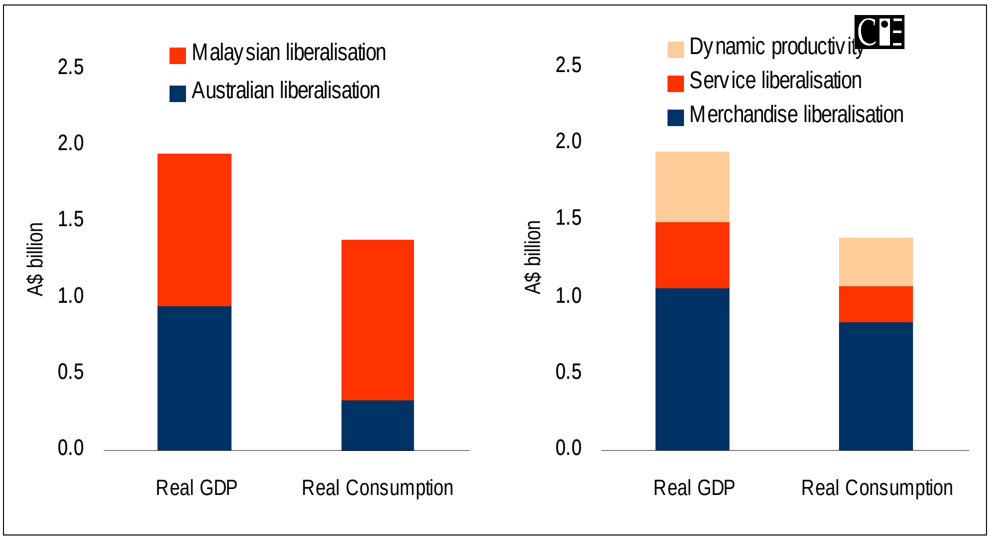
[43] Depending on the services industry, the modelling assumes a reduction in economic rents through increased competition allowing the service to be provided at more competitive prices, or a reduction in costs.

[44] In the case of Malaysia, for example, the tariff reduction for an industry is multiplied by the share of total imports in that industry accounted for by imports from Australia.

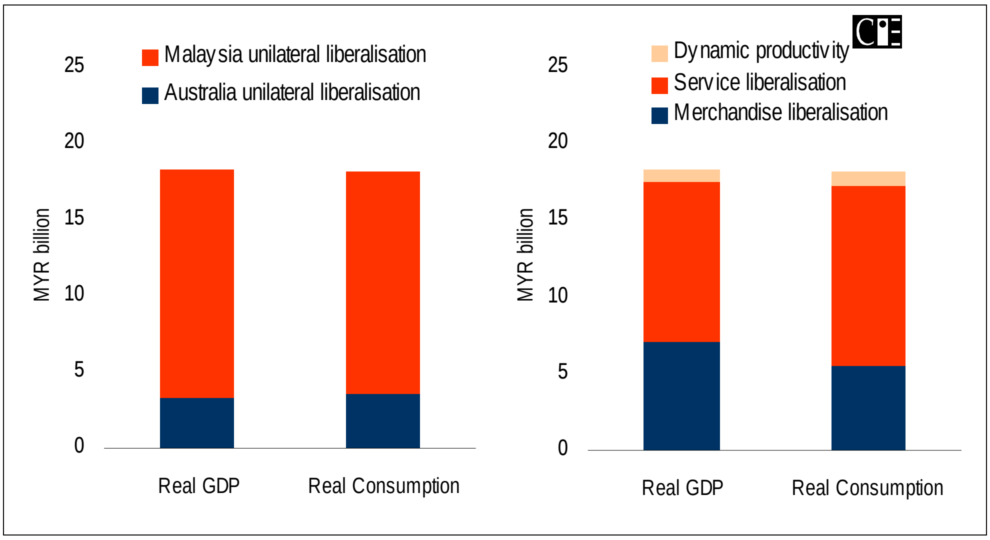
agreement are estimated at $1.9 billion for the period to 2027. Real consumption, similarly evaluated in terms of its net present value, rises by $1.4 billion. The gains to Australia's GDP are derived about equally from its own liberalisation and Malaysia's liberalisation. Most of the gains to Australia's GDP result from merchandise trade liberalisation, although services liberalisation contributes significantly, as do dynamic productivity gains.

Chart 6.2.1
Sources of Australia's gain NPV 2005[a]



[a] Over 2005 to 2027 discounted at a 5 per cent real interest rate.
Data source: APG-Cubed modelling simulation

