

Malaysia: The Potential Effects of FTAs and the Role of Domestic Consensus

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1. What's New in the FTAs

The proliferation of bilateral free trade agreements (FTAs) in East Asian is a recent and new phenomenon. Before the late 1990s, the focus of economic liberalisation for East Asian countries, including Malaysia, was the multilateral trade process. It was not until 1992 when ASEAN reached a milestone agreement to establish a free trade area that finally regionalism in the form of FTAs came into prominence in the region. However, since the onset of the Asian financial crisis in 1998, many countries in the region have embarked on bilateral FTAs. Singapore led with a bilateral FTA with New Zealand, signed in 2000, and has since made five others, with Japan, European free trade area, Australia, Jordan and US. Now other countries have followed Singapore's initiative, and currently India, Japan, Thailand and Korea, in addition to Singapore, are the lead countries, with most number of FTAs. Many of the FTA initiatives in East Asia are currently under various phases of negotiation.

FTAs are being formed between many types of partners: between individual countries in the same region, between individual countries in different regions, between individual country and a regional grouping, between regional groupings, between developing countries or between developed and developing countries. The underlying reason for East Asian countries to choose this form of economic integration to is to generate higher economic growth. With FTA, the countries can regain their growth momentum (their economies suffered a severe downturn during the crisis), expand export market, attract foreign investment, drive domestic restructuring and open protected domestic sectors, reduce inputs costs for exports and make exports more competitive,

look for new markets and overcome the slow progress of liberalisation in WTO. A particularly important reason why countries got onto the FTA bandwagon is the fear of exclusion – without preferential treatment given by FTAs, countries may lose maintain competitiveness in export markets and become less attractive to foreign investment. Business lobby groups are also likely to pressure to improve market access for exports.

Apart from economic factors, strategic and political reasons are also considerations for forging preferential economic relations because they can be used as a reward for co-operation in non-economic matters or an endorsement of a strong relationship. Formation of FTAs can be seen as a way to improve trade relations, which in turn helps to strengthen confidence between neighboring countries. FTAs can be used to encourage competitive liberalisation by setting precedent for areas of economic interest for example in intellectual property rights, investment rules and govt procurement. In another aspect, an FTA could also be seen to have security issues as its objective. For example, the Singapore-US FTA is seen as part of the U.S. efforts in fighting terrorism in the Southeast Asian region.

Each FTA is custom-made and a product of negotiation between the parties. Earlier FTAs mainly promoted trade while the new ones have larger goals such as generating growth, facilitating investment and creating the enabling environment for growth. However, the main elements of FTAs are similar and focus on liberalization and facilitation of trade in goods and services through reduction of tariff and non-tariff barriers including customs procedures and mutual recognition of standards. It also involves wider and deeper liberalisation such as in investment. These “new age” agreements also encompass a closer or comprehensive economic partnership to enhance cooperation and collaboration work in areas such as capacity building, R&D, education and training, media broadcasting and tourism. However, it is the new areas, some of which are not included or are still in nascent stage in the WTO negotiation that are the main interest for further progress to be made in these FTAs arrangements. These areas include:

- i) Services sectors: significant liberalization is expected to be made both in the sectoral coverage and mode of trade in services. Besides the traditional

services sector such as banking and financial services, negotiations are focused on “new growth” services industries such as tourism, medical, professional services (legal, architecture, and management consultancy and courier delivery) and manufacturing related services.

- ii) Investment rules: negotiations are centered on reducing impediments to FDI such as increasing transparency of the investment regime, removing restrictions on foreign equity holdings, prohibition of performance requirement and equal or no less favorable treatment to foreign investors (National Treatment provision).
- iii) Intellectual property rights: commitments in FTAs are expected to go beyond WTO obligations. The primary concerns are on the effect of a more stringent IPR regime on society’s welfare such as public health and protection of biodiversity.
- iv) Government procurement: there is a lot of interest to open up this sector due to the large amount of business involved. The demand is for foreign companies to be allowed to bid for government contracts. At the very least, transparency of government procurement process should be improved.
- v) Electronic commerce: this area is a good example where FTAs can be the avenue to set new rules for trade where internationally recognized conventions has yet to be established. The agreement not to impose taxes on e-commerce transactions in some of FTAs could set the pattern for future global framework governing such activities.
- vi) Competition policy: countries are encouraged to introduce competition policy and normally the framework adopted is from developed countries. Many developing countries are not prepared to comply with such request because the legal requirements of the competition policy can be too rigorous and arduous and not suitable for countries in a lower stage of economic development.

