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Negotiating for a Malaysia-EU FTA

Contesting Interests from Malaysia's Perspective

Tham Siew Yean

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Executive Summary

Malaysia has shifted its focus from multilateral and regional to bilateral agreements due to the current doldrums in the Doha Round and the bandwagon effect from similar shifts in other countries. Despite the importance of trade to the country, negotiations on free-trade agreements (FTAs), especially with developed countries, are fraught with difficulties. Malaysia is still a developing country; its developmental needs may conflict with the requirements of reciprocal market access. Furthermore, FTA negotiations with developed countries generally aim to achieve WTO-Plus commitments that may encounter domestic resistance from different segments of Malaysian society. The objective of this paper is to analyze the contesting interests of different economic groups such as producers (including government-linked companies), consumers and other social groups in the ongoing FTA negotiations with the EU. The findings in this paper indicate that, in this proposed FTA, there are strong contestations within key offensive and defensive interests of Malaysia. Resolving these contestations requires a clear mandate from the government on the importance and priority of this FTA to the country, relative to other agreements.

Contents

Introduction

The protracted years of negotiations in the Doha Round under the World Trade Organization (WTO), which began in 2001, have led to considerable disillusionment with the multilateral framework. More than a decade later an agreement has yet to be concluded. Consequently, most countries have retreated to regional and bilateral trade negotiations in the last decade or so in their attempt to increase market access for their firms. Malaysia is no different. Its trade policy has also shifted from focusing on multilateral and regional to bilateral free-trade agreements (FTAs). The first bilateral agreement was negotiated with Japan in 2003 and concluded in 2005. Subsequently, Malaysia has concluded several other bilateral FTAs, including with Pakistan, New Zealand, India, Chile and Australia. It is currently negotiating more FTAs, including with the European Union (EU) and Turkey. At the regional level, there are also ongoing negotiations for a Trans-Pacific Agreement (TPP), besides investment and services agreements in the ASEAN-Japan and ASEAN India FTAs.

The concern in Malaysia over increasing market access is due to the relatively small size of its domestic economy, especially when compared with other countries in the neighborhood. Accordingly, international trade has played an important part in the Malaysian economy and continues to be the most important component in terms of the country's integration with the rest of the world. In Ernst and Young's Globalization Index, Malaysia is ranked as the 28th most globalized nation among a sample of 60 countries, but is ranked the fifth most globalized in terms of its openness to trade.[1] The importance of trade to the country extends beyond a mere contribution to export revenues, as trade enables the country to reap economies of scale in production as well as to access new knowledge and technology that is frequently embedded in its imports of capital and intermediate goods.

Despite the importance of trade to the country, negotiations on FTAs, especially with developed countries, are fraught with

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[1] The Globalization Index measures the extent to which the world's largest countries by Gross Domestic Product (GDP) are connected to the global economy. The index has five broad categories of indicators: openness to trade, capital movements, labor movements, exchange of technology and ideas, and cultural integration (see www.ey.com/globalization, accessed 21 May 2012).

difficulties. Malaysia is still a developing country and its developmental needs may be in conflict with the requirements of reciprocal market access. Furthermore, FTA negotiations with developed countries generally aim to achieve WTO-Plus commitments that may meet domestic resistance from different segments of Malaysian society. This is most clearly illustrated in the negotiations for a proposed Malaysia-US FTA that came to halt as the government was unable to resolve the 58 contentious issues that were tabled before the cabinet in 2007.[2] Contesting interests can therefore hinder the successful conclusion of FTA negotiations. From this perspective, the current negotiations with the EU are worth examining.

In view of the above, this paper seeks to analyze the contesting interests of different economic groups in Malaysia, such as producers (including government-linked companies), consumers and other social groups in the FTA negotiations with the EU. The structure of the paper is as follows: after the introduction, section 2 provides background information on Malaysia's economic strategy, highlighting the domestic motivations for an FTA with the EU, while section 3 analyzes in depth the contestation in key offensive and defensive areas of interest. The conclusion in section 4 summarizes the main arguments of the paper.

[2] Tham, Siew Yean (2008). Trade Liberalization and National Autonomy: Malaysia's Experience at the Multilateral and Bilateral Levels. Chapter 6 in Nelson, J., Meerman, J. and Abdul, R. E. (eds.), *Globalization and National Autonomy: The Experience of Malaysia*. Singapore: Institute of Malaysian and International Studies (IKMAS) and Institute of Southeast Asian Studies (ISEAS).

Domestic Motivations for an FTA with the EU

Malaysia has a generally stable macroeconomic environment, with relatively low inflation, a surplus in its current account, and a fiscal deficit since recovering from the Asian Financial Crisis (AFC) in 1998. However, overall growth has fallen to about half the average growth in the decade before the AFC. Hence, there is increasing concern as to whether Malaysia is caught in a middle-income trap; it has been in the middle-income category for the last 32 years while countries such as South Korea made the transition to high-income status.