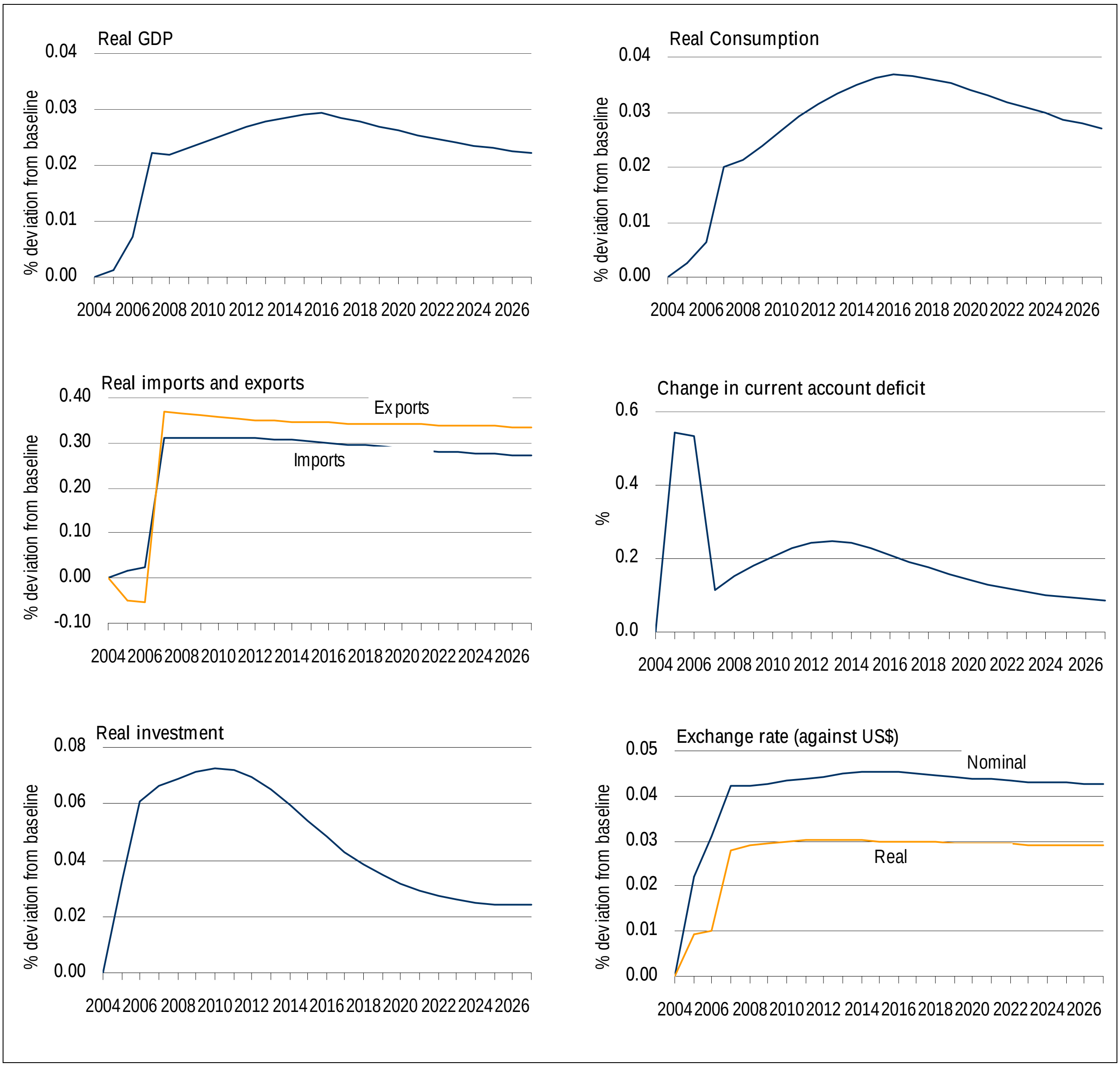
Chart 6.2.2
Sources of Malaysia's gain NPV 2005a



[a] Over 2005 to 2027 discounted at a 5 per cent real interest rate.
Data source: APG-Cubed modelling simulation.

Chart 6.2.2 shows the corresponding results for Malaysia. Its gains are larger than those for Australia – reflecting the fact that initial barriers for both merchandise trade and services are higher for Malaysia. Under the scenario of immediate liberalisation, the net present value of Malaysia's GDP to 2027 rises by RM18.3 billion (around $6.5 billion), over three times that of Australia's gain. Malaysia's real consumption rises by RM18.2 billion ($6.4 billion), over four times Australia's welfare gain. The sources of Malaysia's gains are also different. Most of Malaysia's gains come from removing the distortions in its own market. Services liberalisation is the largest single contributor to Malaysia's gains in real GDP and consumption, although merchandise liberalisation also makes a substantial contribution.

Chart 6.2.3
Macro-economic effects of MAFTA for Australia

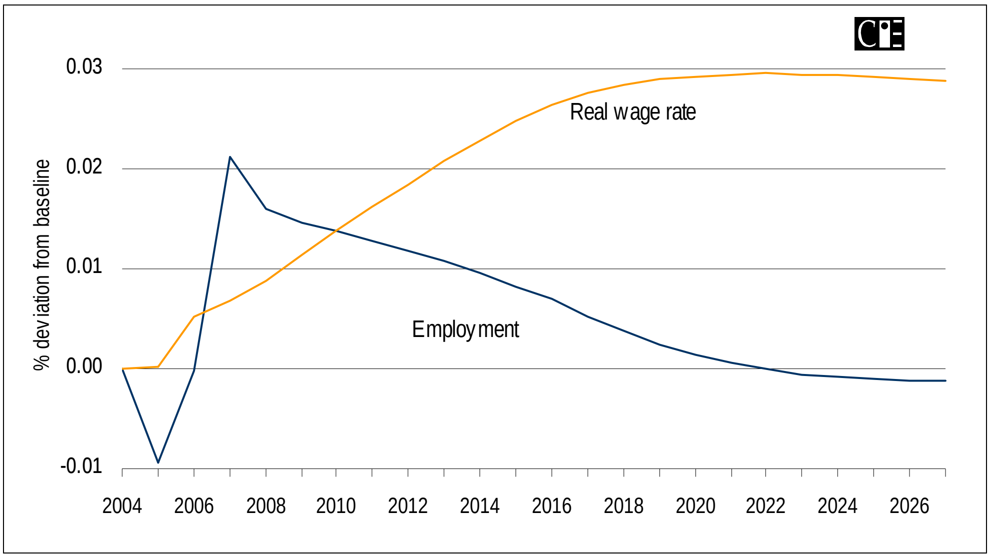


Data source: APG–Cubed modelling simulation.

Chart 6.2.3 provides some additional results for key variables for Australia over time. Real GDP and real consumption in Australia both rise with the introduction of the FTA. The rise in real GDP peaks around a decade out at 0.03 per cent above the baseline (that is above the levels which the model predicts if an FTA is not introduced). Real consumption also peaks about a decade out at around 0.04 per cent above the baseline. Real investment rises as production adjusts to the changed pattern of demand and incentives which flow from an FTA. Real exports (to all destinations) rise quickly to about 0.37 per cent above the baseline by 2007; they are about 0.33 per cent up two decades out. Real imports also rise with the increase in Australian economic activity and lower barriers to Malaysian exports.

The increases in production under an FTA generate higher demand for labour. Although real wages increase initially, this is not sufficient to depress the higher labour demand, resulting in increased employment. The rise in employment peaks at around 0.02 per cent deviation from the baseline in 2007 (equivalent to around 2000 jobs). Over time, as real wages adjust further to the increase in demand for labour, the increase in employment falls back to the baseline level. Real wages remain higher, at about 0.03 per cent above the baseline level around 2020. These trends are illustrated in Chart 6.2.4.

