TRADE

KHAZANAH RESEARCH INSTITUTE

WHY TRADE MATTERS: PART ONE

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Note that throughout this report, terms that are in blue are defined in the glossary.

CONTENTS

BOX ARTICLES

FIGURES

TABLES

ABBREVIATIONS

AANZFTA	:	ASEAN-Australia-New Zealand Free Trade Agreement
AEC	:	ASEAN Economic Community
AFAS	:	ASEAN Framework Agreement on Services
AFTA	:	ASEAN Free Trade Area
AHAA	:	Australian Halal Authority and Advisers
ANZCERTA	:	Australia-New Zealand Closer Economic Relations Trade Agreement
ANZSCEP	:	Agreement between New Zealand and Singapore on a Closer Economic Partnership
APEC	:	Asia-Pacific Economic Cooperation
APSC	:	ASEAN Political-Security Community
ASCC	:	ASEAN Socio-Cultural Community
ASEAN	:	Association of Southeast Asian Nations
b	:	billion
BNM	:	Bank Negara Malaysia
CECA	:	Comprehensive Economic Cooperation Agreement
CEIC	:	Census and Economic Information Centre
CEP	:	Closer Economic Partnership
CER	:	Closer Economic Relations
CPI	:	Consumer Price Index
DOS	:	Department of Statistics, Malaysia
DSB	:	Dispute Settlement Body
E&E	:	Electrical and electronics
EC	:	European Commission
EFTA	:	European Free Trade Association
EPA	:	Economic Partnership Agreement
EPU	:	Economic Planning Unit, Malaysia
EU	:	European Union
FAO	:	Food and Agricultural Organisation
FOB	:	Free on board
FTA	:	Free trade agreement
FTAAP	:	Free Trade Area of the Asia Pacific
GATS	:	General Agreement on Trade in Services
GATT	:	General Agreement on Tariffs and Trade
GCC	:	Gulf Cooperation Council

ABBREVIATIONS

GDP	:	Gross domestic product
GP	:	Government procurement
GPA	:	Government Procurement Agreement
GVC	:	Global value chain
HDC	:	Halal Development Corporation
IIA	:	International Investment Agreement
IMF	:	International Monetary Fund
IO	:	Input-output
IP	:	Intellectual property
IPR	:	Intellectual property rights
ITA	:	Information Technology Agreement
ITC	:	International Trade Centre
ITO	:	International Trade Organisation
JAKIM	:	Department of Islamic Development, Malaysia
KRI	:	Khazanah Research Institute
LNG	:	Liquefied natural gas
LRT	:	Light Rail Transit
m	:	million
MAFTA	:	Malaysia-Australia Free Trade Agreement
MEP	:	Minimum export price
MERCOSUR	:	Southern Common Market
MFN	:	Most-favoured nation
MICECA	:	Malaysia-India Comprehensive Economic Cooperation Agreement
MIDA	:	Malaysian Investment Development Authority
MITI	:	Ministry of International Trade and Industry, Malaysia
MJEPA	:	Malaysia-Japan Economic Partnership Agreement
MNP	:	Movement of natural persons
MOH	:	Ministry of Health, Malaysia
MUI	:	Indonesian Council of Ulama
MUSFTA	:	Malaysia-United States Free Trade Agreement
NAFTA	:	North America Free Trade Agreement
NGO	:	Non-governmental organisation
NT	:	National Treatment
OECD	:	Organisation for Economic Co-operation and Development

ABBREVIATIONS

PMO	:	Prime Minister's Office, Malaysia
PTA	:	Preferential trade agreement
RCEP	:	Regional Comprehensive Economic Partnership
RIA	:	Regional integration arrangement
ROO	:	Rules of origin
RM	:	Ringgit Malaysia
RTA	:	Regional trade agreement
SACU	:	Southern African Customs Union
SME	:	Small and medium-sized enterprise
SOE	:	State-owned enterprise
SPS	:	Sanitary and phytosanitary
t	:	trillion
TBT	:	Technical barriers to trade
TIFA	:	Trade and Investment Framework Agreement
TiVA	:	Trade in value added
TPPA	:	Trans-Pacific Partnership Agreement
TTIP	:	Transatlantic Trade and Investment Partnership
UK	:	United Kingdom
UN	:	United Nations
UNCTAD	:	United Nations Conference on Trade and Development
UN DESA	:	United Nations Department of Economic and Social Affairs
US	:	United States of America
USD	:	United States Dollar
USPTO	:	United States Patent and Trademark Office
USSFTA	:	United States-Singapore Free Trade Agreement
USTR	:	United States Trade Representative
WEO	:	World Economic Outlook
WEF	:	World Economic Forum
WHO	:	World Health Organisation
WTO	:	World Trade Organisation

GLOSSARY

Beggar-thy-neighbour policies	:	Trade or economic measures, such as export subsidies, import quotas and tariffs, imposed with the aim of improving domestic economic conditions, such as raising employment, at the cost of other countries. Such policies may lead to other countries imposing similar measures in response. *Source: Goode (2003)*
Bilateral trade agreements or bilateral FTAs	:	Trade agreements made between two countries. *Source: Goode (2003)*
Capital goods	:	Goods used by manufacturers to produce other goods, instead of being bought and used by consumers. See also consumer goods, intermediate goods, and merchandise goods.
Closed economy	:	An economy which does not have any economic transactions with anyone outside of its borders. *Source: Deardorff (2006)*
Codex Alimentarius	:	The "food code", consisting of standards, codes of practice, guidelines, and recommendations for producing and processing food. It is administered by the Codex Alimentarius Commission. *Source: Deardorff (2006)*
Comparative advantage	:	A concept in international trade theory which says that countries can thrive by specialising in producing goods and services that they are comparatively better at, and then trading the products with other countries. This concept has been used as justification for promoting trade between countries. *Source: WTO (n.d.-a)*

GLOSSARY

Constant prices	:	Prices that have been corrected for inflation in reference to a base year. Also known as real prices. See also current prices. *Source: Deardorff (2006)*
Consumer goods	:	Goods that are bought and used by consumers instead of being used by manufacturers to produce other goods. See also capital goods, intermediate goods, and merchandise goods.
Current prices	:	Prices in the present, rather than in reference to a "base" year. Also known as nominal prices. See also constant prices. *Source: Deardorff (2006)*
Disposable income	:	Income minus taxes plus transfer payments (such as the *Bantuan Rakyat 1Malaysia*, BR1M); that is, the income available to be spent and saved. *Source: Deardorff (2006)*
Export quotas	:	Restrictions or maximum limits imposed by a country on the total value or volume of certain exports. They are designed to protect domestic consumers from temporary shortage of these products by ensuring that not too much of them are exported. Export quotas can also be imposed to improve the prices of specific products on world markets by restricting their supply. *Source: Goode (2003)*
FAO Food Price Index	:	A trade-weighted index that tracks the monthly changes in international prices of five major food commodities, namely, cereal, vegetable oils, dairy, meat, and sugar. The index is compiled by the Food and Agriculture Organisation (FAO) of the United Nations (UN). *Source: FAO (n.d.-a)*

GLOSSARY

Forum-shopping	:	Typically pursuing a dispute using one forum (such as pursuing a dispute using an FTA) after another until a favourable outcome is achieved. *Source: Goode (2003)*
Free trade agreements (FTAs)	:	Agreements between two or more countries in which Members of the agreements commit to reduce the barriers to trade amongst each other. *Source: Goode (2003)*
Government procurement (GP)	:	The purchase of goods and services by government. *Source: Deardorff (2006)*
Government procurement (GP) policies	:	The means and mechanisms through which government agencies purchase goods and services with public resources to fulfil their public service functions. In addition to fulfilling the public service functions, many governments use GP to attain other policy goals, including the promotion of particular local sectors or social groups. *Source: WTO (n.d.-b)*
Gross domestic product (GDP)	:	The monetary sum of goods and services produced domestically (that is, within the borders of a country). *Source: Deardorff (2006)*
Import quotas	:	Restrictions or maximum limits imposed by a country on the value or volume of certain products that may be brought into the country from abroad. Import quotas are designed to protect domestic producers from competition from lower-priced imported products. *Source: Goode (2003)*
Inflation	:	A general increase in the price level in an economy.

Intellectual property (IP) rights	:	These are legal rights that creators have over their creations, including exclusive rights over the use of his/her creations over a designated period of time. The IP rights can be divided into: (a) copyright and rights related to copyright – these are rights over literary and artistic creations, as well as rights conferred to performers and broadcasting organisations, (b) industrial property – which is further subdivided into two areas (i) the protection of distinctive signs (such as trademarks and geographical indications) to stimulate and ensure fair competition and to protect consumers, and (ii) the protection of IP that aims "to stimulate innovation, design and the creation of technology" (such as through patents, industrial designs and trade secrets). *Source: WTO (n.d.-c)*
Intermediate goods	:	An input to production that has itself been produced and that is used up in production. *Source: Deardorff (2006)*
Liberalisation	:	In the context of trade, this generally refers to the partial or complete removal of trade barriers. *Source: Goode (2003)*
Market access	:	The ability of the domestic producers of goods and services to enter a similar market in a foreign country. The accessibility of the foreign market generally depends on the existence and extent of trade barriers. *Source: US Department of State (2001)*
Merchandise goods	:	Goods that are bought and sold.