The government thus launched a New Economic Model (NEM) in 2010 that is intended to propel the country towards a high-income economy, with a targeted per capita income of $15,000–20,000 by 2020.[3] The goals of the NEM – high income, inclusiveness and sustainability – are to be achieved through four pillars of transformation: 1Malaysia (People First, Performance Now), the Government Transformation Plan (GTP), the Economic Transformation Plan (ETP), and the Tenth Malaysia Plan. The first pillar, 1Malaysia, seeks to preserve and enhance unity in the country. The GTP aims to strengthen public services and to facilitate a shift in the government's role in the economy from a driver to an enabler. The ETP is a roadmap for increasing private investment in the country,[4] in line with the changing role of the government in the economy as well as its increasing fiscal constraints. The Tenth Malaysia Plan, also unveiled in 2010, is the most recent of the five-yearly development plans that maps out the government's plan for the country's overall development, from 2011 to 2015.[5]

In line with the private investment-led initiatives in the ETP, FTAs are negotiated to increase market access as well as inflows of foreign direct investment (FDI). The choice of the EU as an FTA partner is due to it being a major trading partner of Malaysia; it was the country's fourth largest trading partner (as well as for exports and imports individually) in 2011.The EU is also an important foreign direct investor in Malaysia. In terms of investment, on average, net

[3] $ in this paper refers to the US dollar ; NEAC 2010
[4] Malaysia (2010a. *Economic Transformation Programme: A Roadmap for Malaysia*. (Putrajaya: Performance Management and Delivery Unit (PEMANDU).
[5] Malaysia (2010). *Tenth Malaysia Plan: 2011-2015*. Putrajaya: Economic Planning Unit (EPU).

FDI flows from the EU accounted for about 29% of total net FDI flows to Malaysia between 2008 and 2011.[6]

Malaysia is also motivated by the FTA negotiations of its ASEAN partners as any increase in their market access is viewed as a serious threat to the competitiveness of local producers exporting the same or similar products to the same countries.

[6] Central Bank, Malaysia (2012). *Annual Report 2011*. Kuala Lumpur: Central Bank.

Identifying Primary Stakeholders and their Interests

In general, the main stakeholders in an FTA are the producers, consumers and civil society at large. However, producers are divided into two groups: those producing for the domestic economy and those producing for export. While the former group favors protection, the latter favors liberalization in exchange for greater market access in partner countries. Consumers and civil society groups are in general against liberalization for various reasons, including a perceived potential negative impact on employment due to the exiting of local firms unable to compete against cheaper imports.

In theory, the government is supposed to mediate between the interests of the different groups since it awards licenses and concessions, and regulates and formulates policies that govern the usage of land and resources, including natural resources. However, the mediating role of the government can be affected when it is directly or indirectly involved in business or the use of natural resources. Since land management is exercised primarily by local state governments in Malaysia, they may have vested interests in some of the land-related issues in FTA negotiations. Moreover, the interests of the different ministries in the government may also differ as they have different key performance indicators (KPIs) that may be affected differently by the proposed liberalization in the FTA that is under negotiation. Since there are 24 ministries in the country, aligning and consolidating the interests of the different ministries is no easy task.

FTA agreements have generally extended beyond mere market access into rule-making that can affect the domestic governance of partner countries. Negotiations on the proposed Malaysia-EU FTA (MEUFTA) started on 6 December 2010. It is a comprehensive agreement covering areas that include market access for goods, services and investment; rules of origin; customs and trade facilitation; sanitary and phytosanitary measures; technical barriers to trade; government procurement; intellectual property rights; competition, and sustainable development (covering labor and the environment). The extensive scope of the proposed agreement makes it necessary to narrow the scope of the analysis in this section to key illustrative sectors or issues as it would not be possible to discuss in any reasonable depth all the chapters in the proposed FTA.

The key offensive sector, palm oil, is chosen based on the economic significance of the sector and its importance as an export product for Malaysia, and because the EU was the second largest export destination for Malaysian palm oil in 2011, after China. The EU's share in Malaysia's exports of palm oil was 11.2%. This industry is also significant because of the considerable presence of the government in the sector, in the form of equity ownership.

In contrast, the main defensive sector – the automotive sector – is chosen based on its strategic importance in Malaysia. European car brands' presence in Malaysia is currently small, controlling only 0.6% of total vehicle sales in the country as they are mainly restricted to the luxury and premium segments.[7] But this is due to the punitive tax structure that makes European cars more expensive than the protected national and locally assembled Japanese brands. An FTA with the EU could remove the pricing advantage of the currently favored non-European brands. In addition, several companies have recently started producing 'completely knocked down' (CKD)[8] European car brands in the country, such as Mercedes Benz, Volvo, Peugeot, and Volkswagen AG (VW). Malaysia also has the second largest passenger market in ASEAN and a sizeable car-buying population.

The services sector is also analyzed since it is the main offensive sector of interest for the EU. Intellectual property rights (IPR) and government procurement are examined as cross-sectoral issues that have potential implications on domestic industries and the governance of Malaysia.