Chart 6.2.4
Changes in employment and wages in Australia



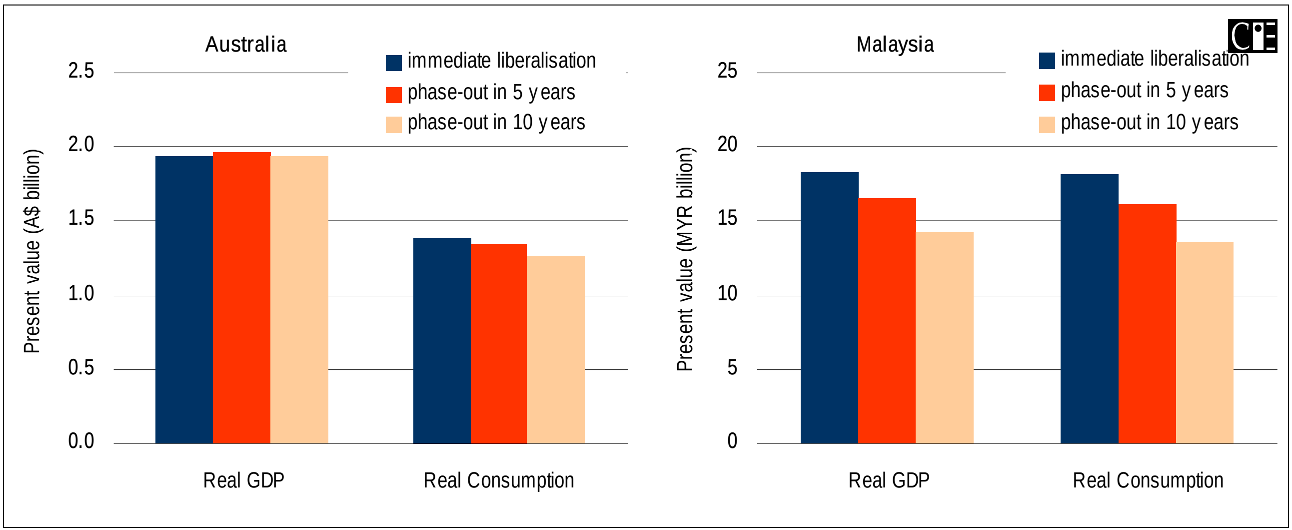
Data source: APG–Cubed modelling simulation.

The results are sensitive to the timing of liberalisation. Chart 6.2.5 illustrates this by comparing the results from APG-Cubed for immediate liberalisation with simulations where liberalisation is phased in over five and ten years. For Australia, real GDP is relatively unaffected by the change in phasing, but real consumption with phasing over 10 years is around 9 per cent lower than for immediate liberalisation. By comparison, for Malaysia longer phasing results in very significant reductions to the gains. With phasing over ten years, Malaysia's gains in GDP are almost 25 per cent lower than when liberalisation has immediate effect, and gains in real consumption are over 25 per cent lower.

Although APG-Cubed is preferred to GTAP in estimating the macroeconomic impact of the FTA, the Centre for International Economics also used GTAP to explore the economy-wide implications of the agreement. The results confirm significant gains from a free trade agreement. For Australia, GTAP shows the increase in economic welfare as a result of an agreement as $186.3 million annually. For Malaysia, it shows an increase of RM719.2 million ($244.1 million) annually.

Sensitivity analysis undertaken with the GTAP model confirms that the finding of significant gains still holds, even when the modelling assumptions are varied widely. The variations considered as part of this analysis include scaling key assumptions about services trade liberalisation, dynamic productivity and key parameters in the model up and down by a factor of two. These changes did not affect the conclusion that both Australia and Malaysia would gain from a bilateral free trade agreement. For Australia, the gain in economic welfare ranged from $99.4 million to $383.2 million annually. For Malaysia, it ranged from RM410.4 million ($139.3 million) to RM1,584.6 million ($537.9 million) annually.

Chart 6.2.5
Present Value of Real GDP and Consumption under Different Phase-In Scenarios (2005[a])



[a] Over 2005 to 2027 discounted at a 5 per cent real interest rate.
Data source: APG–Cubed modelling simulation.

6.3 Impact on Specific Sectors

The GTAP model generates estimates of the impact by industry of a free trade agreement for some 57 sectors covering agricultural, industrial products and services. In the case of the modelling undertaken by the consultant, they include the combined effects of merchandise liberalisation, services liberalisation and dynamic productivity gains.

The results for specific industries should be regarded with caution. The response of any given industry to trade liberalisation depends on a complex set of factors affecting both supply and demand, which are difficult to capture with precision in any model. The sectoral modelling also typically assumes that, in the absence of productivity changes, expansion of some sectors draws on factors of production (land, labour and capital) used by other sectors. Modelling can, however, provide insights into the factors likely to shape outcomes.

Impact on Australia

For Australia, the GTAP results for specific industries are typically small. They are particularly small when compared against the background of changes which would occur over time as a result of rising incomes, changing consumer tastes or technological change. Only two industries experience an increase in output greater than 0.2 per cent (these are raw milk and dairy products). There are no strongly negative results for any sector. Adjustment issues are therefore likely to be quite modest for Australia.

The GTAP results for Australia suggest that a number of different industries expand. In *agriculture and processed foods*, output of raw milk and dairy products expands noticeably, rising in both cases by 0.25 per cent. They experience the largest gains of all industries in percentage terms. There are also small increases in output for beverages and tobacco products (0.04 per cent), partly driven by the decrease in Malaysian tariffs in this sector, and for other meat products (0.01 per cent). Output for some industries (for example, vegetables, fruits and nuts) is unchanged. However, there are also small declines in some agricultural industries (output of wool falls by 0.04 per cent, for example). This occurs in GTAP partly because, as the manufacturing and service sectors expand production, they use more production inputs including labour and capital, meaning that less inputs are available for primary production activities. Dynamic productivity gains in the manufacturing sector, which is the most highly protected, add to this effect.

The Australian *manufacturing* sector expands under an FTA with Malaysia. Malaysia's highest tariffs are in the manufacturing sectors. Hence under a free trade agreement, the corresponding Australian manufacturing sectors are relatively advantaged by trade liberalisation. These sectors also experience the largest dynamic productivity gains. There are small increases in output for the ferrous metals (0.07 per cent) and motor vehicles and components (0.02 per cent) industries. There are small declines in output for some other industries. These include textiles (0.01 per cent), wearing apparel/clothing (0.04 per cent), leather products (0.14 per cent) and "other" (non-ferrous) metals (0.07 per cent). In the case of the textiles industry, the marginal decline in output is accompanied by an increase in both exports and imports.