GLOSSARY

Multilateral trade agreements	:	Agreements between three or more countries. In the context of the World Trade Organisation (WTO), multilateral agreements have a specific meaning as agreements which are binding to all the WTO Members. See also plurilateral trade agreements. *Source: US Department of State (2001)*
Natural persons	:	Distinguishes humans from other entities such as companies, which are also legally defined as persons. *Source: Goode (2003)*
Non-tariff barriers	:	Measures that restrict exports other than tariffs such as import licensing and quotas. See also tariffs. *Source: Goode (2003)*
Plurilateral trade agreements	:	Agreements between several countries that are not necessarily in the same region. In the context of the WTO, plurilateral agreements are those which do not have to be signed by all WTO Members, in contrast to its multilateral agreements. See also multilateral trade agreements. *Source: Goode (2003)*
Regional integration	:	Broadly refers to the process of a grouping of countries seeking to reach a degree of economic integration such as through the harmonisation of various national policies or the adoption of policies that could reach a similar outcome. *Source: Goode (2003)*
Rules of origin (ROO)	:	Provisions that are included in an FTA and are needed to indicate the country of origin of goods. This is to determine what tariffs would apply to the goods, which would depend on whether the country of origin has a trade agreement specifying the tariff rate (if any). *Source: Deardorff (2006)*

GLOSSARY

Safeguards	:	Actions taken to allow countries to restrict imports if they cause injury. *Source: Goode (2003)*
Tariffs	:	Customs duties, or charges, on goods. Tariffs are usually imposed on imports, but are sometimes also imposed on exports. They are a source of income for the government. Import tariffs can become a form of protection for locally produced goods as the costs, and subsequently the prices, of similar imported goods are raised because of the tariffs. *Source: Goode (2003)*
Trade surplus	:	The amount by which the value of exports exceeds the value of imports. *Source: Goode (2003)*

MEMBERS OF KEY REGIONAL INTEGRATION ARRANGEMENTS

Asia Pacific Economic Cooperation (APEC)	:	Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, South Korea, Taipei, Thailand, the US, and Vietnam.
Association of Southeast Asian Nations (ASEAN)	:	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.
European Free Trade Association (EFTA)	:	Iceland, Liechtenstein, Norway, and Switzerland.
European Union (EU)	:	Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the UK.
Gulf Cooperation Council (GCC)	:	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

MEMBERS OF KEY REGIONAL INTEGRATION ARRANGEMENTS

North America Free Trade Agreement (NAFTA)	:	Canada, Mexico, and the US.
Regional Comprehensive Economic Partnership (RCEP)	:	Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, South Korea, Thailand, and Vietnam.
Southern African Customs Union (SACU)	:	Botswana, Lesotho, Namibia, South Africa, and Swaziland.
Southern Common Market (MERCOSUR)	:	Argentina, Brazil, Paraguay, Uruguay, and Venezuela.
Trans-Pacific Partnership Agreement (TPPA)	:	Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US, and Vietnam.

EXECUTIVE SUMMARY

In this report, we will examine how international trade and trade policy integrate the effects of globalisation into the domestic economy and our daily lives. This report is the first in a series of reports on international trade and trade policy. This report contains three chapters:

- Chapter 1: Measuring International Trade
- Chapter 2: Trade and Food Policy
- Chapter 3: Trade and Regional Integration

Why are international trade and trade policy important?
International trade and trade policy are important because they are enablers, integrating the effects of globalisation into the domestic economy, and consequently, affecting our daily lives.

Future work
This is the first report in the Khazanah Research Institute's (KRI's) publication series on international trade and trade policy, one of the key areas in the New Economy for Malaysia (NEM) work track. This publication series generally seeks to highlight and discuss the linkages between trade policies and other domestic policies. Apart from work on this publication series, we aim to analyse Malaysia's trade in value added (TiVA) and expand the discussion of the chapters of this report.

The data presented in this report is current as of 31 October 2015.

INTRODUCTION

INTRODUCTION

International trade has always been an important component in the economies of the Malay Archipelago. Despite this, the extent to which international trade affects our daily lives may not be fully appreciated by many of us.

For example, many of the products and services that we use and consume could be imported, from the basic personal grooming products and food items to the transportation equipment that takes us to work and the mobile phones, personal computers and laptops that we use at work. We could brush our teeth with the Colgate toothbrush made in Vietnam and toothpaste made in Thailand. For breakfast, we may eat *roti canai* made using flour imported from Australia, with *kuah dal* cooked using lentils imported from Sri Lanka. When we go to work, we may use the Light Rail Transit (LRT) network, with carriages supplied by the Bombardier Group in Canada. We could work on laptops manufactured in Taiwan; make phone calls from mobile phones assembled in China; and then relax by watching television shows produced in the US on television sets assembled in South Korea.

Equally important is trade policy, which sets the direction of international trade, specifically, and promotes and affects the economic growth, generally. For example, Malaysia has been studying, negotiating, signing, and enforcing free trade agreements (FTAs) both regionally through the Association of Southeast Asian Nations (ASEAN) and bilaterally with like-minded trade partners, ranging from Australia, India and Japan to Chile, Pakistan and Turkey. In total, Malaysia has signed 12 FTAs. Its current participation in the negotiations for Regional Comprehensive Economic Partnership (RCEP) Agreement and the recently concluded Trans-Pacific Partnership Agreement (TPPA), both dubbed the 'mega' or 'super' FTAs, highlights that the FTA trend is likely to remain, especially as the multilateral trade negotiations at the World Trade Organisation (WTO) are not making much progress. Unfortunately, there is little informed discussion amongst the Malaysian public on the implications of making commitments in such trade arrangements to our daily lives.

This report discusses three trade issues to raise awareness among our fellow Malaysians on the importance of international trade and trade policy as enablers integrating the effects of globalisation into the domestic economy. While readers may identify with some of the subject areas in the chapter on food, concepts such as measuring international trade as well as trade and regional integration may be more abstract. We highlight the key takeaways from these chapters below.

Key takeaways from Chapter 1: Measuring International Trade

International trade is an integral component of the Malaysian economy. Thus, it is important to truly understand and appreciate the size of international trade as an external sector and its contribution to our economic well-being. To do so, we need to understand how international trade is measured.

In 2014, Malaysia recorded a trade surplus of RM83b with a total export value of RM766b and total import value of RM683b[1]. These numbers represent the traditional method of looking at international trade and how much it contributes to the economy.

However, the emergence of the global value chains (GVCs) as the common mode of production, where intermediate goods are imported, processed and later re-exported, implies that not all of a country's value of export originates domestically. Thus, the global trend of unbundling in production and specialisation in tasks necessitates a reassessment of how trade data is collected.

Trade economists have proposed a new method to calculate trade and its economic contribution. Known as the "trade in value added" or TiVA in short, this new method is more refined as it measures the country's contribution to the production of goods and services, that is, the value added, instead of the value of goods each time they cross the national border.

This chapter discusses the different methods of measuring trade, both the traditional method of calculating gross trade as they cross the national borders and the new method of calculating TiVA. This chapter highlights our future research work in the area of international trade and trade policy, as work to calculate Malaysia's TiVA is still in its early stages, as is the case for many other countries.

[1] CEIC

Key takeaways from Chapter 2: Trade and Food Policy

The average Malaysian household spends RM444 or 20.3% of its expenditure on food per month[2]. Malaysia as a nation imported RM14b worth of primary food and beverage products as well as RM29b worth of processed food and beverage products in 2014[3]. As with many countries, Malaysia is vulnerable to the impact of international trade and trade policies for food. These policies play an important role in determining the supply and demand, and subsequently, the prices of food.

At the heart of the trade and food policy debate is the fact that the food sector is a strategic and sensitive sector for many countries, both developed and developing countries. Governments are not only concerned with their economic implications, as strong farmers' lobby groups and soaring food prices can contribute to social and political instability as evidenced in Japan, South Korea, Indonesia, and the Middle East.

Hence, it is not surprising to see governments developing and enforcing a diverse range of food-related trade measures aimed at protecting their food industries. This chapter highlights how these measures are intended to be positive interventions but may have negative results by becoming non-tariff barriers to trade in food and subsequently resulting in higher food prices.

Key takeaways from Chapter 3: Trade and Regional Integration

Globalisation promotes integration including at the regional level. As Malaysian citizens, we are also citizens of ASEAN, of which Malaysia was one of the five founding Member States. Established in 1967, now ASEAN has ten Member States.

[2] DOS (2011)
[3] CEIC

The previous chapters highlighted how Malaysia has been negotiating for and enforcing various FTAs. Malaysia aims to be a member of two mega FTAs – the TPPA and the RCEP. The negotiations for the TPPA recently concluded. This agreement covers 12 countries in the Asia Pacific region – Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US, and Vietnam.

In addition, together with the other ASEAN Member States, Malaysia is currently negotiating the RCEP Agreement with Australia, China, India, Japan, New Zealand, and South Korea. At the same time, ASEAN is also negotiating and enforcing various other FTAs at the ASEAN level.

If entered into force, the TPPA would cover a combined market population of approximately 806 million people and a combined GDP of USD27.98t (RM91.56t), while the RCEP would cover a combined market population of approximately 3.47 billion people and a combined GDP of USD22.58t (RM73.90t) based on the 2014 figures[4]. This chapter introduces the TPPA and the RCEP and briefly explains the ASEAN integration process both among its Member States and between ASEAN as a group and its other trading partners.

Other observations and future work

This is the first report in the Khazanah Research Institute's (KRI's) publication series on international trade and trade policy, one of the key areas in the New Economy for Malaysia (NEM) work track. Our future work will include analysing Malaysia's TiVA; expanding the discussion of the chapters in this report; and highlighting and discussing the linkages between trade policies and other domestic policies including on health services, the movement of people and labour issues, among others.