Contestations in key offensive interests

The palm-oil industry is the fourth largest contributor to the national economy, accounting for 8% of gross national income (GNI) in 2009.[9] Malaysia and Indonesia are the two largest producers of palm oil in the world, contributing slightly more than 85% of total production. Palm oil provides direct employment to 570,000 people in Malaysia.[10] The industry has also been identified as one of the 12 National Key Economic Areas (NKEAs) that are targeted to propel Malaysia to a

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[7] CIMB (2012). Autos: More Vroom to Grow. 26 June 2012: https://brokingrfs.cimb.com/pXroG4ja1UaNx_7Qb8PT4oALUa1C3fIElGNsjijdIuT-zrrvDMOb-SB1WGK0RUQS0BKU86t90.pdf Accessed 9 July 2012.

[8] A knock-down kit contains the parts needed to assemble a product. Typically, the parts are manufactured in one country or region, then exported for final assembly.

[9] Malaysia (2010). *Economic Transformation Programme: A Roadmap for Malaysia*. (Putrajaya: Performance Management and Delivery Unit (PEMANDU).

[10] Basiron, Y. (undated). Trends and Potentials of Malaysia's Plantation Sector: www.mpoc.gov.my. Accessed 15 May 2012.

high-income economy by 2020. Its contribution to GNI is expected to increase more than threefold by 2020. Palm-oil export is an important part of the palm-oil industry; crude palm oil (CPO) is the main export of the agricultural sector, contributing to 7.6% of total exports in 2010.[11]

The industry is dominated by large plantation companies, both private and government-linked companies (GLCs)[12] such as Golden Hope, Kumpulan Guthrie, Sime Darby, whose share of total plantation land increased from 53% in 1980 to 61% in 2011 (Table 1). There are 43 listed plantation companies on the Kuala Lumpur Stock Exchange (KLSE). Besides this, government schemes – such as the Federal Land Development Authority (FELDA), Federal Land Consolidation and Rehabilitation Authority (FELCRA), and the Rubber Industry Smallholders Development Authority (RISDA) – accounted for about 34% of total plantation land in 1980 and 19% in 2011.[13] State schemes held as much as 6% in 1980 and 2011. Smallholders make up the rest of the producers in this industry. GLCs contribute toward the government's coffers while government and state schemes play critical roles in the poverty eradication and redistribution objectives of the New Economic Policy (NEP).[14]

Given the relatively low tariff barriers in developed countries, such as in the EU, for the import of palm oil, non-tariff barriers (NTBs) are the main concern about the trade of this commodity. The specific form of NTBs has changed over time. In the 1980s, the main NTBs largely related to the health and nutritional issues raised by palm oil as compared with other oils. The subsequent development of biofuel as an alternative renewable source of energy has shifted the form of NTBs to green issues, such as greenhouse-gas (GHG) emission savings from the use of biofuels.[15] The sustainability criteria used to assess imports of biofuels into the EU include biodiversity losses, due in particular to deforestation, as land-use conversion from lowland

[11] Ministry of International Trade and Industry (MITI) (2010). *Annual Report 2010*. Kuala Lumpur: MITI.

[12] GLCs are defined as companies that have a primary commercial objective, but in which the government has a direct controlling stake. They are considered as private entities in Malaysia, even though the government –through its investment arm, such as the Permodalan Nasional Berhad (PNB) – holds considerable equity in them.

[13] These entities are some of the institutions established to eradicate poverty under the ethnic-based development strategy of the New Economic Policy (NEP), through the provision of land for resettlement and agricultural purposes, given the rural nature of poverty. For additional information on Malaysia's poverty eradication strategies. FELDA Global Ventures (FGV), the commercial arm of government-owned FELDA, was listed in June 2012 as the world's largest plantation entity, see Ragayah Haji Mat Zin (2011). Strategies for Poverty Eradication. Ch. 11 in *Malaysia: Policies and Issues in Economic Development.* Kuala Lumpur: Institute of Strategic and International Studies (ISIS).

[14] The NEP was launched in 1971, following the inter-ethnic riots in 1969, and sought to reduce poverty and redistribute income among ethnic groups.

[15] European Commission (2009). Trade Sustainability Impact Assessment for the FTA between the EU and ASEAN. Phase 2, Interim Report. TRADE07/C1/C01-Lot 2. Rotterdam: European Commission, DG Trade.

tropical rainforests and peat-swamp forests to oil-palm cultivation releases a considerable amount of GHGs to the atmosphere. Thus, it is not surprising that the Minister for Plantation Industries and Commodities, Tan Sri Bernard Dompok, has stated that barriers to palm-oil trade are a priority item on the negotiating table in the FTA talks with the EU.[16]

Table 1: Distribution of oil palm planted area by category 1980 and 2011

Category	1980 (%)	2011 (%)
Private estates	53	61
Government schemes		
FELDA	30	14
FELCRA	2	3
RISDA	2	2
State schemes	6	6
Smallholders	7	14

Source: Ramasamy et al, 2005[17]

