
MALAYSIA

Mahani Zainal Abidin and Nor Izzatina Aziz

The ASEAN-China Free Trade Agreement (ACFTA) is the first economic integration initiative that Malaysia had entered into through the ASEAN mechanism. This economic integration is important because of its size: in 2010, ACFTA represents a market of 1.9 billion consumers with gross output of US\$6 trillion. The region is highly connected with an annual total trade of US\$4.5 trillion in 2010. The high trade value is significantly contributed by intra-industry trade generated by the multinational and supplier companies engaged in the regional production network.

The large size of ACFTA and the high growth rate of the Chinese economy are among the key reasons for Malaysia to participate in this integration. The Chinese economy sustained high growth and consequently the rising affluence of its consumers is likely to demand more imports. Another compelling reason for Malaysia to join ACFTA is the diversification of its export markets: Malaysia has been very dependent on the United States, the European Union and Japanese markets for its exports. ACFTA will improve Malaysia's market access into China and this will help its export market diversification effort. With the implementation of ACFTA, the removal of trade barriers and improvement of trade facilitation between ASEAN and China is expected to lower costs and subsequently increase trade and investments.

Malaysia's participation in ACFTA presents opportunities for it to be a part of and benefit from China's high economic growth. Even though ACFTA is only one year in its implementation, it is, nonetheless,

important to examine whether the regional integration can produce the outcome that Malaysia is expecting. In this respect, it is not possible to see the full impact due to the early stage of implementation but indications of likely outcome can be a useful milestone.

MALAYSIA LIBERALISATION COMMITMENTS IN ACFTA

The Framework Agreement on Comprehensive Economic Cooperation signed by ASEAN and Chinese leaders in November 2002 marked the first formal effort by ASEAN to be economically integrated with other regions or countries. ACFTA Agreement on Trade in Goods and Dispute Settlement Mechanisms was signed in November 2004. With the signing of this agreement, ACFTA was implemented in stages beginning with the EHP in 2005 and it serves as a springboard for future tariff reductions.

Under the EHP, China has agreed to reduce and eliminate tariffs on agricultural products from ASEAN and this was reciprocated by several ASEAN members. In addition, some manufactured goods were also included in the EHP. EHP covered about 600 agricultural products including livestock, meat, fish and dairy products. Malaysia has listed 503 unprocessed agricultural products such as coffee, animal and cocoa preparation and 87 manufactured goods such as glass envelopes for Cathode-Ray Tubes (CRT) to be eligible for tariff reduction.

TABLE 1
Schedule of tariff reduction for China and ASEAN-6 under the Normal Track

Schedule	Commitments			
Jan 2010	• Eliminate all tariff lines			
Jan 2007	• At least 60% of its tariff lines reduced to 0–5%			
Jul 2005	• At least 40% of its tariff lines reduced to 0–5%			
Applicable Tariff Rates	ACFTA Preferential Tariff Rate			
	2005	2007	2009	2010
20% and above	20	12	5	0
15% (inclusive) – 19.99%	15	8	5	0
10% (inclusive) – 14.99%	10	8	5	0
5% – 9.99%	5	5	0	0
4.99% and below	standstill	0	0	

Source: Association of Southeast Asian Nations

Malaysia's tariff reduction commitments fall under the NT where tariff reduction began in 2005 and was eventually eliminated in 2010. Table 1 shows the stages and rate of tariff reduction under ACFTA for six ASEAN countries (Brunei, Indonesia, Malaysia, the Philippines, Thailand, Singapore) and China.

The majority of Malaysian import duties have been eliminated since 2009, while the remaining ones are in the 0–5 per cent range, with the exception of products in the automotive industry.

To help Malaysian industries adjust to the increased competition as a result of liberalisation, the time frame for tariff reduction has been extended for not more than 150 tariff lines. Tariff lines under this extended timeframe will be eliminated before 2012. The products under this category include polyethylene, polypropylene, polystyrene, rubber tires and tubes, textiles and fabrics, footwear, ceramic products, articles of iron and steel and electrical products.