The push to widen the scope of economic is evident in the concluded FTAs where the commitments have gone beyond the normal trade issues. For examples of these new areas of commitment are as follows:

- i. IPR: more demanding than WTO obligations, for example in the Australia-US FTA
- ii. Government procurement is included in the Japan-Singapore Economic Partnership Agreement (JSEPA)
- iii. E-commerce is included JSEPA
- iv. Competition policy is included US-Singapore FTA
- v. Labour standard is included US-Jordan FTA
- vi. Environment issues is included US-Singapore FTA
- vii. Movement of natural persons is included in the US-Singapore FTA for professionals and for non-professionals in the Australia-Thai FTA
- viii. Legal services and telecommunication is included Australia-Singapore FTA

2. Malaysian Economic Structure

Malaysia views the context of the FTA policy in light of the structure of its economy, namely it is a small open economy but with a relatively reasonable size domestic market. Its reliance on trade cannot be over-emphasized and thus it needs to be competitive. At the same time, Malaysia has sensitive sectors as well as important social considerations. The rapidly changing global and regional conditions require Malaysia to response in a timely and strategic manner. The global environment is becoming more competitive and the scope of trade, particularly trade, is expanding rapidly. FTAs, if used strategically, can be a tool to enhance Malaysia's competitiveness and economic growth. Yet, the FTA path should be consistent and complementary with Malaysia's other international commitments.

Malaysian Economic Growth

| | | |
|---------------|---|------|
| Average 1970s | : | 7.5% |
| Average 1980s | : | 5.8% |
| Average 1990s | : | 7.1% |

Structure of an economy and its commitments to liberalisation are critical factors that determine the approach and options for a FTA. Thus, it is essential to analyse the structure of the Malaysian economy and its existing multilateral, regional and bilateral trade agreements in order to explain the country's likely stance towards economic integration and liberalisation. Malaysia is an open economy where trade constitutes a very significant role and a key driver for economic growth. As an indication of its integration with the global trading system, Malaysia is a member of WTO and other international organisations, ASEAN as well as bilateral arrangements. Notwithstanding this openness, Malaysia does have a few protected sectors and sensitive areas that influence its options for a deeper liberalisation.

For 30 years Malaysia has industrialised rapidly, transforming itself from an economy based on agriculture into one that is dominated by manufacturing and services. Table 1 give a snapshot of the transformation of the Malaysian economy. In 2004, manufacturing accounted for 30% of the nominal GDP while the share for services was 53%, agriculture 8%, mining 6% and construction 3%. The manufacturing sector tends to raise its share of GDP during export-led economic upturns. On the other hand, the share of services sector grows in a more stable manner.

In terms of degree of openness, the manufacturing sector is the most liberalised as seen by its trade performance and a liberal investment regime. Similarly, the agriculture sector is quite competitive and its exports do not enjoy any subsidy. In comparison, the services sector is still relatively less open. In spite of this openness, there are a few sensitive sub-sectors: for example automobile and steel industries in the manufacturing sector and rice and poultry in agriculture.

International trade has played a crucial role in Malaysia's economic development, starting with early export of rubber and tin. Figure 1 shows the structural transformation of Malaysian exports. During the 1970s industrial development was mainly based on export-oriented manufacturing processing and value adding on imported inputs. The two most prominent manufacturing industries that were developed based on this pattern were the electrical and electronics and textiles and wearing apparel industries. The structure of primary commodity exports also changed where since mid 1980s exports of palm oil had replaced the declining exports of rubber and tin.

Exports of manufactured goods accounted for 78% of Malaysia's total exports in 2004 while 14% was by primary commodities. The share of manufactured goods in total exports soared during the 1980s and 1990s from a level of 20% in the late 1970s. Export of electronic and electrical goods formed about 70% of manufactured exports in 2004.