Current findings on palm oil's carbon footprint are contested between foreign agencies and the Malaysian Palm Oil Council (MPOC), thereby leading to the government's query as to whether protectionist sentiments are disguised under the banner of a greener environment.[18]

The deforestation debate also includes the loss of natural habitat and the decimation of the orangutan population. There is the additional issue of substitution of land use from food to biofuel production. Deforestation issues further affect the woods and wood products industry, where the issue of logging, both legal and illegal, is hugely contentious as forest areas are under the jurisprudence of the state, including the allocation of timber and reforestation licenses, as well as regulatory functions. The involvement of state enterprises such as the Sarawak Timber Industry Development Corporation (STIDC) in the timber business raises allegations of rent-seeking

[16] Tropical Chase (2010). *Industry News*. Palm Oil Trade a Priority in FTA Talks with EU. May 28: http://tropicalchase.com/?category=news&Theme=&mode=view&iPage=8&idx=264&dummy= Accessed 7 July 2012.
[17] Ramasamy, B., Ong, D. and Yeung, M.C.H. (2005). Firm Size, Ownership and Performance in the Malaysian Palm Oil Industry. *Asian Academy of Management of Accounting and Finance*, Vol.1: 81-105.
[18] *Business Times*, 30 April 2012. Greener environment or protectionism?

behavior that infringes on the land claims of the indigenous people in this state.[19]

Friends of the Earth Malaysia (Sahabat Alam Malaysia) has collaborated with Friends of the Earth from other countries to reject MPOC's claims on palm oil's carbon footprint and the impact of deforestation on minority communities.[20] Foreign NGOs such as the Bruno Manser Fund of Switzerland have highlighted the plight of indigenous communities in the deforestation associated with the timber industry.[21] The indigenous people have campaigned to protect their rights, with international assistance as in the Borneo Project, funded by the environmental organization, the Earth Island Institute.[22] The government, in turn, has counter-claimed that the NGOs in Malaysia have been funded by foreign NGOs to institute "smear" campaigns against Malaysian palm oil.[23] However, clearly, the indigenous people lack the capacity and capability to protest without assistance.

While NGOs are against further land conversions to support the production and export of palm oil, the government is caught in the delicate balance between the need for growth and hence market access for a product of great economic interest, and the need to regulate and enforce environmental and sustainable measures that may lead to a curtailment of production and export.[24] The involvement of government and state in business, nevertheless, implies there is greater pressure to push for more exports, especially when palm oil is the key offensive interest. How this can be achieved and at what costs in terms of trade-offs with the offensive interests as well as the sustainability requirements of the EU remains to be seen.

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[19] Faeh, Daniel (2011). *Development of Global Timber Tycoons in Sarawak, East Malaysia. History and Company Profiles*. A Report Produced for the Bruno Manser Fund, Switzerland.

[20] Milieudefensie et al (2008). Malaysian Palm Oil – Green Gold or Green Wash? The Netherlands: Friends of the Earth International Secretariat: http://www.foei.org/en/resources/publications/pdfs/2008/malaysian-palm-oil-report Accessed 10 July 2012).

[21] Faeh (2011), op. cit.

[22] www.borneoproject.org. Accessed 10 July 2012.

[23] See for example: http://www.ceopalmoil.com/2009/04/de-linking-ngos-concerns-over-deforestation-and-palm-oil. Accessed 10 July 2012.

[24] Nordensvard, J. and Urban, F. (2011). *The Ambiguous Role of Corporations in Climate Change Mitigation: An Explorative Appraisal of Corporations in China, Malaysia and the US*. Institute of Development Studies (IDS) Working Paper, Vol. 2011, Number 373. London: IDS.

Contestations in key defensive interests

Automotive sector

Although the manufacturing sector is relatively open compared to services, the automotive sector is protected by policy instruments such as import duties, excise and sales taxes, government procurement, and approved permits. This is due to the government's national car strategy, which is motivated by the need to create industrial linkages and Bumiputera[25] entrepreneurship in line with its affirmative action for Bumiputeras under the NEP, as well as subsequent variations of this policy. With protection, the two national cars, the Proton and Perodua, had a respective market share of 30% and 34% of total passenger vehicle sales in 2011.[26] Total passenger vehicle sales in 2011 amounted to 535,113, making Malaysia the second largest passenger vehicle car market in ASEAN, after Indonesia.[27] In contrast, the European brands control only 0.6% of total vehicle sales in the country, largely in the luxury and premium-brand segment.[28] European producers such as Volkswagen and Peugeot have recently established CKD operations in Malaysia in an attempt to penetrate the market.

Proton initially captured 65% of the market share in 1987 under heavy protection and this grew to 73% in 1988. However, its market share started to fall with the entry of the second national car, Perodua, in 1993 as well as the proliferation of approved permits used to bring in more imported cars. Another contributory factor is Proton's slow innovation in new car models. Its market share fell progressively to an all-time low of 25% in 2010.