Finally, we hope this report will act as thought-starters for readers to appreciate the complexity of international trade and trade policy. We also hope this report will promote greater inclusivity of the stakeholders' views in shaping the policy agenda and design as their outcome will affect our daily lives.

[4] IMF (2015), CEIC

BACKGROUND

INTERNATIONAL TRADE AGREEMENTS IN TRADE POLICY

BACKGROUND

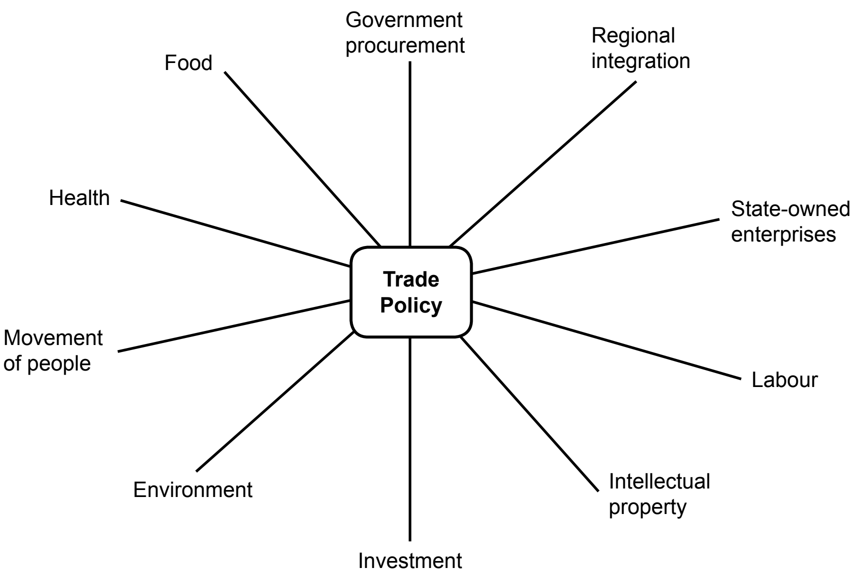
INTERNATIONAL TRADE AGREEMENTS IN TRADE POLICY

Why is this important?

Countries around the world, including Malaysia, propose, negotiate, conclude, sign, ratify, and enforce international trade agreements as part of their international trade policies. As mentioned in the introduction section of this report, the commitments made in these agreements could affect our daily lives including the type, quality, and quantity of the imported goods and services that we purchase and consume.

Additionally, international trade agreements usually incorporate commitments that affect non-trade domestic policies, some of which are highlighted in Figure 1. As such, it is useful to spend some time at the beginning to discuss the various types of international trade agreements currently in existence, why the government negotiates and enforces these agreements, and the components of these agreements with the issues they are trying to address.

Figure 1: Interactions between trade policy and other domestic policies



Various levels of international trade agreements

Trade liberalisation is a process in which countries remove existing barriers to trade in goods, trade in services, and investments in general. By doing so, countries open up their economies and encourage freer flow of trade with other countries, with the aim of promoting economic growth.

In line with this, countries enter into trade agreements with one or more other countries for the purpose of facilitating trade. In these international trade agreements, participants agree to reduce tariffs, quotas and other restrictions on trade between them.

Multilateral trade agreements

Most countries have committed to multilateral trade agreements, which they often use as the basis for their international trade policies. Currently, these agreements are developed and administered by the WTO, which was established in 1995. The WTO is considered the best platform for trade rules-setting in view of its large and diverse membership base. Currently, the WTO has 161 Members (accounting for at least 80% of countries in the world)[5], with the Seychelles being the latest to accede into the 'club'. See Box 1 for further information on the multilateral trading system.

Unfortunately, having a large and diverse membership base sometimes presents challenges, as it is difficult for members to achieve consensus in their decision-making.

The latest round of negotiations, known as the Doha Development Agenda (commonly referred to as the Doha Round), commenced in November 2001. Negotiations were originally set to conclude by 2005. However, to this day, negotiations are still ongoing, making it the longest multilateral trade negotiations round so far, surpassing eight years for the previous Uruguay Round.

One of the reasons for the slow process of negotiations at the multilateral level is that the WTO traditionally adopts a decision on a consensus basis, that is, only after all of its Members have agreed to it. With the WTO membership now in the hundreds, it is more difficult to arrive at a consensus, which has led to the negotiations for the Doha Round to be suspended several times since 2001.

[5] As of October 2015, there are 193 Member States of the United Nations. Source: UN (n.d.)

Box 1: The basics of the international trade regulation system

The need for an international trade regulation institution

In the aftermath of World War II, the international community was anxious to establish measures to prevent such a disastrous event from ever happening again. Many Western leaders shared the view that the key to achieving this goal was through establishing new international institutions to promote and regulate mutually-beneficial economic cooperation.

With this in mind, the leaders met at the Bretton Woods conference in 1944 and established the Bretton Woods Agreement. This agreement gave rise to the charters for establishing the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (which later became part of the World Bank). These institutions, also known as the Bretton Woods Institutions, were envisaged to promote international monetary cooperation, and long term financial and structural development.

The draft proposal for the creation of an international trade institution, known as the Havana Charter, came later in 1947, following negotiations involving 50 countries. This charter outlined the establishment of the International Trade Organisation (ITO), intended to regulate international trade relations. However, the ITO never became operationalised, largely as a result of the lack of approval from the US Congress to ratify the Havana Charter. Following this, by 1951, the US and subsequently other countries abandoned efforts to form the ITO[6].

The path from the ITO to the WTO

While the ITO was not established, another international trade instrument, known as the General Agreement on Tariffs and Trade (GATT), was gaining more traction, with 23 countries (including the US) agreeing to apply the terms outlined in the agreement by 1947[7]. Unlike the ITO, which required

[6] Lester et al. (2012)
[7] WTO (n.d.-d)

signatories to make commitments in sensitive issues such as labour standards and dispute settlement, the GATT was much less ambitious in its scope, focusing mainly on reducing tariffs. This made it easier for countries including the US to commit to the agreement.

The GATT was originally formed to serve as a temporary arrangement while the new ITO was being formed. But without the ITO, the GATT became the only multilateral instrument governing international trade, and as such, more countries decided to become party to it. It soon became necessary to expand upon the provisions outlined in the original GATT, particularly in light of its expanding membership[8].

From its establishment in 1947, the GATT had hosted eight rounds of multilateral trade negotiations. The final round, known as the Uruguay Round, concluded in 1994. This produced the Marrakesh Agreement, in which the GATT contracting countries agreed to the formation of the WTO, which was subsequently officially established on 1 January 1995. The Uruguay Round also produced the bulk of current WTO agreements, which outline rules and commitments that Members have to comply with, on a range of trade areas including trade in goods, trade in services, and intellectual property rights (IPR).

The main roles of the WTO

The WTO is a member-driven organisation, which means that decisions are not made by the secretariat, rather by the Members themselves.

The main aim of the WTO is to promote the reduction of barriers to international trade. As an organisation, the WTO has several functions, which include facilitating multilateral trade negotiations and handling trade disputes.

[8] VanGrasstek (2013)

Facilitating multilateral trade negotiations:

- Even when finalising the WTO agreements in 1994, it was clear to the Members that further negotiations would have to take place in the future to renegotiate and add to the WTO agreements.

- As such, one of the key roles of the WTO is to facilitate such negotiations between its Members.

Handling trade disputes:

- While the negotiating arm of the WTO has been suspended numerous times, its dispute settlement arm has remained active.

- The WTO's Dispute Settlement Body (DSB) acts as a platform for its Members to resolve trade quarrels, as part of the WTO's role for enforcing its rules to ensure that trade flows smoothly.

- Members may bring forward a dispute case to the WTO if they consider another Member to be infringing upon their rights[9].

- To date, Malaysia has only been involved in two WTO DSB cases:

    - Malaysia initiated a complaint against the US regarding the latter's ban on imports of shrimp from Malaysia[10].

    - Malaysia was the respondent to a claim brought by Singapore regarding Malaysia's prohibitions on the imports of certain chemical products (incidentally, the Singapore-Malaysia case was the first ever WTO dispute case)[11].

[9] WTO (n.d.-e)
[10] WTO (2015-a)
[11] WTO (1995)

Trade liberalisation: Means to an end

The WTO does not explicitly advocate for either free trade (in principle, the free movement of goods, services, capital, and labour)[12] or fair trade. In fact, the term "free trade" was not mentioned at all, either in the ITO or in the GATT, as negotiators at the time did not think of free trade as a realistic goal[13]. Although the WTO agreements and negotiations have been focused on trade liberalisation, the official objective for the WTO as outlined in the Marrakesh Agreement was to promote trade with the goal of encouraging development. This includes improving standards of living, ensuring full employment, and increasing the production of and trade in goods and services. As such, trade liberalisation in WTO negotiations is a tool for advancing development through trade, and not the final objective in itself.

However, there is another school of thought which advocates fair trade as a tool to advance the trade for development agenda. This school of thought argues that trade between developed countries and the less developed countries often happen along uneven terms, and thus should be made more equitable. Fair trade advocates for the application of the concept of a 'social premium' in trade and commerce, to take into account improvements in the production of goods, such as improved working conditions for the labourers. Fair trade proponents view the prevailing terms of trade between rich and poor nations as unjust because the prevailing market prices for the goods produced in developing countries are generally too low to reflect the actual compensation for labourers.