The stronger export performance as compared to imports has produced large trade surpluses: in fact monthly trade balance has been positive since early 1998. Trade balance had reached its peak in 1999 when it registered a surplus of US\$5.9 billion and since then it has been declining. In contrast, the services account has been persistently in deficit. The two largest sources of the deficits are by-products of Malaysia's successful industrialisation: a deficit on investment income, mainly as a result of repatriation of profits by FDI and a shortfall on services associated with merchandise trade, namely insurance and freight. Fortunately, the strong trade balance was able to compensate the services account deficit and thus produced a healthy current account position. The current account registered its largest surplus since early 1990s in 1999 (US\$12.6 billion)

The US remains Malaysia's largest export market, with a share of 18.4% of total trade in 2002. Japan is the country's second largest trading partner with a 14.2% share of total trade as well as Malaysia's principal source of imports. EU is increasingly becoming an important export market: total trade with EU was 11.9% of the total trade in 2001. Trade with ASEAN countries has grown rapidly when it reached 24.4% of total trade in 2002. In particular, Singapore has remained to be a major trading partner: in 2002, it

was the second most important export market and third in terms of imports. However, the actual trade with Singapore may be smaller due to its role as an entreport. The biggest change in trade partners came from the rapid rise of China. China was Malaysia's fourth largest single trading partner in 2002, with a share of 5.6% of total trade. Exports to China grew by 26% in 2001, when exports to other destination fell.

Malaysia has a relatively well-developed financial sector. Banks, which include the central bank; commercial banks; merchant banks and discount houses, account for two-thirds of the sector in terms of assets. Non-banks financial intermediaries, which include provident, pension and insurance funds; development finance institutions; savings institutions; and other financial intermediaries such as unit trusts, building societies, leasing, factoring and venture capital companies form one-third of the total sector. Foreign banks also have a substantial presence where they owned about 22% of the total assets of the banking sector. Under a ten-year Financial Sector Master Plan, launched in March 2001, the first phase of financial sector development focuses on the building of domestic banking capacity through consolidation of financial institutions. From 71 institutions before the Asian crisis in 1998, the merger programme resulted in ten domestic banking groups with 30 banking institutions. The second and third stage will involve the progressive liberalisation of the financial sector. In addition, the Capital Market Master Plan (CMMP) was also announced in February 2001, setting out the strategic position and future direction of the domestic capital market. The major objectives of the CMMP are to make Malaysia the preferred market for raising capital, to promote effective fund management industry and a conducive environment for investors; to create efficient institutions in a competitive market environment; to ensure stricter regulation; and to establish Malaysia as an international centre for Islamic finance.

Large inflow of FDI and high domestic savings have financed and sustained Malaysia's rapid growth over the last 20 years. The FDI inflow reached a peak of 8.7% of GDP in 1992-93 but has declined sharply since the Asian crisis: in 2000, FDI inflows stood at 4.2% of GDP in 2000, were barely positive in 2001 and recovered in 2002 but

only to about 3% of GDP. Besides political stability, attractive incentives and open investment policy for the manufacturing sector were among the key attractions for FDI.

A notable feature of the Malaysian development experience was that growth was achieved with equity. In other words that the fruits of economic growth had been distributed well and a large portion of the population has shared these benefits. Considering that Malaysia is a multi-racial society – in 2004, 60% of the population made up of the Malay/Bumiputera (indigenous), 28% Chinese, 9% Indians and the rest others – the distribution achievement is particularly remarkable.

Malaysia has introduced the New Economic Policy (NEP) in 1970 following a racial riot when the Bumiputeras and Chinese groups were unhappy with the then just concluded election result. In 1969, the Chinese had increased the number of seats on in the parliamentary and state elections. As a consequent, the Bumiputeras felt that they were losing political power while their economic position has not improved. On the hand, the Chinese wanted a larger say in the political and economic management of the country with their increasing political representation.

The New Economic Policy had two thrusts: first, the eradication of poverty regardless of race and second, the restructuring of society so that economic activities would not be identified with race. In order to achieve the second thrust, quantitative targets were set: by 1990, the Bumiputeras should hold 30% of the corporate equity, the non-Bumiputeras 40% and foreigners 30%. (In 1969, more than 60% of corporate wealth was held by foreigners with the Bumiputeras holding less than 2%). In addition, it was stipulated that 30% of employment is reserved for Bumiputeras.