The *services sector* expands its output under a free trade agreement. The air transport (0.09 per cent), construction (0.05 per cent), and wholesale and retail trade sectors (0.05 per cent) have the largest increases in output. Air transport and wholesale and retail trade derive their gains from the increase in consumption abroad from Malaysian tourists and students in Australia, while the increase in construction results from the need to service an expanding economy with new infrastructure and buildings. Output rises much more modestly in some other services industries (for example, by 0.01 per cent for the communications sector) and falls in some others. The services sector benefits from improved access via commercial presence in Malaysia, although this does not register in estimates of Australian output generated by the model.

There are significant increases in merchandise *exports* as a result of trade liberalisation under the free trade agreement. GTAP shows appreciable increases in merchandise exports (that is, more than 0.2 per cent) for dairy products (0.87 per cent), ferrous metals (0.42 per cent), wood products (0.39 per cent), other mineral products (0.38 per cent), vegetable oils and fats (0.31 per cent), metal products (0.31 per cent), paper products (0.25 per cent), and motor vehicles and components (0.25 per cent). In general, these increases are driven by cuts in Malaysian tariffs, although dynamic productivity gains can also boost exports by increasing the competitiveness of the industry. For some industries, exports decrease because production is diverted from the export market when a downstream industry expands its demand or because the industry contracts overall. Examples are raw milk (a 0.25 per cent decline)[45] and leather products (a 0.19 per cent decline).

In the services sector, the modelling assumes an expansion of exports of tourism and educational services. This is refected most noticeably in the GTAP results for the wholesale and retail trade sector, where exports rise 1.38 per cent. The model shows a decline in exports for some other services industries, including insurance (0.18 per cent down) and other business services (0.16 per cent down). However, these estimates do not include the gains to these industries from improved access through commercial presence.

Australia's *bilateral trade with Malaysia* expands strongly. Australia increases its exports to Malaysia by $198.3 million, representing a 5.5 per cent increase in the long run. Malaysia increases its exports to Australia by RM760.4 million (6.3 per cent) or $258.1 million. In terms of dollar value, the biggest increases in Australia's exports to Malaysia are manufactures (including processed foods) and services. Almost all of the expansion in Malaysia's exports to Australia is for durable and non-durable manufactures.

Changes in *employment* in Australian industries tend to follow the changes in industry output, but they are also affected by other factors (for example, sectors where dynamic productivity increases substantially will demand less labour). Overall, the changes to employment at the industry level are extremely modest, confirming that adjustment issues are unlikely to be significant for Australia. There are small percentage increases in employment in some sectors (for example, wholesale and retail trade and construction) and small declines in some other sectors (such as other metals). The modelling shows a small decline in employment in the textiles industry (0.01 per cent) and the wearing apparel industry (0.04 per cent), but no change in employment in the motor vehicles and components sector. Real wages rise across all sectors.

Impact on Malaysia

In Malaysia's case, most GTAP industries experience an increase in output as a result of a free trade agreement. As for Australia, many of the changes are small, with only

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[45] Exports in this case are diverted to provide inputs for the downstream dairy products industry, which expands its output and exports.

12 sectors experiencing a change in output greater than 0.2 per cent. Declines in output occur for a limited number of industries in Malaysia, but they are small.[46]

The *light manufacturing and processed food industries* that increase output noticeably are dairy products (0.36 per cent), beverages and tobacco (0.24 per cent), leather (0.74 per cent) and wood products (0.31 per cent). In the case of the leather and wood products sectors, the principal factor behind the increase in output is Australia's tariff liberalisation, which is responsible for over 80 per cent of the output change. Australia's liberalisation stimulates export led growth both directly and via secondary/downstream exporting sectors. Malaysia's dairy and beverages and tobacco sectors also have relatively high effective tariffs, and as such experience large dynamic productivity gains. These in turn drive the observed change in output.

Malaysia's highest tariffs are in the *heavy manufacturing industries*. However, all eleven heavy manufacturing sectors experience increases in output, and 7 of those sectors experience noticeable changes in output. These sectors include ferrous metals (where output rises by 0.38 per cent), metal products (0.39 per cent), and motor vehicles, trucks and parts (0.64 per cent). These increases are driven by several factors, including Australia's tariff liberalisation in these sectors; the expansion of the Malaysian economy under the free trade agreement (which increases the demand for heavy manufactured products); and dynamic productivity gains as Malaysia liberalises.

The Malaysian motor vehicle and components industry illustrates the operation of these factors. As noted, the GTAP modelling in this case projects an appreciable rise in output in this industry of 0.64 per cent, with employment also increasing significantly. Almost two thirds (0.4 percentage points) of this gain flows from Australia's trade liberalisation in this sector, which contributes to increased demand for Malaysian motor vehicles and components. But about one third (0.22 percentage points) flows from dynamic gains which see productivity and competitiveness in the industry increase as it liberalises.

In the Malaysian *services sector*, almost all sectors increase output under the free trade agreement. However, the increases in output are generally not large. The largest increases in output occur in business services (0.17 per cent) and insurance (0.14 per cent). The increased commercial presence of Australian firms in these sectors improves their efficiency, as well as the efficiency of downstream industries which use these services intensively.

The GTAP results show appreciable increases in *exports* for a number of Malaysian industries under a free trade agreement, with 16 of the 57 GTAP industries showing a global increase in exports of 0.2 per cent or more. The largest increase (4.79 per cent) occurs for motor vehicles and components. Other industries which record sizeable increases in export volumes include dairy products (3.99 per cent), beverages and tobacco products (1.03 per cent), leather products (0.77 per cent), metal products (0.63 per cent), paper products (0.60 per cent) and ferrous metals (0.57 per cent). Increases in exports are the result of two main factors, bilateral trade liberalisation

[46] In some cases, both Malaysian and Australian output and exports expand for an industry. This can happen where the free trade agreement increases the global competitiveness of both industries, for example through dynamic productivity gains.

under the FTA, and dynamic productivity gains which improve the global competitiveness of the industry itself or industries which provide inputs.

Changes in *employment* typically move in the same direction and by a similar magnitude to the change in industry output. However, there are some industries where employment falls marginally in spite of an increase in industry output. Overall, GTAP shows the demand for labour remaining strong, with nominal wages increasing by 0.16 per cent.