In contrast, Perodua has made increasing inroads into the domestic market, at the expense of Proton. Part of the reason could be the public perception that the car is no longer a national car since its equity restructuring in 2001; its manufacturing arm, Perodua Auto Corporation Sdn. Bhd., has 41% of its equity owned by Daihatsu Motor Co. Ltd. and 10% owned by Mitsui & Co. Ltd.[29] Hence, its

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[25] This term refers to the Malays and indigenous groups of the country. The New Economic Policy (NEP) was introduced after the inter-ethnic riots in 1969, to reduce poverty and redistribute income among the ethnic groups, thereby leading to affirmative actions to improve the economic position of the Bumiputeras.

[26] CIMB (2012), op. cit.

[27] Kavan, Mukhtyar (2012). Changing Face of the ASEAN Automotive Industry through 2015 and Beyond. Presented at the Automotive Summit 2012, 21 June 2012: www.assemblytechexpo.com/image/mr.kavan.pdf Accessed 9 July 2012.

[28] CIMB (2012), op. cit.

[29] Aminar Rashid Salleh. 2010. Supporting Effective & Smart Partnership: Government & Private Sector Working Together Towards A Competitive Corporation: www.intanbk.intan.my/i-portal/dl/ppa2010/aminarrashid.pdf Accessed 20 October 2011.

manufacturing is effectively controlled by Daihatsu, a subsidiary of Toyota, with a strong niche focus on the compact-car segment in Malaysia.[30] This has two important implications. First, in terms of R&D, Perodua can leverage the technology of its parent company, Toyota. This lowers its production costs as less investment in R&D is needed. The eight models turned out in the last 17 years were not built from scratch but were mainly adapted from Daihatsu or Toyota models. The focus of the plant in Malaysia is reportedly on pressing, painting and assembling.[31] Second, its production system is planned from the perspective of Toyota's supply-chain management in Asia.[32] Hence, the decision on whether the Malaysian plant should import parts and components from other plants in ASEAN is based on costs of transportation and the size of the domestic market. This enables the company to overcome some of the problems associated with economies of scale that have and still plague the production of Proton. However, both cars continue to focus on the domestic market, as only 4% of production is exported in contrast to the 50% exported from Thailand.[33]

Not surprisingly, the government has been searching for a partner for Proton after the Asian Financial Crisis (AFC) in 1998. However, negotiations to sell the share in Proton of Khazanah (a government-linked company that holds the government's share in Proton) to foreign partners fell apart in 2007 due to the government's insistence on keeping Proton as a domestically owned company. Finally, in January 2012, Khazanah sold its entire stake in Proton to DRB-Hicom, a privately owned Bumiputera company that is a leading car distributor and importer as well as assembler of various car brands.

The main stakeholders who are likely to champion continued protection are both national car companies, including the new owner of Proton, the Bumiputera vendor support system that was implemented to develop Bumiputera entrepreneurship in the automotive parts and components industry, recipients of approved permits, and former prime minister Mahathir, who started the national car projects and has remained as Proton's adviser. At stake also are the large numbers of Bumiputeras who are employed in the national car companies and their vendor and sales dealers.[34] Consumers

[30] Tham, Siew Yean (2012). Trade Policy Formulation in Malaysia: Navigating between the Economic and Race Paradigms. Draft chapter 6 in Anthony Milner, Rahman, A.E. and Tham, S. Y. (eds.), *Transforming Malaysia: Dominant and Competing Paradigms*. Draft Book Manuscript submitted to Institute of Southeast Asian Studies (ISEAS), Singapore.
[31] Kuchiki, Akifumi (2007). *A Flowchart Approach to Malaysia's Automobile Industry Cluster Policy*. Institute of Developing Economies (IDE) Discussion Paper no. 120. Tokyo: IDE.
[32] Kuchiki (2007), op. cit.
[33] Kavan (2012), op. cit.
[34] Tham, Siew Yean (2012), op. cit.

have little choice since public transport is poor; they will continue to support the national cars as long as they are cheaper than other cars of their type.

In contrast to the domestic pressures to protect, liberalization pressures, which first emerged under the ASEAN Free Trade Area (AFTA) agreement, have continued through the bilateral agreements of Malaysia. Given Japan's strong interest in the automotive sector, Malaysia had to agree to reduce the tariff barriers for completely built units (CBUs) in this sector in the Malaysia-Japan Common Economic Partnership Agreement (MJCEPA), concluded in 2005. However, since Proton mainly produces cars of a smaller engine capacity, the elimination of tariffs for CBUs from Japan for this range of cars (less than 3,000 cc) has been pushed on to 2015, while tariffs for cars with bigger engine capacities are scheduled for earlier reduction. In the most recently concluded agreement, the Malaysia-Australia Free Trade Agreement, concluded in March 2012, tariffs for vehicles with engines less than 2,500 cc are scheduled to be eliminated by 2016.[35] Thus it is most likely that tariffs for this sector will be reduced in the proposed Malaysia-EU FTA, based on the precedent established in the earlier FTAs of Malaysia. But it remains to be seen if the potential agreement can address the other policy instruments such as the use of excise duties and sales taxes, used to protect this sector.