[12] Goode (2003)
[13] VanGrasstek (2013)

Multi-track trade policy includes bilateral and regional trade agreements

In view of the difficulties in negotiating at the multilateral level, many countries are shifting or have shifted their focus on negotiating and enforcing trade agreements at other levels: bilateral trade agreements between two countries; regional trade agreements between countries in the same region; and plurilateral trade agreements between many countries from different regions. Examples of these agreements include:

- **Bilateral**: The Malaysia-Australia Free Trade Agreement (MAFTA)
- **Regional**: The ASEAN Free Trade Area (AFTA) Agreement; the Trans-Pacific Partnership Agreement (TPPA)
- **Plurilateral**: The WTO Government Procurement Agreement (GPA); the WTO Information Technology Agreement (ITA)

Unlike in the WTO's multilateral trading system in which trade agreements involve all 161 of its Members, these agreements are between smaller numbers of like-minded trading partners. Bilateral, regional, and plurilateral agreements may have different depth and breadth of commitments. This is discussed further in Box 8 of Chapter 3.

As a start, countries may just commit to Trade and Investment Framework Agreements (TIFAs) setting the basic rules for trade and investment activities. They may eventually agree to have FTAs, which could address a range of issues including trade in goods and trade in services. For example, FTAs may theoretically commit participating countries to eliminate tariffs between them. In practice, however, FTAs often allow for an agreed upon set of exceptions to protect sensitive products.

An FTA may also be known by different terms such as an economic partnership agreement (EPA), closer economic relations (CER), and a comprehensive economic and cooperation agreement (CECA). The names highlight the agreement's content, which may be more than just trade liberalisation. See Table 1 for details and examples.

Table 1: Different types of international trade agreements

Variations of FTAs	Description	Example
Trade and Investment Framework Agreement (TIFA)	Precursor to a full-blown FTA.	Malaysia-US TIFA
Free Trade Agreement (FTA)	Basic agreement – greater market access for trade in goods and (some) services. But latest FTAs are getting more comprehensive.	MAFTA
Economic Partnership Agreement (EPA)	Basic FTA plus trade in services, investment and economic cooperation.	MJEPA
Closer Economic Partnership (CEP)		ANZSCEP
Closer Economic Relation (CER)		ANZCERTA
Comprehensive Economic Cooperation Agreement (CECA)	Basic agreement plus investments plus (economic and non-economic) cooperation issues.	MICECA

It is noteworthy that FTAs do not necessarily result in free trade – not all forms of trade restrictions are eliminated through FTAs. In addition, FTAs are essentially agreements between countries that result in countries reducing their policy space on some issues in exchange for expected benefits derived from the FTA. Thus, trade policy can sometimes be seen as a subset of foreign policy. FTAs are typically legally binding, thus allowing for the governments and sometimes the investors of Malaysia's trading partners to sue the Malaysian government for a breach of Malaysia's FTA obligations.

FTAs and the WTO

The WTO has flexibilities in allowing its Members to enter into FTAs, but maintains that these FTAs should complement and not threaten the multilateral trading system. In line with this, the WTO outlines specific criteria for its Members to enter into FTAs, as set out in these rules:

- Paragraphs 4 to 10 of Article XXIV of the WTO General Agreement on Tariffs and Trade (WTO GATT) allow Members to form unions and free trade areas covering trade in goods.

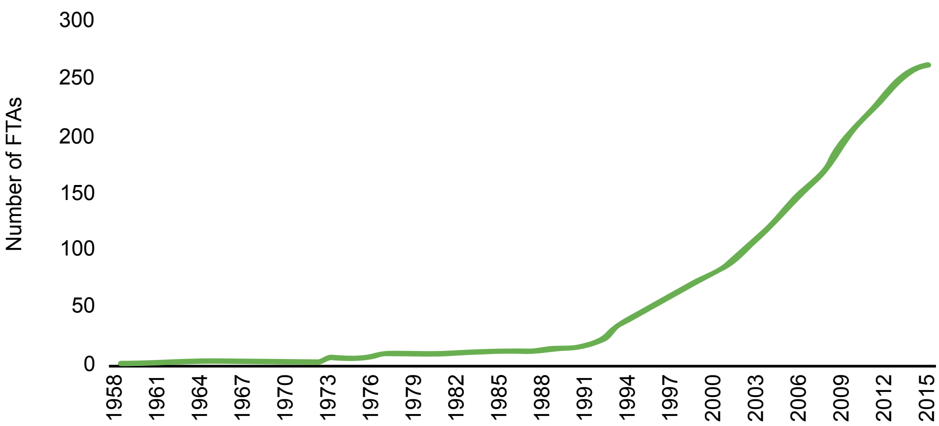
- The so-called Enabling Clause allows developing countries to receive preferential treatment from other WTO Members. As such, developed countries are exempted from the WTO requirement to comply with the most-favoured nation (MFN) principle. Thus, developed countries are able to give more favourable treatment to developing countries compared to other developed countries (see Box 2 for an explanation on the MFN principle). In addition, the Enabling Clause allows developing countries to establish trade agreements among themselves[14].

- Article V of the WTO General Agreement on Trade in Services (WTO GATS) allows Members to participate in FTAs covering the area of trade in services, for both developed and developing countries, provided that the FTAs fulfil specific conditions.

Most WTO Members have taken advantage of these flexibilities.

[14] WTO (1979)

Figure 2: Cumulative number of FTAs in force (by date of entry into force)



Source: Adapted from WTO (n.d.-f)

As can be seen in Figure 2, there has been an increased proliferation of FTAs, especially since the early 1990s. As of 7 April 2015, WTO Members have notified 449 trade agreements with 262 of these agreements currently in force. The WTO observed that most of these agreements are FTAs and partial scope agreements, that is, trade in goods or trade in services only agreements[15].

There are concerns that FTAs may result in fewer gains and benefits for their Members as compared to the WTO agreements as there are fewer countries participating in these FTAs. Additionally, there are views that the stricter and more comprehensive FTA rules may restrict the flexibility provided for the developing countries in the WTO agreements.

15 WTO (n.d.-g)

Box 2: Non-discrimination principles in international trade agreements

Non-discrimination is fundamental to the success of trading arrangements such as the WTO agreements or FTAs. There are two key non-discrimination principles incorporated into the WTO agreements and the FTAs – these are the most-favoured nation (MFN) and national treatment (NT) principles.

Most-favoured nation (MFN) principle

Trading partners that sign a trade agreement are generally not allowed to discriminate amongst the trading partners in that agreement – should a country grant special treatment to one trading partner, this must be extended to the other trading partners of the trade agreement. This principle can be applied in different areas:

- Not to discriminate between same (or similar) imported goods from different countries.
- Not to discriminate between foreign service providers from different countries.
- Not to discriminate between investments from different countries.

National treatment (NT) principle

Once foreign nationals, investments, and/or imports from other countries have crossed borders, trading partners that sign a trade agreement are required (with exceptions) to treat them no less favourably than they treat domestic nationals, investments and/or products[16]. This means that a country could positively discriminate by providing better treatment (such as incentives) to the foreign nationals or products as compared to its domestic nationals and/or products. This principle can be applied in different areas:

[16] For WTO agreements, this provision is outlined in Article III.4 of GATT 1994.

- Not to impose non-tariff barriers that protect the sale of local products as compared to imported products.
- Not to prohibit foreign services suppliers from providing services currently provided by domestic services suppliers.
- Not to impose licensing requirements that can only be fulfilled by domestic investors as compared to the foreign investors.

Exceptions to these principles include the general, security, and balance of payments exceptions as contained in the trade agreements.

Malaysia and FTAs

The Ministry of International Trade and Industry, Malaysia (MITI) has provided these four key reasons for Malaysia to negotiate and enforce FTAs:

- To seek better market access by addressing tariffs and non-tariff barriers.
- To further facilitate and promote trade, investment, and economic development.
- To enhance the competitiveness of Malaysian exporters.
- To build capacity in specific targeted areas through technical cooperation and collaboration[17].

Malaysia's first FTA was with Japan. The Malaysia-Japan Economic Partnership Agreement (MJEPA) was proposed in December 2002 and signed three years later in December 2005. Since then, Malaysia has negotiated many FTAs at bilateral, regional, and plurilateral levels, with varying degrees of success. For example, the bilateral Malaysia-US FTA (MUSFTA) was abandoned as the US decided to focus on negotiating the larger TPPA. Most of these FTAs are currently in force – see Table 2 for their status.

[17] MITI (2014)

Table 2: Malaysia's FTAs

		Key dates		Trade with Malaysia	
FTA	**Status**	**Sign/ Suspend/ Abandon**	**Entry into force**	**Total trade in 2014 (RM b)**	**Ranking**
Malaysia-Japan	In force	Dec 2005	Jul 2006	137.3	3
Malaysia-Pakistan	In force	Nov 2007	Jan 2008	4.7	22
Malaysia-US	Abandoned	Mar 2010	N/A	116.7	4
Malaysia-Australia	In force	Mar 2012	Jan 2013	53.2	7
Malaysia-New Zealand	In force	Oct 2009	Aug 2010	8.2	19
Malaysia-Chile	In force	Nov 2010	Feb 2012	1.2	61
Malaysia-India	In force	Sep 2010	Jul 2011	45.2	8
Malaysia-Turkey	In force	Apr 2014	Aug 2015	3.2	31
Malaysia-EFTA	Ongoing negotiations	Negotiations in progress		11.3	-
Malaysia-EU	Ongoing negotiations	Negotiations in progress		143.9	-
TPPA	Negotiations concluded	Negotiations concluded in Oct 2015		556.9	-
ASEAN-EU	Suspended	Apr 2009	N/A	143.9	-
ASEAN-Japan	In force	Apr 2008	Dec 2008	137.3	3
ASEAN-Korea	In force	Aug 2006	May 2009	59.6	10
ASEAN-India	In force	Aug 2009	Jan 2010	45.2	8
ASEAN-China	In force	Nov 2004	Jul 2005	207.7	2
ASEAN-Australia-New Zealand	In force	Feb 2009	Jan 2010	61.3	-
ASEAN-Hong Kong	Ongoing negotiations	Negotiations in progress		47.7	6
RCEP	Ongoing negotiations	Negotiations in progress		900.0	-

Source: Compiled from the WTO and ASEAN websites as well as various websites of trade ministries in various countries. Trade data from WITS.