As in any integration agreement, there are industries that are carved out due to sensitivities or their strategic importance. These are products that are placed in SL and HSL. Currently, Malaysia has 416 products in the SL and 285 in the HSL. Tariff rates for these products will be reduced but will not be eliminated. Iron and steel and automotive products are among products listed under SL. Duties for Sensitive products will be reduced to 20 per cent by 2012 and to between 0 to 5 per cent by 2018. On the other hand, tariffs for the Highly Sensitive products will be reduced to 50 per cent by 2015.

ACFTA also included services liberalisation but the agreement was only signed in 2007. The ASEAN-China Services Agreement is an important step forward for Malaysia considering the commitments it made are deeper than those made under the General Agreement in Trade in Services (GATS). The sectors committed are architecture, engineering, telecommunications, financial services, education, health, tourism, computer services, management consulting services, environmental services, recreational services and transport services. For architecture, engineering, financial services and education, their liberalisation commitments are expected to be even deeper once the Protocol to Implement the Second Package of Specific Commitments under the Agreement on Trade in Services is signed in August 2011. The Services Agreement, however, excludes liberalisation in government procurement and government related services.

ASSESSMENT OF ACFTA AFTER ONE YEAR OF IMPLEMENTATION

Trade in Goods

Malaysia's total trade with China had increased from RM23.8 billion in 2000 to RM147 billion in 2010—a six-fold increase—as shown in Table 2. It is unclear whether this huge increase was attributed only to ACFTA, because China's accession into the WTO in 2001 and its phenomenal growth rate have substantially expanded China's trade with the region and the world. The WTO accession had made China a very competitive and attractive manufacturing location and it became a critical node in the regional production network. The resulting high growth of China's manufacturing exports might serve as the catalyst for higher exports from other countries in the regional production network such as Malaysia to supply intermediate goods for further processing in China.

However, it is noteworthy that the rate of export growth from Malaysia to China has risen significantly after the signing of ACFTA. The low export growth in 2009 was due to the global financial crisis but exports rebounded strongly in 2010. In contrast, the rate of import growth is very much lower compared to exports. This trend had turned the negative trade balance into a positive one from 2009.

TABLE 2
Malaysia's exports to and imports from China (RM million)

	Export	Growth rate (per cent)	Import	Growth rate (per cent)	Total trade	Trade balance
2000	11,507.2		12,320.5		23,827.8	(813.2)
2005	35,153.1	8.8	49,879.9	27.1	85,032.9	(14,726.8)
2006	42,612.0	21.2	58,259.6	16.8	100,879.6	(15,639.6)
2007	53,037.9	24.4	64,712.7	11.1	117,750.6	(11,674.7)
2008	63,435.0	19.6	66,853.7	3.3	130,288.7	(3,418.6)
2009	67,241.1	6.0	60,660.0	(9.3)	127,901.1	6,581.1
2010	80,595.1	19.9	66,432.9	9.5	147,027.9	14,162.2

Source: Malaysian Statistical Department

This rising trade has made China a significant trading partner for Malaysia. In 2000, China was ranked the ninth most important market for Malaysian exports and the sixth most important source of import. By 2010, China has become the second largest export market and import

source for Malaysia: China's share in Malaysia's total exports and imports was 12.6 per cent and 12.5 per cent respectively.

Although Malaysia's exports to China have increased significantly, its structure remains largely unchanged as shown in Table 3. These 10 products constitute more than 60 per cent of Malaysian exports to China and they are electrical and electronic machinery (8471, 8473, 8525 and 8542), vegetable products, mainly palm oil (1511 and 1516), petroleum products (3910 and 3901) and rubber products (4005 and 4001). This shows that ACFTA does not change the structure of exports by improving market access for other export products from Malaysia. The increased export value may be attributed to either ACFTA or the high Chinese growth or both.