Services sector

Unlike in manufacturing, equity ownership in services is not completely open to foreigners. Foreign ownership is generally capped at 30%, while 30% Bumiputera ownership is mandatory based on the NEP requirements.[36] The Foreign Investment Committee (FIC) was set up in 1974 for approving non-manufacturing activities that are not under the jurisdiction of any ministry, as well as for the acquisition of corporate ownership (under the *Guidelines for the Acquisition of Assets, Mergers and Takeovers*) and property ownership (under the *Guidelines for the Acquisition of Property by Local and Foreign Interests*). This restriction on foreign equity ownership was removed for the manufacturing sector after the AFC in 1999 and it was also relaxed for selected service sub-sectors such as telecommunications. There are notable exceptions, such as the banking and insurance sector where 100% foreign equity ownership is permitted for locally incorporated foreign banks, foreign Islamic banks, international Islamic banks, and international *takaful,* or Islamic insurers and reinsurers.

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[35] Australian Government, Department of Finance and Deregulation (undated). Malaysia-Australia Free Trade Agreement RIS 2012. Regulation Impact Statement. 1 June: ris.finance.gov.au/files/2012/07/02-MAFTA-RIS-120528.doc. Accessed 13 July 2012.

[36] The NEP allocated equity ownership in Malaysia at 30% for Bumiputera, 40% for non-Bumiputera and 30% for foreigners.

The FIC ruling was repealed in 2009 in line with the government's policy shift to a more service-oriented economy, as outlined in the Third Industrial Master Plan[37] and Tenth Malaysia Plan.[38] Although this deregulation led to the removal of the 30% Bumiputera equity requirements for newly listed companies, it was replaced with the Securities Commission's new guidelines for newly listed companies to have 12.5% Bumiputera ownership in the case of non-strategic industries.[39] [40] However, liberalizing unilaterally does not mean that Malaysia is willing to make binding irreversible commitments in FTAs, as domestic requirements can be reversed more easily than FTA commitments.

Allowing 100% foreign equity ownership in services is often resisted as it will end the Bumiputera equity privileges in development. This has already occurred in manufacturing, much to the dissatisfaction of some segments of the affected community. Hence, when Malaysia unilaterally liberalized 27 services sub-sectors with the removal of the 30% Bumiputera privileges in 2009, the Minister for Trade and Industry had to clarify that the liberalization would not affect Bumiputera participation in services as their participation in the 27 sectors opened for liberalization was minimal.[41] Similar concerns were expressed at the launch of the Malaysia-Europe Forum (MEF) and the inaugural MEF-European Union Kuala Lumpur Roundtable in 2009.[42]

Apart from the equity issue, which pertains more to Mode 3 in the delivery of services, or FDI in services, there is the question of domestic regulations. The services sector is governed by different regulations, administered by the ministries that regulate the sub-sectors in services. These ministries are also responsible for formulating sub-sectoral development and liberalization policies. Service providers in almost all sectors are required to apply for a license from the relevant ministries before they are authorized to provide a given service. Consultative meetings are held with the various stakeholders in regulatory reviews as well as in policy

[37] Malaysia (2005). *The Third Industrial Master Plan: 2006-2020*. Malaysia: Ministry of International Trade and Industry (MITI).

[38] Malaysia (2010). *Tenth Malaysia Plan: 2011-2015*. Putrajaya: Economic Planning Unit (EPU).

[39] Strategic industries refer to water, telecommunications, ports and energy.

[40] European Delegation to Malaysia (2011). Investment Incentives in Malaysia. Kuala Lumpur, 29 June. DELMYS-VP/SP D (2011) D00480: www.malaysia.nlembassy.org/...kuala-lumpur/...malaysia/...malaysia/invest... Accessed 13 July 2012.

[41] The Insider (2009). Mustapa: Liberalization won't hurt Bumiputras, 13 May 2009: http://www.themalaysianinsider.com/litee/malaysia/article/Mustapa-Liberalisation-wont-hurt-Bumiputras/ Accessed 9 July 2012.

[42] Malaysia-Europe Forum (MEF) 2009. The Launch of the Malaysia-Europe Forum (MRF) and the Inaugural MEF-European Union (EU) Kuala Lumpur Roundtable. 12 November 2009. Berjaya Times Square Hotel, Kuala Lumpur.

formulations. The key stakeholders are the industry players, as represented by the respective industry associations, as well as government-linked companies (GLCs). The GLCs' presence in services is substantial due largely to the privatization of former government monopolies such as telecommunications, electricity, postal communication, as well as the government's participation in business through public-private partnerships. The presence of GLCs can, in turn, complicate liberalization efforts as the incumbent tends to resist market-opening pressures.

Furthermore, while the ministries have the technical expertise in their specialized fields, they may not have the capacity or capability to analyze the impact of liberalization in their sector. Some sub-sectors are better equipped and may have their own development plans, including a plan for progressive liberalization, such as the financial and capital market development. Given the heterogeneous nature of services and their differing capabilities to handle liberalization, liberalization in services in general tends to be cautious rather than bold and comprehensive across the four modes of delivery.