6.4 Impact by State and Territory in Australia

A free trade agreement with Malaysia is expected to have a positive impact on each of the States and Territories of Australia. Table 6.4.1 shows the estimated impact on Gross State Product derived from GTAP modelling, after taking into account the differing composition of output in each State or Territory. The States with the largest economies, New South Wales and Victoria, experience the biggest gains in dollar terms. Percentage gains are fairly evenly spread across all States and Territories.

Table 6.4.1
Change in Gross State Product

	ACT	*NSW*	*NT*	*QLD*	*SA*	*Tas*	*Vic*	*WA*	*Total*
$ million	3.1	58.8	2.0	27.6	10.5	2.7	43.2	16.5	164.5
Per cent of GSP	.020	.022	.022	.020	.020	.020	.021	.019	.021

Source: GTAP results, ABS. GSP refers to Gross State or Territory Product.

The specific impact on particular regions within States or Territories is not identified by the modelling. The impact here would depend on the industry specialisation of different regions, and is likely to be appreciable for some regions. As one example, dairy producing regions are likely to benefit from the increase in output projected to occur in this industry under a free trade agreement. The GTAP results suggest that some regions specialising in manufacturing (for example, on motor vehicles and components) would also expect to benefit.

Chapter 7. Suggested Architecture of an Australia-Malaysia Free Trade Agreement

The impact of free trade agreements depends on their scope and coverage, as well as the timing of liberalisation. This chapter therefore looks at the architecture which would need to underpin any FTA with Malaysia, so that it might contribute positively to strengthening the relationship and improving economic welfare in both countries. As required by the Terms of Reference, it also considers possible strategies to address any adjustment costs, and at other possible means for deepening economic, trade and commercial relations between Australia and Malaysia.

A number of factors need to be taken into account in considering the architecture of an Australia-Malaysia FTA. First, as members of the World Trade Organization, both Australia and Malaysia have certain obligations in international trade law in relation to free trade agreements, which are outlined below. As APEC members, both economies have welcomed the APEC Best Practices Guide for RTAs/FTAs, which sets out principles which support the achievement of free and open trade and investment in the region.

As members of the AFTA-CER Closer Economic Partnership, Australia and Malaysia are also committed to efforts to promote trade, investment and regional economic integration with the aim of doubling trade and investment by 2010. In agreeing in November 2004 to commence negotiations on a free trade area, ASEAN, Australia and New Zealand have also agreed to a number of guiding principles on the modalities and timing for the agreement which have implications for any Australia-Malaysia FTA.

7.1 Objectives and Principles of an FTA

If Australia and Malaysia were to agree on negotiating an FTA, the primary objective should be the same as that of other FTAs both parties are involved in negotiating; namely to raise the levels of economic growth and, thereby, raise living standards in Malaysia and Australia by:

- liberalising bilateral trade and investment to encourage greater trade and investment flows bilaterally and with third countries;
- creating a larger economic market, thereby promoting productivity through greater competition and economies of scale;
- providing a framework for closer economic cooperation and addressing trade problems and barriers, including through appropriate commitments on transparency;
- taking advantage of the synergies and complementarity of both economies to mutual advantage; and
- adding momentum to regional and multilateral trade liberalisation efforts.

In order to be consistent with WTO rules (Article V of the General Agreement on Trade in Services and Article XXIV of the General Agreement on Tariffs and Trade), the FTA must cover substantially all trade in goods and services, with the latter understood in terms of there being no *a-priori* exclusion of any services sector or mode of supply.

Both Australia and Malaysia are strong supporters and active members of the multilateral trading system and have common interests in many areas of the Doha Round where ambitious outcomes are sought (including, in the case of agriculture, through common membership of the Cairns Group). Both, therefore have an interest in ensuring an FTA complements and supports these efforts. It would be important for any FTA to seek to build on Australia's and Malaysia's commitments in the WTO (that is, it should be WTO-plus). This should include addressing issues, such as investment liberalisation, which are only partly covered by WTO disciplines and which have the potential to deliver substantial benefits to both parties.

In formulating the architecture of an FTA between Australia and Malaysia that advances these objectives, the two sides should take into account that Australia and Malaysia are at different stages of economic development, would bear different adjustment costs and gain different benefits from an FTA. However, it should also be noted that the gains from an FTA are typically greater when liberalisation proceeds more quickly and they are also likely to be more significant for Malaysia than Australia.[47] For the ASEAN-Australia and New Zealand FTA, Ministers adopted the principle that any FTA should be fully implemented within 10 years. It could be expected, therefore, that the implementation period for a bilateral agreement with Malaysia would fall within this timeframe.

7.2 Relationship to an ASEAN-Australia and New Zealand Free Trade Area

The relationship between an Australia-Malaysia Free Trade Agreement and an ASEAN-Australia and New Zealand Free Trade Area has been raised on a number of occasions in consultations for this Scoping Study. It is, of course, also an issue for Australia's bilateral agreements with Singapore (SAFTA) and Thailand (TAFTA).

The two processes are complementary and could proceed in parallel. In practice, it is likely that a bilateral agreement with Malaysia would be negotiated more quickly than an ASEAN-wide agreement. It is also likely that it would involve further and faster liberalisation in most sectors. Access to Malaysia would then tend to be governed by the bilateral agreement, rather than the ASEAN-wide agreement. It would, of course, be important to ensure that any ASEAN-wide agreement allowed individual members to move faster, on a bilateral basis, than with the group as a whole. For the existing bilateral agreements with Singapore and Thailand, as well as for any bilateral agreement with Malaysia, it would be important to ensure that the more liberal arrangement would apply in the event of an inconsistency.

Even so, issues of uniformity and consistency would need to be addressed in both negotiations, with a view to minimising complexity. There would, for example, be

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[47] Both of these propositions are illustrated in the economic modelling in Chapter 6 of this report. Gains from FTAs typically flow more strongly to the smaller economies in them.

benefits in adopting broadly consistent provisions regarding rules of origin or harmonisation of standards.

There would also be advantages in ensuring that, as far as practicable, the approaches adopted are consistent with other agreements to which Australia and Malaysia are parties.