The share of the top 10 imports from China is much less than that of exports: the share is about 45 per cent of total imports from China as shown in Table 4. Although the size of the top 10 imports is less than the top 10 exports, the same observation can be made, namely the import structure has not changed much since 2005. These imports are electrical machinery and equipment, telecommunication equipment, sound recorders and televisions, either as a whole or as parts and components. Unlike exports, the values of these top 10 imports have not increased

TABLE 3
Top 10 Malaysian Exports to China (HS4 digit), 2005–2010

Rank	2005	2006	2007	2008	2009	2010
1	8,542	8,542	8,542	8,542	8,542	8,542
2	1,511	1,511	1,511	1,511	1,511	8,474
3	8,473	8,473	8,473	8,471	8,471	1,511
4	4,001	4,001	4,001	8,473	8,473	8,471
5	8,471	8,471	8,471	4,001	4,005	4,001
6	1,516	4,005	4,005	4,005	2,709	4,005
7	3,901	2,710	1,516	2,709	4,001	2,709
8	8,529	3,910	2,709	1,516	1,516	1,516
9	4,403	1,516	3,901	3,901	2,711	2,711
10	2,711	9,030	2,905	8,525	3,901	2,710
Total RM million	20,130	27,368	36,782	46,022	49,794	55,595
Per cent of export to China	57.3	64.2	69.4	72.6	74.1	69.2

Source: Department of Statistics, Malaysia

very significantly from 2006 to 2010. In other words, the import pattern from China is becoming more diverse.

TABLE 4
Top 10 Malaysian imports from China (by HS4), 2006–2010

Rank	2005	2006	2007	2008	2009	2010
1	8,473	8,473	8,473	8,473	8,473	8,542
2	8,542	8,542	8,542	8,542	8,542	8,473
3	8,471	8,471	8,534	8,471	8,471	8,471
4	8,529	8,531	8,529	8,529	8,517	8,529
5	8,531	8,534	9,800	8,517	8,529	8,517
6	8,534	8,529	8,504	8,534	8,504	8,541
7	8,525	9,800	8,525	8,504	8,541	8,504
8	9,800	8,525	8,501	8,536	8,536	8,534
9	8,504	8,504	8,536	8,501	8,501	8,536
10	2,709	8,541	8,544	8,531	8,443	8,901
Total RM million	26,084	31,421	28,528	30,137	27,314	25,675
Per cent of import from China	52.4	53.9	44.1	45.1	45.0	38.6

Source: Department of Statistics, Malaysia

The matching of exports to and imports from China indicated a strong intra-firm trade in intermediate inputs for the electrical and electronic industry. This may lead to concern about low value added as the imports only undergo modest processing before being re-exported to China.¹

It is too early to derive any conclusive observation about the impact of ACFTA from the pattern of Malaysian trade with China because this economic integration has only been implemented a year ago. What is clear is that the trade relationship is growing strongly but this could have been the result of the strong Chinese economic growth that spurred higher domestic demand as seen by the expanding demand for primary commodities and agricultural products. The rising trade could also be attributed to the strong growth of Chinese exports, where Malaysia is part of the regional production networks that supplies inputs for final processing in China.

1 Shimelse Ali and Uri Dadush, "Trade in Intermediaries and economic policy", *VoxEU*, 9 February 2011, www.voxeu.org/index.php?q=node/6088

Investments

Another key element in ACFTA is the investment component. For Malaysia, the inclusion of this chapter is expected to enhance Malaysia as an investment location and attract more Chinese funds to Malaysia. Table 5 shows investment from Malaysia into China and vice versa from China into Malaysia. From 2005 to 2007, Malaysia's investment into China was much larger than that from China into Malaysia. One could say that Chinese investment was almost negligible. However, Chinese investment into Malaysia jumped in 2008 and 2009.

Most of the Chinese investments were in infrastructure projects, utilities and resource industries and not in manufacturing. The State Grid Corporation of China will invest up to US\$11 billion to develop the Sarawak Corridor of Renewable Energy. However, China's investment in Malaysia has yet to overtake that from the United States, Japan, Hong Kong and Singapore. A further positive development is that the China Banking Regulatory Commission has approved Malaysia as an approved investment destination under China's Qualified Domestic Institutional Investor scheme. With this move, more funds from China are expected to flow into Malaysia. This shows that the liberalisation of the manufacturing sector through reduction of tariff rates (i.e. ACFTA) is not a factor in attracting Chinese investment but instead other strategic factors and measures are responsible for the larger inflow.