FTAs are getting more complex and comprehensive

Countries around the world continue to negotiate FTAs despite the issues and challenges that arise from their negotiations and enforcement. FTAs are no longer just about establishing free trade areas and trade liberalisation; they are also used to commit trading partners to what had been traditionally non-trade matters such as labour, culture, and the environment. These are evidenced in the FTAs negotiated with the developed trading partners, especially the US and the EU.

Apart from the comprehensiveness of the FTAs scope and coverage, they also have deeper and stronger commitments. These are evidenced in the details in the FTAs text. For example, the MJEPA text incorporated 14 chapters, while the ASEAN-Australia-New Zealand FTA (AANZFTA) incorporated 18 chapters, including chapters on e-commerce and the movement of natural persons (MNP). The recently concluded TPPA has 30 chapters.

Table 3 highlights the chapters of the TPPA. Many US-based FTAs are usually complex and comprehensive, with commitments going beyond the WTO requirements in terms of scope and coverage as well as depth, and we can expect similar level of commitments for the recently concluded TPPA. For example, the TPPA includes chapters on areas that are not traditionally considered trade issues, such as labour, environment, and state-owned enterprises. The TPPA also has specific trade in services chapters for the telecommunications and financial services sectors.

In an FTA, there may be many different chapters that are involved in the discussion of broad policy issues such as food, health, and labour. Using the proposed TPPA as an example, provisions affecting the food policies might be discussed in at least six chapters, including chapters on the market access for goods, the rules of origin, and technical barriers to trade. These chapters have extensive breadth and depth of commitments. The TPPA highlights how the different chapters in an FTA obliges the Members to link their trade commitments to their various domestic policies. We will discuss these in further detail in the next chapters.

Table 3: The TPPA is comprehensive

Chapters	Contents
1	Initial Provisions and General Definitions
2	Trade in Goods
3	Textiles and Apparel
4	Rules of Origin (ROO)
5	Customs Administration and Trade Facilitation
6	Sanitary and Phytosanitary (SPS) Measures
7	Technical Barriers to Trade (TBT)
8	Trade Remedies
9	Investment
10	Cross-Border Trade in Services
11	Financial Services
12	Temporary Entry for Business Persons
13	Telecommunications
14	Electronic Commerce
15	Government Procurement (GP)
16	Competition Policy
17	State-Owned Enterprises (SOEs) and Designated Monopolies
18	Intellectual Property (IP)
19	Labour
20	Environment
21	Cooperation and Capacity Building
22	Competitiveness and Business Facilitation
23	Development
24	Small and Medium-Sized Enterprises (SMEs)
25	Regulatory Coherence
26	Transparency and Anti-Corruption
27	Administrative and Institutional Provisions
28	Dispute Settlement
29	Exceptions
30	Final Provisions

Source: MITI (2015-a)

Process of forming and enforcing an FTA

The time taken to negotiate, sign, and ratify an FTA typically reflects the number of complex issues addressed under an FTA – the more complex the negotiations, the longer it takes. Figure 3 illustrates the general process of forming an FTA, although this may differ country-to-country. For example, when performing the scoping study of an FTA, countries such as Australia receive submissions from the public to identify the issues that need to be addressed under the FTA. This highlights the importance of stakeholder engagements to ensure that the country's interests are protected and to allow for maximum benefits to be gained from the enforcement or implementation of the FTA.

Once negotiations conclude, the FTA would need to be signed and then ratified. Ratification of an FTA may not always come immediately after the FTA is signed. In the case of the US-Colombia FTA, it was entered into force more than five years after it was signed. In addition, even after an FTA enters into force, there is a usually a review process undertaken that allows the trading partners to review their enforcement progress and negotiate new issues into the agreement.

Figure 3: Basic timeline for the FTA process

This timeline may vary according to the complexity of the FTA					
1-6 months	3 months- 1 year	1 month- 1 year	6 months- 5 years	3 months- 2 years	Annually or otherwise specified

PROPOSAL
- Trade and economic missions organised to identified FTA partner.
- Proposal of FTA usually announced during meeting of high level government officials/leader.
- Leaders express commitment to negotiate.

SCOPING STUDY
- ***May be done jointly or in parallel.***
- May include complex models on FTA benefits.
- Public consultations.

OFFICIAL DISCUSSION
- Discuss outcome of study.
- Decide whether to proceed with FTA - countries may modify requests.

NEGOTIATION
- Most crucial part of FTA process as countries seek greater market access, among others.
- Further modifications on requests are common.
- Countries work out agreement draft.
- Legal scrubbing process.

SIGNED
- Signed by ministers/ leaders of both countries.
- ***Countries sometimes agree on a Framework Agreement before negotiating the details of the obligations. This is known as an Early Harvest Programme.***

RATIFIED
- Debated in parliament or congress.
- Problems when opposition does not agree to FTA.

ENTER INTO FORCE
- Implementation of FTA.

REVIEW
- Review of outcome.
- Countries may seek further improvement in commitments.

Conclusion

Since the early 1990s, FTAs have become increasingly more popular among countries worldwide. FTAs cover a wide breadth and depth of issues that go beyond just the import and export of goods – issues such as trade in services, IPR, labour, and the environment. This means that trade policies, including those promoting FTAs, could potentially impact our everyday lives without us realising it. This Background section provides an overview of the different types of trade agreements that exist, the general trends in FTAs, and Malaysia's FTAs specifically. The next sections look into specific issues related to trade agreements – how trade is measured, food policy, and regional integration.

Box 3: Background on international trade agreements: For more information go to …

The World Trade Organization: A Very Short Introduction, by Amrita Narlikar

This pocket-sized book provides an explanation of what the WTO is, what it does, and how it goes about executing its tasks. It also gives an understanding of the mandate, structure, and functioning of the WTO that is essential to appreciating the issues related to the organisation.

Background on Malaysia's FTA Involvement, by MITI

MITI is responsible for planning, introducing, and implementing international trade and industrial policies in Malaysia. This includes negotiating Malaysia's FTAs. Among others, the MITI website contains details of Malaysia's FTAs with its various trading partners.

More information can be found on the following website:
http://fta.miti.gov.my/index.php/pages/view/4

CHAPTER 01

MEASURING INTERNATIONAL TRADE

CHAPTER 1

MEASURING INTERNATIONAL TRADE

Why is this important?

Understanding how international trade is measured is important, as this will reveal the contribution of trade to the Malaysian economy as well as the level of obligations that Malaysia can commit to and demand from its trading partners via international trade agreements.

Introduction

Malaysia is a well-known trading nation. In fact, trade has always been an integral part of the Malay Archipelago's economy. But how much of the Malaysian economy is made of international trade and how does Malaysia perform in international trade vis-à-vis other countries?

In 2014, Malaysia's total exports and imports were RM766b and RM683b, respectively. Together, they constituted 131% of the gross domestic product (GDP)[18]. Meanwhile, the 2015 WTO International Trade Statistics reported that Malaysia was ranked 23rd among the merchandise goods exporting countries and 26th among the importing countries in 2014[19]. To put things into perspective, Malaysia's exports were 10% of China's total merchandise exports, and Malaysia imports were about 8.7% of the US total merchandise imports in 2014[20].

[18] Malaysia's exports and imports in 2015 up to August were RM498b and RM444b, respectively. Source: CEIC.
[19] WTO (2015-b)
[20] WTO (n.d.-h)

Malaysia's trade composition

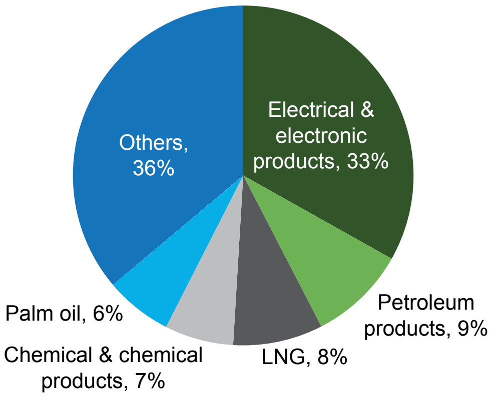
Figure 4 and Figure 5 show Malaysia's trade composition. Interestingly, Malaysia's most exported and imported commodities are the same, which are the electrical and electronics (E&E) products. This implies that the E&E products are imported as intermediate goods which are then re-exported after some processing and value addition in Malaysia. In fact, intermediate goods are the largest portion of Malaysia's imports, followed by capital goods and consumer goods.

In 2014, E&E made up 33% and 28% of total exports and imports, respectively. Other major exports for Malaysia include petroleum products at 9% of total exports; liquefied natural gas (LNG) at 8%; chemicals and chemical products at 7%; and palm oil at 6%. Meanwhile, other major imported products for Malaysia in 2014 were petroleum products at 12% of total imports; and chemicals and chemical products at 9%.