Some of these targets have been achieved. The incidence of poverty has been dramatically reduced from 49% in 1970 to 5% in 2002. However, the targets for the restructuring of society were not fully attained: Bumiputeras corporative equity holding was only 18% in 2002. In view, of these shortfalls, a new policy, the National Vision

Policy, was introduced to replace the NEP. The National Vision Policy contains the targets of the NEP but there was no timeline set for the achievements of these targets.

This “social contract” is an important consideration in the Malaysia economic policy framework and management, especially the issue of equity ownership. Thus, it is a critical consideration in the liberalisation initiatives taken in the Malaysian multilateral and bilateral trade agreements. The overarching consideration is that liberalisation commitments must be designed in the context of a balanced development to produce sustainable high growth, which fulfill the national objectives. As such the formation of domestic consensus and consultation with the various interested parties and stakeholders is a necessary part of the process of multilateral and bilateral agreements

3. Malaysian Trade Policy

As an open economy Malaysia has a liberal trade policy. Trade liberalisation is conducted through the WTO process and is complemented by regional and bilateral agreements. Presently, the average bound tariff is 14.9% and 65% of tariff lines are bound. Malaysia continues to review its tariff rates and has introduced autonomous liberalisation for example in health services and education sectors. For the services, efforts are being made to gradually liberalize the sector. Foreign participation is allowed subject to conditions such as ownership rules of up to 70% limit of foreign equity holdings, commercial presence through joint ventures and limitation on the number of foreign personnel.

a) WTO

Malaysia is a founding member of the WTO by virtue of its membership in the GATT since 1957. Malaysia is able to adhere to its WTO obligations as it has:

- Subscribe to multilateral trading rules as a member of the GATT;

- Continuously been undertaking voluntary reduction and tariff elimination (autonomous liberalisation) to enhance Malaysia's competitiveness; and
- Adopted open and transparent trade policies and measures over the years.

For trade in goods, a majority of tariff lines is bound at 30%.

In the General Agreement on Trade in Services (GATS) Malaysia offers a total of 64 activities - 20 activities in financial sector and 44 activities in non-financial sector. The commitments made are in the following activities : Business services, financial services, education, health, tourism, and Professional services (accounting, legal, integrated engineering, architectural and engineering services, construction and related engineering services).

These GATS commitments was made on the basis of standstill position when Malaysia entered into the agreement in 1994, that Horizontal commitments of maximum 30% foreign equity allowed in commercial presence (Mode 3) and land acquisition and for movement of natural persons (Mode 4) is subjected to restrictions on intra-corporate transferees.

b) **ASEAN Free Trade Area (AFTA).**

AFTA is Malaysia's existing FTA commitment at the regional level. The primary objective of AFTA is to enhance ASEAN's position as a competitive production base producing for both the regional and global markets. This is to be achieved through promotion of intra-ASEAN trade and industrial linkages, specialisation and economies of scale, and promoting the region as an efficient and competitive production base for investments. AFTA has three component programmes:

- **Common Effective Preferential Tariff (CEPT):** this tariff reduction schedule for manufacturing, processed agriculture and non-processed agriculture goods was signed in 1992. The target is to achieve tariff between 0-5% in 2003 for the

six original member countries, 2006 for Vietnam, 2008 for Lao PDR and Myanmar and 2010 for Cambodia. Quantitative restrictions and other non-tariff barriers will also be eliminated.

In 2003, for ASEAN-6, a total of 44,361 or 98.80% of total tariff lines (products) are in the Inclusion List, which mandated the tariff to be reduced to 0-5%. Out of this, 99.55% have duties between 0-5%.

Country Breakdown – ASEAN-6

| | | |
|-------------------------|---------------------|----------------------|
| Brunei - 99.18% | Indonesia - 100% | Malaysia - 99.26% |
| Philippines - 98.81% | Singapore - 100% | Thailand - 99.92% |

Although the CEPT scheme is almost fully implemented, there are a number of products, primarily automotive where the liberalisation was slower.

- **ASEAN Framework Agreement on Services (AFAS):** signed in 1995 for freer trade in services. It is aimed at enhancing co-operation in the service sector among member economies by eliminating intra-regional trade restrictions and expanding the scope of liberalisation in services beyond those already undertaken under the GATS. In other words, the AFAS commitments are envisaged to be “GATS-plus”. Under the AFAS, initial negotiations focused on five sectors - financial services, transport, telecommunications, tourism and professional business services.