7.3 Scope and coverage

As noted already, Article XXIV of GATT and Article V of GATS provide some guidance to WTO members on FTAs. But they do not prescribe what chapters are to be negotiated. They do, however, require that such agreements do not constitute more restrictive regulations of commerce or erect barriers to third Parties or cut across their rights as WTO members. It is for the FTA partners to decide on the content of their agreements with WTO obligations in mind, as well as the depth and breadth of commitments.

Generally, the more comprehensive the liberalisation under an FTA, the greater the gains that can be expected under it. The Parties would forgo gains by limiting the scope of the agreement or providing too many exceptions. Modern FTAs are not only about gaining increased or improved market access. They are designed to integrate, to the extent possible or desirable, the economies of the Parties to the Agreement.

The sections of an FTA which address trade in goods are critical. As noted in Chapters 3 and 4, much of the trade between Australia and Malaysia occurs at zero or low tariffs. But there are also significant remaining impediments to bilateral trade which earlier sections of this report have documented. In liberalising tariffs, it would be important to address all tariffs, including tariff peaks and tariff escalation. It would also be important to address comprehensively non-tariff barriers to merchandise trade and not seek to circumscribe the targeted range of non-tariff measures at the outset. Much of the gains to Australia and Malaysia from an FTA will come from liberalisation of trade in goods.

The FTA should contain elements which go beyond tariffs and address, amongst other things: services trade and investment, customs procedures, technical barriers to trade, import licensing and tariff quota administration arrangements and sanitary and phytosanitary (SPS) measures (quarantine arrangements). Other elements include, but are not limited to, provisions relating to the protection of intellectual property rights, competition issues, institutional arrangements, safeguards, dispute settlement and other elements of government regulation and administration that restrict trade. It is important to keep the range of issues to be included or addressed as wide as possible.

Australia considers it important that any FTA include a mechanism for high-level review, to ensure that the agreement is operating effectively and that it remains dynamic and provides a basis for continued and further liberalisation and cooperation between the two economies. Sector-specific working groups might be one way to ensure ongoing consideration of ways to advance cooperation in particular areas. Effective dispute settlement provisions would provide added certainty for the business community that the provisions of the agreement would be enforced.

Services Trade

This report has suggested that there would be significant benefits to both Australia and Malaysia from steps to liberalise further services trade. Chapters 3, 4 and 5 have identified a wide range of impediments which affect each of the four GATS "modes of supply", as well as areas where it would be possible to extend mutually beneficial cooperation.[48]

From Australia's perspective, it would be important to address directly major services sectors, such as education, professional services, telecommunications, financial services and tourism. Chapter 4 and 5 have suggested that greater liberalisation and cooperation in these areas would benefit both countries. Malaysia has also identified a number of specific services issues of interest to it (including recognition of skills, business mobility and cooperation on tourism and education). The interests of both sides would need to be considered in negotiations as part of a balanced outcome.

Some examples of the kind of services which are of interest to Australia and which might be addressed in an agreement are as follows.

Education: Chapters 4 and 5 have noted that current procedures adopted by the Malaysian Public Service reduce Australia's attractiveness as a destination for students travelling abroad for their education. There are also impediments to the delivery of educational services through commercial presence in Malaysia and cross border supply (distance education). Improvements in the recognition of Australian qualifications by Malaysia, based on the comparability of award outcomes and the quality of the qualification as established under the Australian Qualification Framework, would be a positive step in addressing some of these barriers. So would liberalisation of current arrangements restricting the operations of Australian branch campuses in Malaysia or other arrangements by which Australian educational institutions maintain a local presence.

Professional Services: Chapter 4 has shown that there are a number of barriers to trade in legal services, accounting and taxation services, architectural services and engineering services. It would be important that any FTA seek to address these barriers, which include restrictions on commercial presence; restrictions on commercial association between domestic and foreign professionals, and unnecessary residency, licensing or registration requirements before professionals are allowed to practise.

Telecommunications: As earlier Chapters have noted, Malaysia has made only limited undertakings on commercial presence in its GATS Schedule in this sector. Commercial presence is, in principle, limited by a cap of 30 per cent for both basic and value-added telecommunications. However, the rules are not applied in all circumstances, with investments that exceed the 30 per cent limit sometimes allowed, giving rise to some uncertainty for potential investors. Australia would welcome a relaxation of rules governing commercial presence. A more liberal and consistent approach to Australian firms could be developed in the context of a free trade

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[48] The four modes of supply are discussed further in Chapter 4.

agreement. An FTA might also provide an opportunity for both countries to reaffirm, or make new commitments to, best practice regulatory disciplines.

Financial Services: There are significant restrictions on commercial presence, as well as on the operations of financial institutions operating in Malaysia. It would be important to address these in negotiations for any FTA.

Cooperation and Further Liberalisation in Other Areas

It has also been suggested[49] that there would be advantages, in the context of an Australia-Malaysia Free Trade Agreement, in steps to promote cooperation and further liberalisation in a number of other areas, including the following:

Customs Procedures: Cooperation and negotiated commitments in an FTA could include, among other things, commitments to improve the efficiency of customs procedures; improved dialogue and exchanges of information on relevant laws, procedures, technologies and examination methods; and cooperation on provision of advance rulings on the tariff classification of goods. It could also promote cooperation on implementing paperless trading initiatives. An FTA would also provide a framework for formal cooperation on issues such as commercial fraud.

Industrial Technical Barriers to Trade: There is significant scope within the WTO framework for cooperation between member states to improve cooperation bilaterally. An FTA could build on the foundation of regional cooperation on technical regulations and standards through APEC and between ASEAN and Australia and New Zealand. It could strengthen commitments for closer alignment with international standards and streamlined conformity assessment procedures, and provide a concrete framework with which to pursue those aims. Goods that are significant in Australia's and Malaysia's trading relationship should be a particular focus.

Sanitary and Phytosanitary (SPS) Issues: There is scope to improve the exchange of information on biosecurity issues and enhance the consultation processes in order to facilitate cooperation, including the harmonisation of sanitary and phytosanitary measures and other agricultural and food standards. Trade should be further facilitated through the review of relevant inspection, testing, certification and other import and export approval systems to ensure these are reasonable and necessary. Greater consistency in Halal certification procedures between Australian and Malaysia should also be a priority.