Malaysia's major trading partners

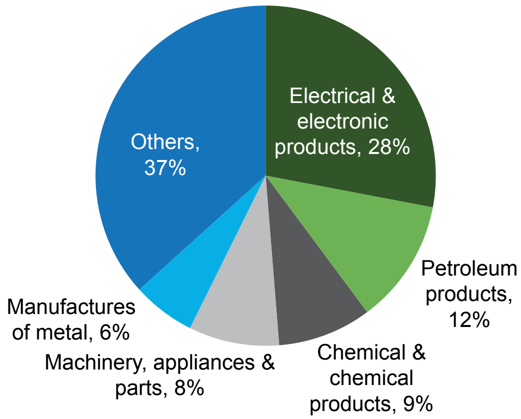
Where did Malaysia's exports go to and where did Malaysia source its imports from? Figure 6 and Figure 7 show that Malaysia's major trading partners are mostly located in the Asia Pacific region. In 2014, the top five export destinations and import sources were the same countries which were China at 12% and 17% of total exports and imports, respectively; Singapore (14% and 12%); Japan (11% and 8%); the US (9% and 8%); and Thailand (5% and 6%).

Figure 4: Malaysia's exports in 2014



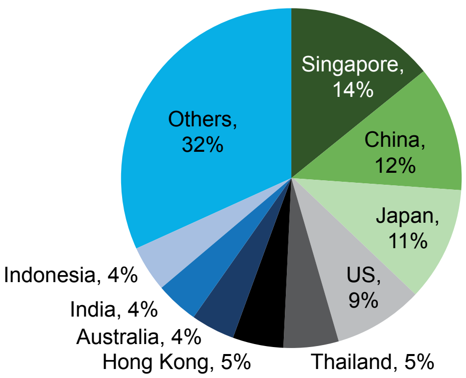
Source: MITI (2015-b), CEIC

Figure 5: Malaysia's imports in 2014



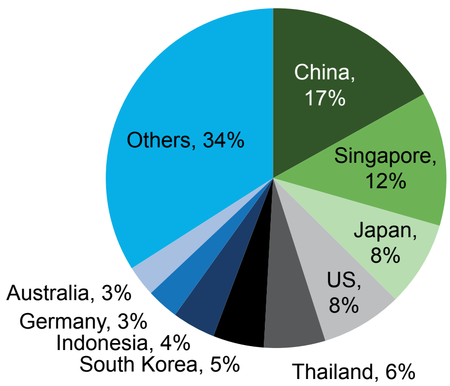
Source: MITI (2015-b), CEIC

Figure 6: Malaysia's 2014 export destinations



Source: WITS (n.d.)

Figure 7: Malaysia's 2014 import sources

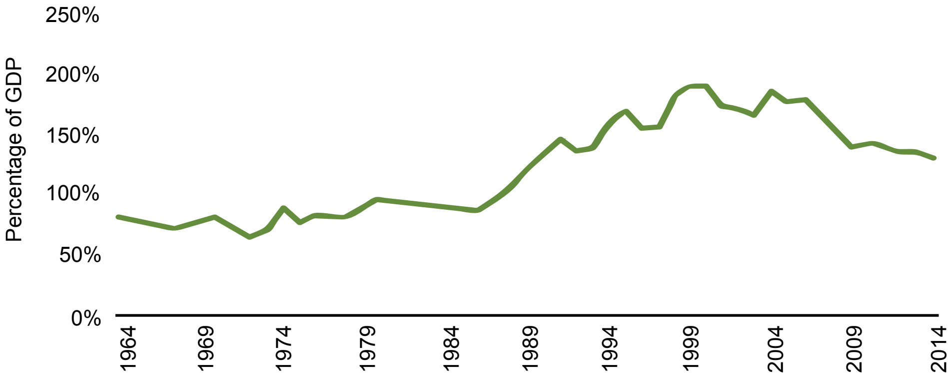


Source: WITS (n.d.)

Malaysia's trade openness

Malaysia has always been an open economy. Its total trade, which refers to the sum of exports and imports, as a percentage of the GDP, has been consistently above 65% since the mid-1960s – see Figure 8. Total trade increased by 104 percentage points from 88% of the GDP in 1985 to reach its peak of 192% in 2000. Since then this ratio has gradually decreased with the 2014 ratio at 131%.

Figure 8: Malaysia's total trade in goods



Source: CEIC

Source of the international trade data

Where do these international trade figures come from? The source of most international trade statistics is the customs departments, which, together with the respective international trade ministries, regulate the international export and import activities. In the case of Malaysia, the Royal Malaysian Customs Department is responsible for facilitating the international trade activities and recording the value of imported and exported products each time they cross the national border as this is when they change ownership from foreign to national.

This is not a bad way to collect data, but it misses a few important aspects of international trade. First, the customs departments, including the Royal Malaysian Customs Department, only manage and record the export and import of *merchandise goods*. They do not capture data on the export and import of services. For example, they would record the data on the importation and exportation of pharmaceutical products, but they would not record the wages paid for the service of a foreign healthcare professional working in a private hospital in Kuala Lumpur[21]. Although the latter would constitute as an import of healthcare services, via the movement of natural persons (MNP), it is not recorded as an international trade transaction by the Royal Malaysian Customs Department which only oversees trade in goods and not trade in services. Data on trade in services is captured instead under the current account of the balance of payments. This is collected by the Central Bank of Malaysia (BNM).

Second, the international trade data records the value of the goods each time they cross into the national border (import) and out of the national border (export). Specifically, in the case of imports, the number recorded can include the cost, insurance, and freight (cif) charges for bringing the goods into the country.

On the other hand, in the case of exports, the number records the *total* value of the goods brought out of the country, without taking into consideration that the value of the goods may include the cost of imported inputs which were used to manufacture the said goods. For example, a television (worth say, RM1,000) exported from Malaysia may contain electronic parts (worth say, RM500) imported from other countries such as South Korea or Japan. Thus, the value of the exported television which actually originated from Malaysia is only RM500 (RM1,000 – RM500) or 50% (RM500 ÷ RM1,000 x 100%) of the value recorded as export in international trade data (international trade data would record Malaysia's television export as RM1,000 instead of RM500). This will be discussed in more detail later in this chapter in the part entitled 'Specialisation in tasks: The global value chain (GVC)'.

Finally, the customs international trade data does not include unofficial trade activities such as smuggling. In the past, Malaysia has lost substantial government revenue from illegal imports or smuggling for goods ranging from tobacco and alcohol to petrol fuel and cooking oil.

[21] Meanwhile, the employment tax is under the purview of the Inland Revenue Board of Malaysia.

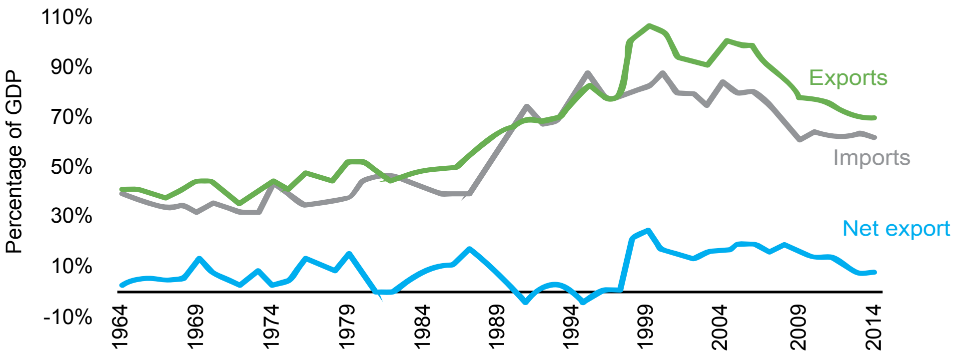
Relationship between gross international trade and GDP

Gross international trade data is one of the key components of the system of national accounts. The system of national accounts is a comprehensive set of statistical data that captures the economic transactions undertaken by the residents in the economy. Within this, we have the GDP. In 2014, Malaysia's GDP at current prices was RM1.1t[22].

There are several ways to measure the GDP. One of them is the consumption method, which assumes that we consume what we produce. There are four components of 'consumption' in the GDP: private consumption, savings (or investments), government expenditure, and net export or the external sector. The last component is where the gross international trade data comes in. Net export refers to total export less total import[23].

Figure 9 shows Malaysia's net exports as a percentage of GDP since 1965. With the exception of the global financial crises years in early 1980s and 1990s as well as late 1990s, Malaysia has always been recording relatively high net exports as a percentage of GDP. Malaysia's net export in 2014 was RM83b or 8% of GDP.

Figure 9: Malaysia's trade in goods 1964-2014



Source: CEIC

[22] CEIC
[23] Mathematically, net export = total export – total import.

GDP and the input-output (IO) table

GDP and value added to production

Unlike the *gross* trade data from the customs department, the GDP refers to the *value added*, or the contribution to the economy. In other words, GDP takes into account the value added at each step of the production.

Imagine a closed economy comprising only three activities: the planting of paddy, the milling of glutinous rice (*beras pulut*), and the making of *tapai* (fermented glutinous rice). Suppose the production of paddy in a particular year was RM500. All the paddy is milled to produce glutinous rice, the total production of which is worth RM800. The glutinous rice is then used to make *tapai* worth RM1,000.

How is the GDP in this imagined economy measured? There are two ways, through the value of the final production or through the value added at each level of production. Both methods will arrive at the same number – see Figure 10:

- Value of the final production:
  The value of the final product (the *tapai*) is worth RM1,000. So the GDP is RM1,000.