In the 3rd Round of Negotiations under Common Modified Sub-sector Approach held in March 2004, member countries had considered an improvement in

commitments to expand 7 sectors onto the fast track programme and make commitments for additional 27 sectors.

- **ASEAN Investment Area (AIA):** signed in 1998 governing investment liberalisation. The establishment of AIA is expected to encourage investors to think increasingly in the regional terms and adopt a regional investment strategy and network of operations. The scheme aims to promote a more efficient division of labour and industrial activities across the region, creating opportunities for greater industrial productivity and cost competitiveness.

4. Malaysia's FTA Initiatives – Joining in the Fray

In addition to the existing multilateral and regional trade integration agreements, Malaysia is also embarking on new bilateral and regional FTA initiatives as shown in Table 2:

i) **The Malaysian-Japan Economic Partnership Agreement.**

On 11 December 2003, Malaysian and Japanese leaders agreed to commence formal negotiations on a bilateral economic partnership between the two countries. Currently in the two countries are in the third round of negotiations. The main elements in the Agreement are:

- Liberalisation, facilitation and cooperation measures;
- Flexibility in dealing with sensitive sectors;
- The FTA component will include industrial and agricultural goods, services trade, investment, rules of origin, standards and conformance, small and medium scale industries, customs

procedures, safeguards, enhancement of business environment and dispute settlement; and

- Cooperation areas will include education, human resources development, ICT, R&D, and science and technology.

ii) ASEAN - China FTA:

The Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China was signed in November 2002. The agreement is to be implemented within the next 10 years and ASEAN domestic industries are expected to be able to take advantage of the massive Chinese market. Some key features of this agreement are:

- It will enter into force on 1 July 2003.
- Includes an early harvest package covering Chapters 1-8 (agriculture products such as live animals, meat and meat products, fish, dairy produce, other animal products, live trees, edible vegetables and edible fruits and nuts) of the Customs Harmonised System and selected specific products beyond those chapters (palm kernel oil, vegetable fats and oils, margarine, cocoa products, coffee, soap, stearic acid, erasers and glass envelopes)
- Contains guidelines for negotiating an FTA in goods, services and investment
- Identifies other areas for economic cooperation
- Sets the timeframes and deadlines to negotiate specific arrangements to implement the Framework Agreement including provisions on dispute settlement

iii) **ASEAN - Japan FTA**

While engaging separately with a number of ASEAN countries, Japan is also initiating the Framework for Comprehensive Economic Partnership (CEP) between ASEAN (as a group) and Japan, which was signed in October 2003, in Bali Indonesia. The Work Programme includes:

- Trade and investment facilitation and liberalisation
- Cooperation in other areas, such as science and technology; HRD, SMEs, ICT, tourism and hospitality; transportation and logistics; and energy.
- CEP to start in areas where implementation is feasible such as technical assistance and capacity building, trade policy and business sector dialogue, and facilitation of business mobility.
- Two track process is envisaged for FTA negotiations: first, the bilateral FTAs between Japan and selected ASEAN countries with a common set of rules of origin and second, a region-wide CEP to be implemented by 2012

Negotiation of ASEAN-Japan FTA will begin in April 2005

iv) **Trans Regional EU-ASEAN Trade Initiative (TREATI)**

In April 2003, ASEAN and EU Ministers had agreed to work towards the establishment of TREATI to enhance ASEAN-EU economic partnership. The main areas of cooperation include trade and investment facilitation and promotion, technical barriers to trade, sanitary and phytosanitary (SPS) measures, customs, and tourism.

The roadmap for the implementation of TREATI includes the identification of priority sectors and activities by end of March 2004,

and finalization of detailed work programme in each area by end of June 2004. The implementation of TREATI could pave the way for a future preferential trading agreement between ASEAN-EU

v) ASEAN - South Korea FTA

Negotiations will begin in 2005.

vi) ASEAN-India FTA

Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India was signed in October 2003. Main elements of Framework Agreement provides for negotiations to establish FTA in goods, services and investment, contains an early harvest package on goods and trade facilitation measures, and identifies areas for cooperation activities aimed at capacity building.

vii) Malaysia-US Trade and Investment Framework Agreement (TIFA)