Investment: This would need to be addressed as part of the liberalisation of services trade, but it would also be important to address it more broadly. Improvements could be achieved through reducing foreign equity participation limits, liberalising pre-establishment investment screening regimes, providing for greater transparency and certainty in decision making processes and ensuring that investors have access to appropriate legal protection. This area has the potential to deliver very significant gains to both economies. Malaysia, for example, would benefit significantly from

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[49] See Chapter 5 for details.

measures which would increase its attractiveness to Australian and other foreign investors. Australia would benefit from greater two-way investment.

Movement of Natural Persons, Business Mobility: An FTA would allow for cooperation to streamline management of visas and entry requirements, particularly for business persons. It could address restrictions on the number of specialists allowed to enter as Intra-Corporate Transferees (ITCs) and the number of skilled personnel that foreign firms can employ.

E-commerce: The trade and investment links between Australia and Malaysia would be facilitated by cooperation on e-commerce. An FTA could lead to both countries agreeing not to impose customs duties on electronic transmissions (currently the subject of a moratorium in the WTO). It could provide a framework for both to clarify the use of United Nations Commission on International Trade Law (UNCITAL) based model laws. An FTA could also promote greater cooperation in such areas as the use of e-commerce in trade administration and customs, authentication, privacy, data protection, consumer protection and anti-spam measures.

Competition Issues: As Chapter 5 has suggested, an effective competition regime can strengthen substantially the gains from trade liberalisation and promote economic development. Malaysia does not currently have a national competition regime and an FTA would provide a framework in which Australia could share its experience in developing and implementing a competition regime. There would be potential gains to both countries not only from consultations and information sharing, but from future collaboration and cooperation on issues ranging from policy formulation to enforcement.

Intellectual Property: The benefits from bilateral trade and investment would be increased through measures in an FTA enhancing the protection and enforcement of intellectual property (IP) rights. Under an FTA, both countries might acknowledge present international commitments and agree to accede to or ratify other relevant international agreements. An FTA could result in agreement to implement measures that strengthen the effectiveness of their IP regimes, and could also provide for agreement on information exchanges and cooperative agreements between government agencies, educational institutions and other organisations.

Government Procurement: Australia and Malaysia could explore avenues for opening up more opportunities in Government Procurement. Depending on the outcome of these discussions, an FTA could include agreement on, for example, consultation mechanisms; suppliers' rights, including principles for identifying eligible suppliers and their application; coverage of entities; and minimum procedure requirements.

7.4 Adjustment Issues

It is possible that Australia and Malaysia will face some adjustment issues in specific sectors as a result of entering a free trade agreement. The analysis in this report suggests, however, that adjustment problems will generally be very small in most sectors in both economies. In the case of motor vehicles, for example, Australia specialises on larger and luxury vehicles, while Malaysia's focus is on smaller cars.

Trade in textiles and clothing between the two countries is limited.[50] Long-run changes in sectoral output shown by the GTAP model and discussed in Chapter 6 are small, particularly when considered against the background of greater changes likely to be caused by rising incomes, changing consumption patterns and technological change. For both economies, the overall welfare gains from the agreement are solid and worthwhile.

Any adjustment issues in the more difficult sectors can, to some extent, be accommodated by longer phasing arrangements. But it should also be borne in mind that longer phasing will typically also reduce gains. It would also be possible for both Australia and Malaysia to address adjustment costs through national policies, intended to facilitate a transfer of labour and capital to sectors where they can be more productively employed, while minimising the impact of change on those adversely affected. Potential injury to domestic industries because of an FTA can also be addressed by including appropriate safeguard provisions in the agreement.

7.5 Other Steps to Improve Australia-Malaysia Relations

This report has reaffirmed that Australia and Malaysia have a strong relationship across a wide range of issues. There is, however, scope to build the relationship further. As Chapter 2 has noted, the Joint Trade Committee, which is the main body overseeing bilateral trade and investment relations, has evolved into a forum with a forward-looking agenda which seeks to identify and address key issues which are of interest to the private sector and which are likely to further develop the bilateral relationship. There is also close cooperation in many other areas.

A free trade agreement would strengthen and deepen this relationship. As with the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) it is likely that the scope of cooperation would develop over time, building much closer economic integration between the two economies. Regular high-level review of the way in which the agreement was operating would encourage continued cooperation. Provision for change should be included in any agreement to allow improved benefits to flow to each country.

Any FTA should act as an umbrella-type agreement to encourage deeper and strengthened links between Australia and Malaysia through business contacts and associations. It should also acknowledge the important role played by bodies such as the Australia Malaysia Business Council and the Malaysia Australia Business Council.

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[50] Chapter 4 provides a more detailed discussion of adjustment issues for the motor vehicle and textiles and clothing industries.

Chapter 8. Conclusion

Australia's bilateral relationship with Malaysia is already strong and wide-ranging. Two-way trade in goods and services between the two economies amounted to some \$8.6 billion in 2003-04, which ranks Malaysia as our tenth largest trading partner. Malaysian investment in Australia has been growing strongly, with Malaysia our 13th largest source of investment. Trade and investment ties are underpinned by strong people-to-people links, including in business and education. There is also substantial cooperation between the two Governments, in areas ranging from defence to the arts.

The two economies are highly complementary. Australia has strong agricultural and mining commodities and services sectors, as well as strengths in some metal and elaborately transformed manufactures. Malaysia is a prominent manufacturing exporter (especially of electronic products), has significant strengths in tropical agriculture and growing strengths in services. Each economy occupies important niches in the other's markets. Australia is thus a major supplier of education services to Malaysia, along with agricultural products, processed foods and base metals. Malaysia is an important supplier to Australia of petroleum products, electrical equipment and electronic products.

Both economies are highly open to merchandise trade and much of the trade in goods between them takes place at zero or low tariffs. However, there are still significant impediments to bilateral trade and investment, which a free trade agreement could address. In Malaysia's case, the main impediments are in the services sector and some parts of manufacturing. Australia's main barriers are in passenger motor vehicles and parts, and textiles, clothing and footwear.

A free trade agreement would provide solid and worthwhile benefits to both countries. Economic modelling carried out for this study, and reported in Chapter 6, suggests that the gains to Australia would be \$1.9 billion in real GDP in net present value terms in the period to 2027. For Malaysia, they would be significantly higher, at an estimated RM18.3 billion (around \$6.5 billion) over the same period.[51] The modelling also suggests a significant expansion in bilateral trade, with Australia's exports to Malaysia increasing by 5.5 per cent and Malaysia's exports to Australia increasing by 6.3 per cent as a result of an FTA in the long run.