- Value added at each level of production:
  The value added, or the 'economic contribution', by each actor in the economy can be calculated by subtracting the cost of input from the value of the good produced. At the milling stage, for example, the input used (paddy) is worth RM500 and the good produced (glutinous rice) is worth RM800. So the value added by the miller is RM300 (RM800 – RM500). For the paddy planting stage, we assumed that no input was used (obviously, paddy planting in real life is more complex than this but we simplified it for the sake of illustrating the GDP concept). The value added by each actor in the economy is then as follows:

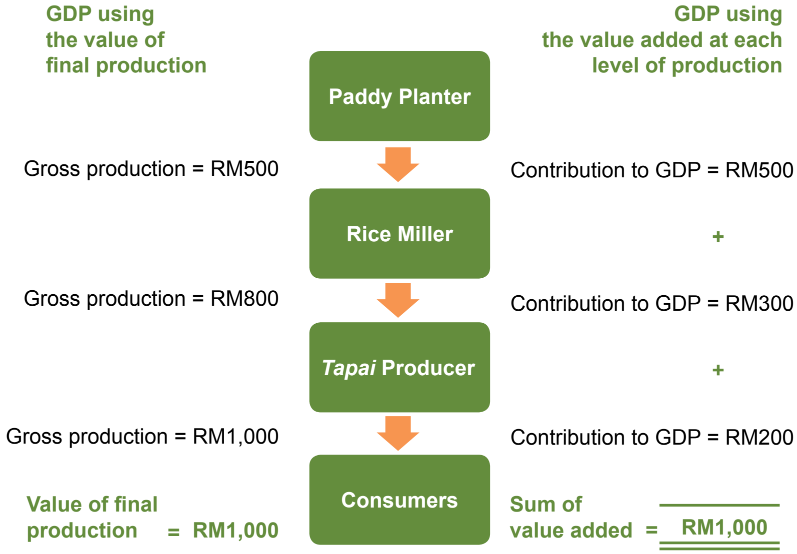
  Paddy farmer: RM500 (RM500 – RM0)

  Rice miller: RM300 (RM800 – RM500)

  Tapai maker: RM200 (RM1,000 – RM800)

  Summing up the value added at each level of production will give us a GDP of RM1,000 (RM500 + RM300 + RM200), which is the same as the value of the final product in the economy (the *tapai*).

Figure 10: Measuring the GDP



GDP can also be measured through the incomes of the actors in the economy. This method breaks down the GDP into three main components which are compensation of employees (also known as labour wage), operating surplus (profits), and net taxes on production. The previous example was too simplistic to illustrate this method, as we did not incorporate any assumption about workers, employers or taxation.

Linking GDP to the IO table

Another more detailed source of data for GDP is the input-output (IO) table. It describes the relationship concerning the production and consumption of commodities and the services between producers and consumers across different sectors in the economy. The DOS is responsible for the construction of the IO table for the country. The more developed countries update their IO tables annually while many countries including Malaysia update their IO tables every five years. The latest IO table available for Malaysia is for the year 2010 which was published in August 2014.

Tables 4 and 5 highlight that between 2005 and 2010, the IO table shows that the GDP share of the tertiary sector expanded by 7.3 percentage points while those of the primary and secondary sectors shrank by 0.9 and 6.5 percentage points, respectively. The IO table also breaks down the GDP by compensation of employees (labour wage), operating surplus (profits), and net taxes on production. In 2010, labour compensation composed only 32.3% of the GDP while operating surplus made up a large chunk of 66.5%.

Table 4: Value added and contribution according to the IO tables by industry

	2005		2010	
	Value (RM b)	Contribution (%)	Value (RM b)	Contribution (%)
Primary sector	**109.4**	**21.5**	**166.2**	**20.6**
Agriculture, fishery and forestry	36.2	7.1	77.0	9.6
Mining and quarrying	73.2	14.4	89.2	11.1
Secondary sector	**181.2**	**35.6**	**234.6**	**29.1**
Manufacturing	151.5	29.8	184.9	23.0
Electricity, gas and water	13.9	2.7	21.7	2.7
Construction	15.8	3.1	28.0	3.5
Tertiary sector	**218.7**	**42.9**	**404.3**	**50.2**
Wholesale and retail trade	53.2	10.4	112.4	14.0
Hotel and restaurants	10.8	2.1	19.6	2.4
Transport and communication	40.6	8.0	58.0	7.2
Finance and insurance	37.8	7.4	73.8	9.2
Real estate and ownership of dwellings	20.4	4.0	24.3	3.0
Business and private services	22.0	4.3	45.6	5.7
Government services	33.8	6.6	70.5	8.8
Total	**509.3**	**100.0**	**805.2**	**100.0**

Note: The figures in this table may not add up due to rounding.
Source: DOS (2014)

Table 5: Value added and contribution according to the IO tables by income

	2005		2010	
	Value (RM b)	Contribution (%)	Value (RM b)	Contribution (%)
Compensation of employees (labour wage)	145.7	28.6	260.3	32.3
Operating surplus (profits)	363.5	71.4	534.9	66.5
Other net taxes on production	-	-	9.9	1.2
Total	**509.3**	**100.0**	**805.2**	**100.0**

Note: The figures in this table may not add up due to rounding.
Source: DOS (2014), DOS (2010)

Specialisation in tasks: The global value chain (GVC)

Malaysia's total exports in 2014 was RM766b. However, as previously mentioned, the value may not entirely originate from Malaysia as it also contains the value of imported intermediate inputs which were used in the production of the exported goods.

Thus, a more accurate measure of international trade is becoming increasingly relevant as companies increasingly unbundle their production activities and specialise in tasks. This means that the production or manufacturing activities of a single product do not have to take place entirely in one country.

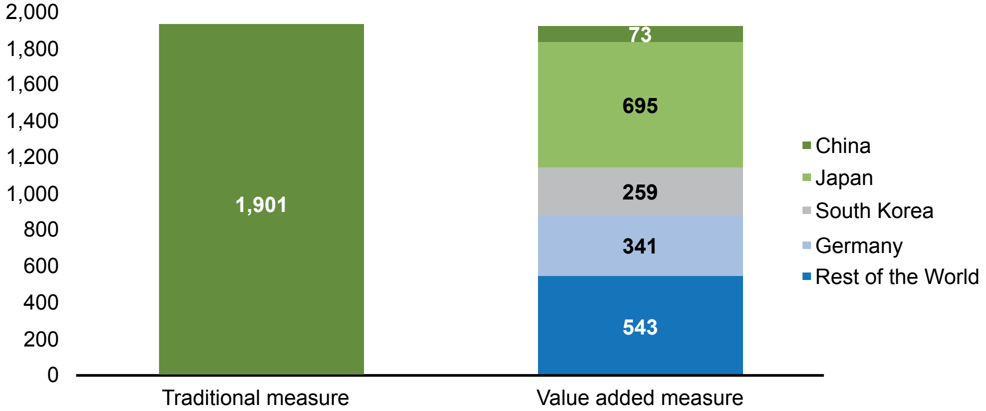
In reality, such practice has been in existence for decades and is known by many different terms including the 'global supply chain', 'international production networks', and 'offshoring', among others[24]. The situation is more complex now and the industry value chain can be 'sliced' even 'thinner'. Known as the 'global value chain' (GVC), it takes the comparative advantage concept to a higher level. The E&E industry is a good example of how manufacturers use the GVC model for their operations and strategies.

[24] Park et al. (2013)

GVC in the iPhone production

Trade protectionists argue for the manufacturing process to be kept in the home countries as the likes of international production networks and offshoring would siphon away jobs, profits, and government revenue (through loss of taxes) to the host countries. Such argument may be misleading.

Figure 11: The US trade balance in iPhones (USD m)



Source: Adapted from Bo Meng and Miroudot (2011) as quoted in WEF (2012)

For example, the manufacturing of iPhones is usually attributed to China. In reality, China gets the credit for iPhone manufacturing only because it does the final assembly of the product before the phones are exported and distributed to the consumers. The intermediate inputs that go into the iPhones are actually produced in many countries such as Germany, South Korea, and Japan. Figure 11 shows the US trade balance in iPhones which, by the traditional measure of trade, records a trade deficit of USD1.9b with China.

However, when the imported intermediate inputs used by China to assemble the iPhones are taken into consideration, only USD73m or less than 4% of the total trade deficit actually originated from China. Components from Japan, Germany, South Korea, and other countries contributed to a bigger portion of the trade deficit.

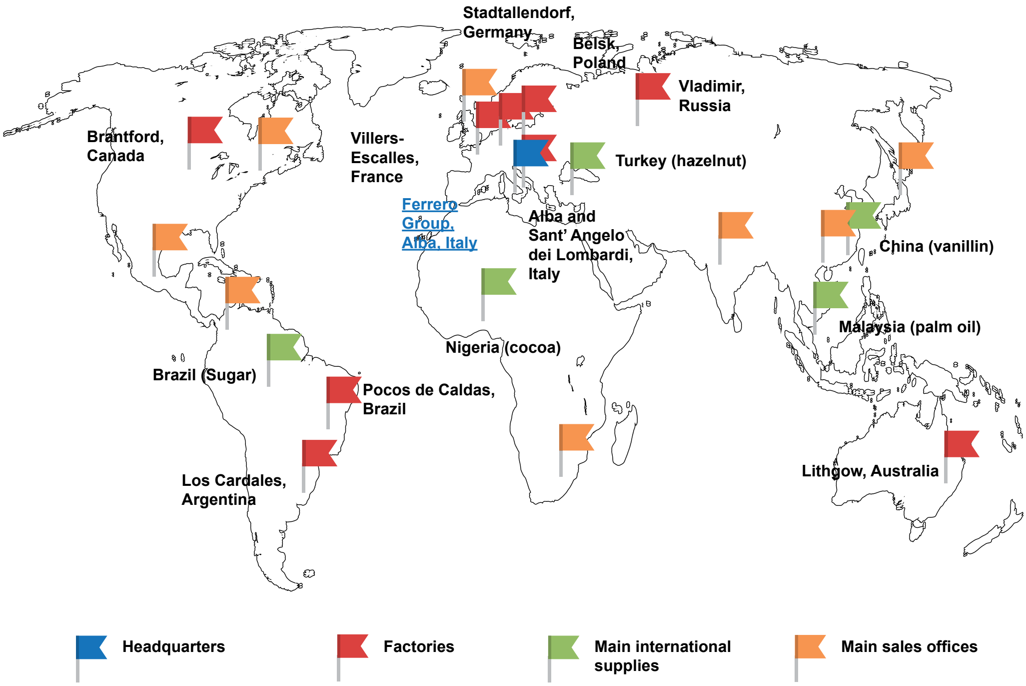
GVC in the Nutella production

The food production has also caught on the GVC process. Figure 12 is a graphic representation of the value chain for Nutella, a famous hazelnut and cocoa spread, sold in approximately 75 countries. Ferrero International SA, the company that produces Nutella, has its headquarters in Italy and nine factories worldwide in locations as far away as Australia and Russia.