Malaysia signed a Trade and Investment Framework Agreement (TIFA) with the US in May 2004, a precursor for a possible free trade agreement (FTA) between the two countries. TIFA will provide a forum and opportunity for bilateral dialogues and consultations in the area of trade and investment between both countries, thus enhancing commercial relations. It is expected to increase the private sector confidence in Malaysia as an attractive investment destination and trading partner.

vii) Malaysia- Australia, Malaysia-New Zealand, Malaysia-Korea and Malaysia-India

Under study

5. Potential Impact of FTAs for Malaysia

In assessing the impact of a closer economic integration arrangement, a number of factors need to be considered. Although the Malaysian economy has made tremendous progress, it has to move up the value chain for the manufacturing sector and further develop the agriculture and services sectors in order to achieve a sustained high growth. There lies the question of the role of trade and investment policies in contributing to the development of the Malaysian economy. For industries and activities that are not fully ready or still at the nascent stage of development, the pace of liberalisation should be considered carefully. The progressive liberalization, the approach adopted by the WTO, takes into account the objectives of national policies and sensitive areas. Another important consideration is the building of economic fundamentals for future growth, namely capacity building and the advancement of SMEs and R&D capability. Yet, the focus on domestic priorities has to be counter check with the external developments. The world economic climate is becoming much more competitive and policy differentials between nations are becoming narrower. Moreover, the web of FTAs that are emerging may create new production and trade network and regime in Asia.

Like most developing countries, Malaysia also has some concerns associated with a rapid and deep liberalisation of its economy. The uneven level of playing fields between FTA partners has major implications on the outcome of the agreement. These include the readiness of industries for liberalisation, capacity and information about industries and adjustment problems e.g. unemployment and displacement of domestic producers. Effectiveness of the commitments must also be measured against the implementation capacity and enforcement mechanism readiness. Among the greatest

concerns of developing countries about FTAs is the possibility of encroachment of the agreement commitments on domestic policies. Another key concern is the treatment of sensitive sectors: liberalisation for economic efficiency should be balanced with responsibility to serve their developmental objectives. The outcome of the agreement will depend, to a large extent, on the complementarity of partners' economies, country specific assets and negotiating capacity. As such the attributes of the FTA partners are an important consideration.

Economic impact

Generally the impact of an FTA on the Malaysian economy is expected to be positive because it is a very open economy, with only few sensitive sectors and has benefited from its participation in the global economy. Liberalisation can produce higher economic growth, create employment and increase income. The manufacturing sector has a low tariff regime and has liberalised fully the equity condition where foreigners are allowed full ownership in the manufacturing sector. The remaining few protected industries, namely automotive and steel, will reduce their tariff rates progressively under the AFTA scheme. It is important the liberalisation for the sensitive sector be done gradual to minimise unemployment and loss of business for suppliers, vendors and sub-contractors. Further liberalisation is likely to induce greater restructuring to increase efficiency and competitiveness. As a result Malaysia may be better able to position itself in the regional and global production network. The initial adjustments in terms of loss of employment can only be compensated when the sector enjoys rapid growth because of increased competitiveness.

Similarly, the impact on the agriculture sector is likely to be minimal because the primary commodities do not receive any protection. Protection is only for selected agricultural activities such as rice and poultry due to reasons of food security. The agriculture export products such as palm oil and rubber received no protection, incentives or subsidy. If tariff on agriculture exports can be reduced especially in developing

countries, Malaysia will enjoy a significant gain and the sector can continue to grow and provide jobs.

The impact on export competitiveness can also be positive. The preferential treatment received will maintain or improve competitiveness through better market access. Cheaper imported inputs can lower the costs of production and in turn increase welfare of the general public and enhance export competitiveness. The opening of the economy can increase competition in the domestic economy and consequently improve efficiency and competitiveness. These can culminate in Malaysia as an attractive investment location.

At the same time, any FTAs agreement will also have its down side. Too deep or too fast opening up of sensitive sectors will result in serious structural adjustment problems such as higher unemployment and loss of productive capacity. Similarly, rapid liberalisation of the services sector may marginalize local services suppliers who are less competitive as compare to foreign services providers, who operate at a larger scale and with well-established operations. There is a possibility that the dominance of foreign services providers may crowd out the local ones. Services exports also may not be able to expand strongly if the FTA agreements do very little to address the issues relating to the movement of people. The expected growth may be insufficient to compensate for these losses. For agriculture exports, there may not be significant increase if tariff reduction is not substantially be accompanied by the assistance to meet the health and other technical standards.