Government procurement

As other countries, Malaysia has long used government procurement to further the development needs of the country. In Treasury (or implementing agency) circulars to all government bodies, it is clearly stated that Bumiputera suppliers, producers, works and other providers, as well as members of the Malay Chamber of Commerce for government contracts, should be preferred.[43] However, the same applies to domestic providers, without any ethnic conditions attached. It is therefore not surprising that Malaysia is *not* a member of the Plurilateral Agreement on Government Procurement. Malaysia has also used its negotiating capacity to form a coalition with other developing countries such as India, Pakistan and China to resist the inclusion of a multilateral agreement on government procurement in the protracted negotiations under the Doha Round. This coalition appears to have succeeded in suspending indefinitely all work on negotiating for such an agreement.[44] Malaysia has also managed to negotiate the exclusion of a chapter on government procurement in the bilateral FTAs that have been concluded thus far, as there is concern that such a commitment would curtail the government's ability to use the Bumiputera Vendor Development Program, including procurement from GLCs, to fulfill the country's affirmative actions.

[43] McCrudden, C. and Gross, S.G. (2006). WTO Government Procurement Rules and the Local Dynamics of Procurement Policies: A Malaysian Case Study. *The European Journal of International Law,* vol. 17 no. 1: 151-185.
[44] McCrudden and Gross (2006), op. cit, 184.

McCrudden and Gross[45] also highlighted abuses in the implementation of the preferential policy as it has been used as an avenue for rent-seeking behavior. For example, Bumiputeras awarded contracts by the government may sub-contract their project to non-Bumiputeras.[46] Bumiputeras therefore act as middle-men who collect rents, based on the affirmative action policy. Mahani (2011) claims that these practices were more rampant in the early days of the NEP and have become less common in recent times. But there is no published robust research-based evidence to support or refute her claims. Rent-seeking clearly compounds the difficulty in opening up government procurement in FTA negotiations.

NGOs and civil society also oppose the inclusion of government procurement in the prospective agreement with the EU. They are concerned with the potential impact on Malaysian small and medium enterprises (SMEs). The Third World Network (TWN), for example, claimed that Malaysian SMEs benefit from closed government procurement via programs such as the Vendor Development Program, including procurements from GLCs.[47] TWN further asserted that government spending on government procurement in the domestic economy would help the economy to recover faster during recessions due to the multiplier effect. Hence, opening government procurement to foreigners would reduce domestic spending and the touted beneficial multiplier effect. Despite the lack of substantial empirical evidence to back these claims, the TWN is deemed to be a research-based NGO in trade policy advocacy,[48] with a clear anti-liberalization stance. There is unfortunately no documented evidence on the extent to which it influences trade policy formulation in the country.

Hence, it does not seem likely that a substantive government procurement chapter can be concluded in any FTA negotiation given the great resistance within the government, vested interests and protests from civil society. A feasible government procurement chapter may just focus on transparency issues and have numerous caveats to cater to Malaysia's domestic requirements or an extended phase-out period.

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[45] McCrudden and Gross (2006), op. cit.

[46] Mahani, Zainal Abidin (2011). The New Economic Policy: Impact on the Private Sector. Private Sector and Economic Growth. In *Malaysia: Policies and Issues in Economic Development*. Kuala Lumpur: Institute of Malaysian and International Studies (ISIS).

[47] Third World Network (TWN) (2008). Preliminary analysis of the likely impact of a US/EU free trade agreement on Malaysian small and medium enterprises: www.ftamalaysia.org/file_dir/57172350648771a540fb2c.doc Accessed 13 July 2012.

[48] Mably, Paul (2006). Evidence Based Advocacy: NGO Research Capacities and Policy Influence in the Field of International Trade. IDRC Working Papers on Globalization, Growth and Poverty No. 4. IDRC, Canada.

Intellectual property rights (IPRs)

Malaysia is a signatory of WTO's Trade-related Aspects of Intellectual Property Rights (TRIPs) Agreement, which was concluded under the WTO, as well as a member of several international treaties related to IP, including the Paris, Berne and Nice Conventions.

NGOs such as the Consumers Association of Penang (CAP), a key national NGO, have campaigned against TRIPs Plus issues in FTAs. In fact, CAP along with 32 other NGOs forwarded a memo on 3 December 2010 to MITI expressing the NGOs' concerns about the impending MEUFTA negotiations.[49] In the case of IP, the memo used the example of an increase in the price of medicine in Guatemala after the inclusion of data exclusivity (DE) as a possible outcome for Malaysia in the event of a TRIPs Plus chapter in the prospective FTA with the EU. On 28 February 2011, a coalition of NGOs protested outside the venue of the second round of negotiations in Kuala Lumpur, because of the perceived negative impact on HIV patients of a potential reduction in accessibility to affordable HIV drugs, and the potential negative impact on the poor and the economy.[50]