Malaysia's investments in China continue to be high and they are in

TABLE 5
Chinese and Malaysian direct investment (RM million)

Investment	2005	2006	2007	2008	2009	2010 (Q1 to Q3)
Malaysia into China	821	1,022	681	1,063	1,435	547
Annual growth rate (per cent)	—	24.5	(33.4)	56.1	35.0	(61.9)
China into Malaysia	23	42	59	1,106	1,239	914
Annual growth rate (per cent)	—	82.6	40.5	1774.6	12.0	(26.2)

Source: Bank Negara monthly statistics

Note: Figures before 2008 are from reported equity investment. After July 2010, Bank Negara Malaysia, the Malaysian central bank, made some changes to its reporting format.

manufacturing and services sector. In the retail sector, Parkson Retail Group, controlled by Malaysia's Lion Group has 47 self-owned and managed stores in China and in 2010 it invested 300 million yuan for expansion. Malaysia's Sime Darby Group has also ventured into logistics and utilities services in China. Currently, it operates the Weifang port near Weifang city and its water treatment plant provides treated water for industrial use at the Shandong Hai Hua Development Zone and Hanting Northern District in Shandong province. Sime Darby's operation in Weifang has grown ever since and in 2009, the company was offered a multi-billion dollar development project there, which included township projects. Like the Chinese investment, Malaysian investors went to China not because of ACFTA; the attraction was and is the large Chinese domestic market. Investment by Malaysia and China is expected to grow but this growth is not driven by ACFTA.

FEEDBACK FROM INDUSTRIES

The implementation of ACFTA has caused some concerns among Malaysian businesses. Malaysian business associations continue to voice their fear of unfair competition and uneven level playing. The complaints against implementation of ACFTA are likely due to:

- lack of preparedness among Malaysian industries; and
- aggressive selling of Chinese products

The Malaysian steel and iron manufacturers are reportedly facing a stiff competition operating in ASEAN and even domestically. Despite huge capacity upgrading, ACFTA is forcing these manufacturers to upgrade further and install new steel-making capacities. ASEAN steel manufacturers are worried about China's ability to export steel at a lower price to ASEAN.² Apparently, China is facing 55 trade actions on steel products filed by the United States, the European Union and several ASEAN countries.

In another complaint, the Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCIM) has been calling for a limit of 10 per cent annual growth of imports from China to ensure that dumping of China's goods does not happen. The ACCIM also admitted that local industries are not fully prepared for the removal of import tariffs for 90

2 "Local steel companies face tough outlook", *The Star*, 1 January 2011, biz.thestar.com.my/news/story.asp?sec=business&file=/2011/1/1/business/7700928

per cent of the goods traded in ACFTA.³ Despite the figures showing Malaysia to be a bigger beneficiary of ACFTA since its implementation, the grievances reported by the small and medium enterprises continue to grow. Some reported of having to deal with high export standards requirements upon entry to China, but the same standards are not implemented in Malaysia for imports.

CONCLUSION

The review of one year of ACFTA's implementation must ask two questions:

1. Has it increased trade?

The evidence shows that Malaysia's trade with China is growing. However, the expansion is not entirely due to ACFTA because part of this trade increase is linked to China's recovery from the global financial crisis which has boosted imports by China from ASEAN countries. The Malaysian case shows that ACFTA has not changed the structure of Malaysian exports to China.

2. Has it increased investment?

Chinese investment into Malaysia has increased. However, like trade between Malaysia and China, the impact of ACFTA on investment between the two countries is still inconclusive. The investment relationship between China and Malaysia has become stronger, although most investments are in resource-based sectors, services and infrastructure and not in manufacturing.

This review could not provide a conclusive answer about the impact of ACFTA because of the short period of implementation (12 months). However, there are indications that this regional integration initiative can produce the benefit envisaged by the member countries.

While there are concerns about the losses that might be experienced by the manufacturing sectors, ACFTA can provide large benefits to Malaysia particularly in services trade. Currently, Malaysia has a comparative advantage in education, health and tourism services and Islamic finance and banking. With greater progress in the trade in services agreement made under ACFTA, Malaysia may increase its services trade with China.

3 "Businesses need to adjust to new market realities", *The Star*, 22 February 2010.

For ACFTA to be fully effective, significant progress is needed. Among the areas that can bring immediate benefit is improvement in trade facilitation, which the private sector considers as a key obstacle to trade. ACFTA started with the low-common denominators among the 11 nations and these commitments must be continuously improved, especially in tackling complex issues like the environment, labour standards, health standards, government procurement, and investment and competition policy.