Social impact

The social impact primarily has to deal with the potential threat of unemployment. Although some industries may enjoy high growth and improved competitiveness, there are those that experience business closure and rising unemployment. Another consideration is the removal of performance requirements on foreign investment may

have the most serious impact of human resources development. Without these requirements such as the transfer of technology, efforts to improve workers' skills may be hampered. If there are no requirements that some senior posts be allocated to locals, there is the likelihood that local managers could never get the experience to improve their management skills. Too burdensome IPR commitments that go beyond the WTO mandate may be detrimental to the public through, for example higher costs of medicine. For developing countries like Malaysia with a lower per-capita income, too heavy commitments may increase the costs of good and services beyond the reach of the general public.

Malaysia's objective in embarking in an FTA is not only to enhance economic efficiency through liberalisation and improvement in market access but also to achieve a more comprehensive and closer socio-economic relationships and to strive for a balanced outcome. Ensuring that cooperation forms a critical element of the agreement is essential for human resources development because the main element in cooperation is capacity building, involving training, skills improvement and educational exchanges. Competitive FTAs can create confusion among businesses as a result of different regulations and rules of origin contained in the many FTAs. Developing countries usually have weaker negotiation capacity and this may limit their capability to get the maximum outcome from these agreements. Most of all, FTAs must be designed as building blocks for the multilateral trading system.

6. Role of Domestic Consensus

The real impact of FTAs will fall on industries, companies, workers and the general public. Therefore, building a domestic consensus is critical if we were to ensure a balanced outcome of an economic integration arrangement that will improve the well being of the society.

Who are the parties that form domestic consensus?

They are the groups that represent the human interests and industries in formulation of trade policy at national and international levels:

- a) Industry groups – the issue of interest to these groups is growth and viability of industries and economic activities. If the private sector is not fully engaged in the FTA process, it is feared that they may not be unaware of the full implication of FTA liberalisation. In this way, the private sector may not be fully prepared for the eventual changes that will happen and the adjustments required. For example, in the case of entry of foreign-owned hypermarkets, there are concerns that domestic retailers may be displaced with the mushrooming of these hypermarkets. On the positive side, if the industry is fully engaged, the local SMEs can be nurtured to be suppliers to these hypermarkets and in the end through this channel become global suppliers. Therefore, it is important to consult the industry groups to know their interests and concerns.
- b) Union of workers – this group is likely to be most affected and their main concern is employment. On the positive side, more jobs can be created if the FTAs can generate new investment and businesses. On the other hand, there can be significant loss of jobs if the FTAs resulted in relocation of industries from the country and/or closure of businesses. Another aspect of human resources relates to training and up grading of skills: the issues is whether FTAs reduce the govt ability to institute measures to upgrading of skills to keep up with economic restructuring.
- c) Legislators – legislators want to ensure a sustained, balanced and high growth and development for their constituencies. Legislators are members of the national legislative bodies, which are responsible to approving rules and regulations that govern their countries. As representatives of the people, legislators have the duty to ensure that commitments made at the international level are in line with the interest of the nation. Since trade agreements impose commitments and obligations on a country, legislators

should participate in the process of reviewing trade agreements to ensure that the interests of the country's citizens, the ones who will eventually feel the impact of the agreements, would be taken into account. On the other hand, liberalisation also has its benefits, primarily bringing faster economic growth and development and offering the opportunity to increase income. Legislators should ensure that any review of a trade agreement contains an assessment of both the benefits and concerns of their constituencies.

- d) Environmental groups – this group believe that economic liberalisation and the accompanying growth process, if done too fast and unplanned, can caused severe environmental damage. Thus, FTA agreements should adhere to environmental regulation for long-term sustainable development.
- e) Civil societies – these groups represent the interest of the general public. Primarily, these groups want to make sure that the outcome of the FTAs will benefit the people of the country. For example whether the costs of provision of services and public goods such as medicine will increase as a result of the FTA agreements

Developing Domestic Consensus

It is important that domestic consensus is developed if a government wishes to be aware of the likely reaction of its citizen and to get the people acceptance of the economic integration. The commitments made in the agreement are binding and can have major ramifications both in the short and long-term. Consultation with domestic consensus groups is essential before a negotiation position is formed. In this way the government can be evaluate the interests, concerns, flexibility and the impact of commitments made. Consultation should be made with:

- Industry groups to understand their interest that should be promoted as well as their concerns. At the same time, these consultation platforms can be the avenue

to explain the need to increase competitiveness through liberalisation of the economy.