A free trade agreement is consistent with the broader policies being pursued by both countries. For Australia, an FTA would deepen its integration with the ASEAN economies, building on agreements negotiated with Singapore and Thailand. It would help to promote Australia's commercial interests in Malaysia as it liberalises trade on a preferential basis with other economies, including in the region. It would strengthen our commercial relationship with an economy about one fifth the size of Australia's, which is nevertheless a very important player in global and regional trade with good prospects for further rapid growth. It would serve to complement and reinforce liberalisation efforts in the regional and multilateral arena. More generally, an FTA with Malaysia would strengthen the broader bilateral relationship.

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[51] In both cases, gains are in net present value terms, at 2005 currency values.

For its part, Malaysia would benefit from a closer relationship with the fourth largest economy in the region, and one of the most strongly performing developed economies over the last decade. It would also help to protect its export markets under new preferential arrangements Australia has negotiated with Singapore, the United States and Thailand. Malaysia's attractiveness as an investment destination would increase, particularly if it were to liberalise further its investment regime and make it more attractive to business.

A free trade agreement would provide a basis for stronger cooperation and related liberalisation on customs issues, industrial technical barriers to trade, SPS issues, investment, business mobility, education, electronic commerce, competition issues, intellectual property and government procurement. The scope of cooperation would almost certainly develop over time, just as it has with Australia's Closer Economic Relationship with New Zealand.

This study has demonstrated that the case for a free trade agreement with Malaysia is very strong and recommends that Australia enter into negotiations to establish a comprehensive agreement. If Malaysia, as a result of considering its own study, is agreeable to this course and the two Governments decide to commence negotiations, the specific proposals in Chapter 7 should be examined when considering the architecture of the agreement.

List of Acronyms and Abbreviations

AAT	Administrative Appeals Tribunal
ACBC	AFTA-CER Business Council
ACCC	Australian Competition and Consumer Commission
ACIF	Australian Communication Industry Forum
AFTA	ASEAN Free Trade Area
AGA	Australian Gas Association
AGTP	Australian Generalised Tariff Preference
AMBC	Australia Malaysia Business Council
AMF	Australia-Malaysia Foundation
ANZ	Australia-New Zealand
ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
ANZGPA	Australia New Zealand Agreement on Government Procurement
APEC	Asia Pacific Economic Cooperation
AQF	Australian Qualifications Framework
AQIS	Australian Quarantine Inspection Service
ASEAN	Association of South East Asian Nations
ASIC	Australian Securities and Investments Commission
ATM	Automatic Teller Machine
AUQA	Australian Universities Quality Agency
AUSFTA	Australia-US Free Trade Agreement
BIT	Bilateral Investment Treaty
BNM	Bank Negara Malaysia
CACA Act	*Commonwealth Authorities and Companies Act 1997*
CBU	Completely Build Up
CMM	Capital Market Master Plan
CEP	Closer Economic Partnership
CER	Closer Economic Relations
CKD	Completely Knocked Down
COAG	Council of Australian Governments
CPGs	Commonwealth Procurement Guidelines
CRICOS	Commonwealth Register of Institutions and Courses for Overseas Students
CTC	Change in Tariff Classification
DAFF	Department of Agriculture, Fisheries and Forestry
DEWR	Department of Employment and Workplace Relations
DIMIA	Department for Immigration and Multicultural and Indigenous Affairs
DSM	Department of Standards Malaysia
DVS	Department of Veterinary Services
EPU	Economic Planning Unit
ESM	Emergency Safeguard Mechanism
ESOS	*Education Services for Overseas Students Act 2000*
ETMs	Elaborately Transformed Manufactures
FDI	Foreign Direct Investment
FIC	Foreign Investment Committee

FIRB	Foreign Investment Review Board
FMAA Act	*Financial Management and Accountability Act 1997*
FSANZ	Food Standards Australia New Zealand
FSM	Financial Sector Master Plan
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GI	Geographical Indicators
GMP	Good Manufacturing Practices
GPEG	Government Procurement Experts' Group
HS	Harmonised System
IAS	International Accounting Standards
ICT	Information and Communications Technology
ICTs	Intra-Corporate Transferees
IEC	International Electrotechnical Commission
IFIS	Imported Food Inspection Scheme
IOR-ARC	Indian Ocean Rim Association for Regional Cooperation
IPEG	Intellectual Property Rights Experts Group
IPPC	International Plant Protection Convention
IPR	Intellectual Property Rights
IRA	Import Risk Analysis
ISDS	Investor State Dispute Settlement
ISO	International Organization for Standardization
JAKIM	Malaysian Department of Islamic Affairs
JAS-ANZ	Joint Accreditation System of Australia and New Zealand
JPA	Malaysian Public Services Department
JTC	Joint Trade Committee
JWG	Joint Working Group
LAN	National Accreditation Board
MAAC	Malaysian Australian Alumni Council
MAACWG	Malaysia Australia Agricultural Cooperation Working Group
MABC	Malaysia Australia Business Council
MAF	Malaysia-Australia Foundation
Matrade	Malaysian External Trade Development Corporation
MCMC	Malaysian Communications and Multimedia Commission
MFN	Most Favoured Nation
MIA	Malaysian Institute of Accountants
MIDA	Malaysian Industrial Development Authority
MITI	Ministry of International Trade and Industry
MoU	Memorandum of Understanding
MSC	Multimedia Super Corridor
NAMA	Non-Agricultural Market Access
NATA	National Association of Testing Authorities
NCC	National Competition Council
OECD	Organisation for Economic Co-operation and Development

OIE	World Organisation for Animal Health
PAE	Professional Assessment Examination
ROO	Rules of Origin
RPL	Recognition of Prior Learning
SAFTA	Singapore-Australia Free Trade Agreement
SAI	Standards Australia International
SME	Small and Medium size Enterprise
SPS	Sanitary and Phytosanitary
STMs	Simply Transformed Manufactures
TAFTA	Thailand-Australia Free Trade Agreement
TBT	Technical Barriers to Trade
TCF	Textile, Clothing and Footwear
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
VET	Vocational Education and Training
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

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