MITI's response to the NGOs (which is undated and posted on the website of the ministry[51]) insists that "it is generally accepted that the provision of DE does not alter the accessibility of generic products in the country". It further asserts that the Ministry of Health has sufficient safeguard mechanisms in place to ensure that any negative impact will be minimized in the extremely rare situations where DE becomes crucial and may have an impact on the availability of generic products. Five safeguard measures are also listed on the website. The amount of information given in MITI's response to the NGOs on this issue is rather unusual as FTA negotiations and strategies in Malaysia are typically not disclosed nor debated in public.[52] Public consultations with all stakeholders are so rare that multiparty dialogues are recommended as the way forward for the future FTAs.[53]

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[49] FTA Malaysia (2010). NGO Memo to MITI on EU-Malaysia FTA and TPP. 3 December.
www.ftamalaysia.org Accessed 05 May 2012.

[50] www.twn.org Accessed 21 April 2012

[51] Ministry of International Trade and Industry (MITI) (undated). "Responses to the NGOs on Free Trade Agreements": www.miti.gov.my Accessed 22 April 2012.

[52] MITI does hold private consultations with stakeholders, such as the producers in the case of briefings to the Federation of Malaysian Manufacturers (FMM) and other business associations. According to MITI, NGOs are also consulted as part of the process. These consultations may not garner much input from the private sector as they have limited capacity and time to research the issues. Nor do they guarantee that the input will be taken into consideration in the final output.

[53] Wan Khatina Nawawi et al (2010). Conclusion. Ch. 10 in Wan Khatina et al, *Complexity of FTAs*. Kuala Lumpur: Khazanah.

Another concern is the potential negative impact on local manufacturers that are essentially generic drug producers.[54] In its response to the NGOs, MITI also claims that there will be additional safeguard measures during implementation that will effectively address the concerns of the local generic industry. MITI's painstaking response indicates that it is prepared and ready to undertake and work out the difficult IP issues involved in the proposed MEUFTA.

[54] www.ftamalaysia.org Accessed 05 May 2012; Ida Madieha binti Abdul Ghani Azmi (2010). TRIPS-plus Obligations through Free Trade Agreements. Chapter 8 in Wan Khatina et al, Wan Khatina et al. *Complexity of FTAs*. Kuala Lumpur: Khazanah.

Conclusion

Negotiations on a comprehensive FTA will not be easy. There are multiple stakeholders involved, while the complexity of the issues taxes the capabilities of developing countries to ascertain fully the potential benefits and costs. This is aggravated by the fact that Malaysia is constrained by lack of data and research support in providing empirically sound research-based guidance for policy-making; academia is not included in the negotiations, while there is limited research capacity within the government. More importantly, developmental goals and affirmative action can clash with the demands for reciprocal market access by partner countries. Concurrently, a small trading economy such as Malaysia's is keen to lock in its market access to other countries. The negotiated outcome therefore has to strike a balance between the economic and developmental needs of the country. This is particularly important where rules and regulations are imported into a country via its trade commitments.

The contesting interests highlighted in this paper are inevitable as the extensive scope of the proposed FTA will have a different impact on different segments of Malaysian society. NGOs and civil society, for example, oppose more palm-oil exports, in the interest of the environment and the land rights of the indigenous people, while the government is motivated to raise production to increase export revenues, and even more so when it is engaged in the business itself. Sensitive issues such as affirmative action for the Bumiputera community can only be resolved if longer timelines or caveats are permitted in the agreement. Including commitments related to the governance of a country has grave implications for the policy space, autonomy and sovereignty of the country. While some of these rules are deemed to be international or global best practices, which could facilitate domestic reforms in order to conform to such best practices, it is important for a developing country such as Malaysia to consider carefully domestic capacity and capabilities as well as readiness to implement such reforms.

In this regard, Malaysia has to be very clear on the importance of this FTA to the country. This, in turn, is determined by Malaysia's strategy and priorities in its engagement with the world. This is partly influenced by the strategies of other countries in the region, as these are Malaysia's strongest competitors. This can be seen in Malaysia's failed bilateral with the United States, where it was motivated by Thailand's efforts to negotiate a bilateral agreement with the US.

Without a similar FTA with the US, Malaysia was fearful of losing the American market to the Thais. A similar case can be made for the current proposed agreement with the EU. On the other hand, many economists have highlighted a shift in the global economic center of gravity from west to east. Malaysia's focus has always been in the ASEAN as well as the wider East Asian market. In this scenario, ASEAN agreements, including Malaysia's commitments in extra-ASEAN-wide agreements, will hold more weight than an agreement with the EU. The government must therefore choose and prioritize carefully the importance of an agreement with the EU as compared with other FTA agreements that are currently being negotiated, such as the TPP.

A clear mandate on the importance and priority of the FTA to the country will enable the negotiators to see how much might be sacrificed in order to reap the clearly targeted benefits of the FTA. Without such a mandate, it will be difficult for them to know how much to push for and how much to hold back.

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