- SMEs groups should be given special attention because they are the most vulnerable or the most flexible to move to more productive activities. Through these consultation processes, we can improve their potential for continued participation in the national economy as well as furthering their development and expansion.
- Workers groups to understand the economic activities that are most vulnerable to liberalization as well as the areas where employment opportunities can be expanded. The consultation process can also be utilized to get feedback on the design of programmes to effectively up-grade skills and job mobility
- Civil societies and environmental groups to consider and address their concerns. The broader and long term benefits of liberalisation and economic integration can also be explained

Legislators have a special role. In some countries, the ultimate approval of the commitments made in trade agreements lies with the legislators. In this case, they should have an early awareness about the trade agreements being negotiated and the implications to the country, both economic and strategic. Asian countries have participative legislative regimes where the democratic system allows discussion on trade policies that affect the economy and well being of the people. In this way, some stakeholders such as the business community and the civil society could voice their views on trade matters through their legislative representatives. However, in most countries, debates on the effects of trade policies are done after the agreements have been signed. It is not uncommon that the executive branch takes the lead in making decisions about trade policies and agreements before they are discussed or approved by the legislators. The ratification of trade agreements by the legislative body is normally a smooth process and does not demand extensive changes to the content of the agreement, which is already agreed by the executive branch.

The legislators also have another important role that is of understanding the obligations of the commitments made and in some cases the required legislative changes and perhaps even new laws. They also should be able to explain these changes and the impact of the agreements to their constituents.

The roles of the various groups in reaching a domestic consensus should be carried out in the context of the national development. The interests promoted by the domestic groups may not coincide with the principles of economic integration. For example, the labour groups are very concerned about the loss of jobs as a result of increased competition, which is the product of liberalisation of tariffs, a corner stone of any trade economic integration agreements. In general, if multilateral and bilateral trade agreements bring growth, then most of the issues raised by the domestic interest groups would be irrelevant because jobs loss and higher costs of products caused by more stringent intellectual property rights can be off set by an expanding economy and a rise in income. If, on the other hand, growth is minimal, the effects of the structural adjustments may be difficult to be absorbed by the society. However, even when there is growth, domestic consensus is still necessary as the fruits of economic integration may not benefit all sections of the society.

Hence, consultation alone may be insufficient. What is also important is the co-ordination of the domestic interest. In the Malaysian experience, this co-ordination is done at various levels. The various interests of the racial groups are discussed and agreed at the political level, for example in the long-term National Vision Policy (discussed in Section 2) which spelt out the formula of sharing the economic cake. Concerns of industries and labour groups are coordinated by the relevant ministries through periodical consultations. The voice of civil societies is increasing now becoming an essential mobiliser of public opinions and it functions as a channel to gather the public reactions and inputs to obligations made by trade agreements. The executive branch of the Government is usually the final coordinator of these various interests.

7. Conclusion

The proliferation of FTAs in such a short time will require both understanding of the issues involved and the effects of the commitments made. Many quarters are still unsure about the likely impact of these agreements. A positive outcome of FTAs that is an economic expansion and growth, will overcome some of concerns of domestic interest groups. Since these “new age” agreements cover liberalisation beyond the multilateral obligations, the views and inputs from domestic interest groups should be part of the broad consensus approach for FTAs.

There are national policies that should not be compromised, development goals to be achieved and economic efficiency to be gained. The outcome of trade agreements should be fair and can provide flexibility for Malaysia to continue its development policies. The WTO has put in place the framework to allow a liberalisation process that can accommodate the different stages of development among countries. In this respect, progressive liberalisation can provide adjustment period for domestic industries.

FTAs are preferential agreements that fast-tracked the global economic integration process, with potential major consequences. Hence, FTAs must take care of the interest of all parties, and produce a balanced outcome. Developing domestic consensus is an essential part of achieving this goal.