

## *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.<sup>1</sup> 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 18<sup>th</sup> 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***

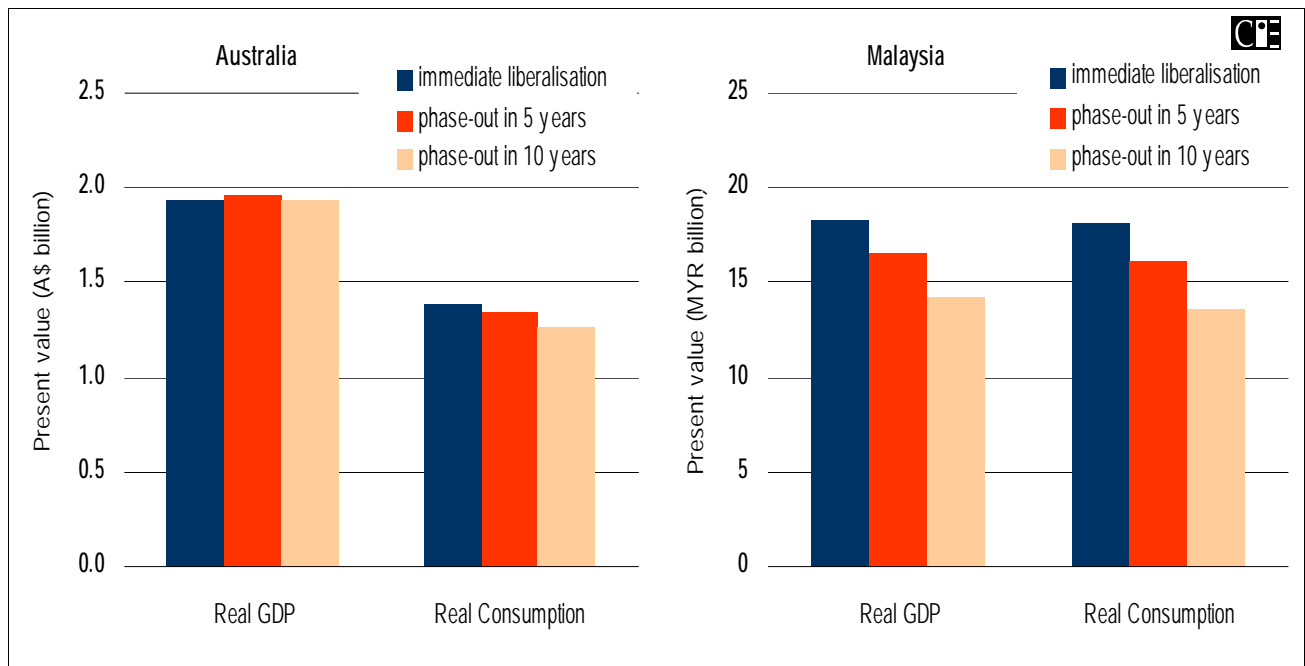
Australia's two way trade with Malaysia was valued at some \$8.6 billion in 2003-04. The trading relationship is highly complementary. Key Australian merchandise exports reflect Australia's strengths in agricultural and mining commodities, processed foods and metal-based and elaborately transformed manufactures.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

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<sup>1</sup> 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<sup>a</sup>



<sup>a</sup> 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 13<sup>th</sup> 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).<sup>2</sup> 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

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<sup>2</sup> 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.