The production of Nutella uses ingredients sourced from all over the world: palm oil from Malaysia, cocoa from Nigeria, hazelnut from Turkey, sugar from Brazil (and Europe), and vanillin from China. International trade facilitates the production of Nutella on a global scale, allowing the manufacturer to source ingredients from around the world and locate factories close to the final consumer markets – countries in Europe, North America, South America, and Oceania – where Nutella is in high demand[25].

[25] Backer and Miroudot (2013)

Figure 12: The Nutella global value chain



Source: Adapted from Backer and Miroudot (2013)

Trade in value added (TiVA)

Given the increasingly complex nature of production (whereby inputs from other countries are used in the manufacturing of a good which may then be exported), it is easy to see how the gross international trade data could be misleading in terms of recognising a country's contribution in international trade activities. The value of a country's exports may not have entirely originated from the said country.

The iPhone example illustrates the need for a more detailed method of measuring trade. A new approach that has been proposed is known as 'trade in value added' or TiVA in short. This method is similar to the one used to measure GDP by calculating the value added at each level of production. Instead of calculating the value added of each actor in the economy, TiVA calculates the value added each time goods and services cross the national border.

To illustrate the concept of TiVA, imagine a simple global supply chain whereby Malaysia imports silicon worth USD100 (RM316.2) from Japan. This silicon is used to produce semiconductors worth USD120 (RM379.4). Malaysia then exports the semiconductor to China – see Figure 13.

Figure 13: Gross exports versus value added (three-country trade)

How would Malaysia's export be recorded in this example? How would the trade figure recorded by the gross international trade data differ from that of TiVA?

- Gross trade data (the traditional method):
  The total value of the semiconductor exported to China was USD120 (RM379.4). So gross trade data would record Malaysia's export as USD120 (RM379.4).

- TiVA method:
  The TiVA of a country can be calculated by subtracting the cost of the imported input from the value of the exported good. The export in value added for Malaysia in this hypothetical example can be calculated as follows:

  Input imported from Japan (silicon):
  USD100 (RM316.2)

  Good exported to China (semiconductor):
  USD120 (RM379.4)

  Malaysia's export in value added:
  USD20 (RM63.2) or
  USD120 – USD100 (RM379.4 – RM316.2)

  In other words, of the USD120 (RM379.4) worth of semiconductor exported to China, USD100 (RM316.2) originated from Japan while the remaining USD20 (RM63.2) originated from Malaysia.

The above was a relatively simple example of a GVC spanning three countries with one imported input and one exported good. Needless to say, the global production networks in real life are more complex as they involve multiple countries importing and exporting multiple goods and services, making the calculations of TiVA much more challenging.

This is further complicated by the fact that the value added may return to the country of origin as imported intermediate inputs (to be used for further processing, incorporated into a new product, and possibly, re-exported) or final goods (to be consumed by the local consumers).

Is it good to have a high TiVA?

TiVA is generally higher in countries such as Indonesia[26], South Africa, and Chile[27] because of their large export of commodities. Thus, having a large TiVA is not necessarily an indicator that a country's economy is contributing substantially to the production of goods and services, apart from being the owner of raw materials or primary products.

Malaysia is an interesting case as it has a large primary sector, particularly the palm oil and the oil and gas industries, as well as large manufacturing and E&E industries. Small open economies tend to have higher import content in their exports[28].

There is increasing desire for countries to upgrade their position in the GVCs and specialise in activities with higher value added which bring more income. However, there is also the concern that higher value added activities would require higher level of workforce skills and education, and employ fewer people, although this may not be necessarily true for all industries.

Following this reasoning, there is, sometimes, a trade-off between higher value added and lower employment opportunities. Thus, for countries with a large labour force of low skilled workers, upgrading their position in the GVC and moving into higher value added activities may not be the priority.

[26] OECD-WTO (n.d.)
[27] World Bank (2014)
[28] OECD (2013)

Conclusion and future work for the Khazanah Research Institute

International trade plays a significant role in the Malaysian economy. The traditional gross international trade data provides us the details on the composition and the openness of the economy. The new TiVA method of measuring the international trade provides a more refined approach to understand the underlying structure of the industries in the economy.

This chapter highlights our future research work in the area of international trade and trade policy. Among others, we will utilise the published OECD-WTO TiVA indicators, as work to analyse TiVA is still in its early stages of development.

Box 4: Measuring trade: For more information go to …

Input-Output (IO) Table by the DOS

The IO table describes the relationship concerning the production and consumption of commodities and services between producers and consumers across different sectors in the economy. The most recent IO table was published by the DOS in August 2014 for the year 2010. The IO tables for 2010 and 2005 can be downloaded from DOS' website.

More information can be found on the following website:
https://www.statistics.gov.my/index php?r=column/cthemeByCat&cat=81&bul_id=ZmpVRjRaUG9raFpoYkdRZVYrdFRpdz09&menu_id=YmJrMEFKT0p0WUIxbDl1bzZydW9JQT09

'Made in the World' Initiative by the OECD and the WTO

The aim of the joint initiative is to facilitate discussion on measuring and analysing TiVA. One of the projects under the initiative attempts to measure countries' TiVA using the global IO table. The database has several indicators of TiVA for 61 economies (including Malaysia) and 34 sectors.

More information can be found on the following website:
- https://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm
- http://www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm

CHAPTER

02

TRADE AND FOOD POLICY

CHAPTER 2

TRADE AND FOOD POLICY

Why is this important?

As with many countries, Malaysia considers its food sector to be a strategic and sensitive sector. One of the key end goals for its agrofood policy is to ensure availability, affordability, and accessibility of food for the country, as well as to promote national food security and safety[29]. This chapter discusses how countries develop food-related trade measures aimed at protecting their food sector. While these measures are intended to be positive interventions, they may have unintended negative results by becoming non-tariff barriers to trade of food which may subsequently lead to higher food prices.

Introduction

The concern on the ability for us to feed ourselves has become increasingly pressing as the world population continues to grow. According to the UN's 2015 Revision of the World Population Prospects, the world population reached 7.3 billion in mid-2015. With the world population expected to increase to 9.7 billion by 2050, food production would need to be intensified[30].

'Food security', is a term coined to highlight the need for "people, at all times, [to] have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life."[31] It was established during the 1996 World Food Summit as part of the global concern on food sustainability[32]. This was then adopted as one of the key deliverables for the UN Millennium Development Goals. On the supply side, globalisation and international trade have led to the food we have on our table originating from different parts of the world.

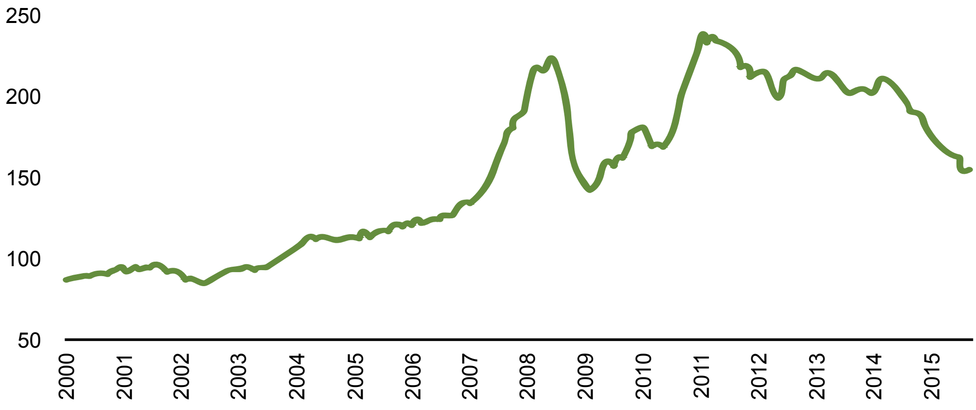
29 EPU (n.d.)
30 UN DESA (2015)
31 FAO (1996)
32 Ibid.

As food affects the overall social, political, and economic landscape of a country, governments globally have implemented various policies to control both the demand and supply of food. In the case of Malaysia, the goal to ensure the availability, affordability, and the accessibility of food continues to be monitored. In 2014, Malaysia imported RM14b worth of primary food and beverages products as well as RM29b processed food and beverages products[33].

Trends for international food prices

The United Nations Food and Agricultural Organisation (UN FAO) keeps track of the world food prices through its Food Price Index – see Figure 14. The index experienced an especially sharp increase between 2007 and 2008 during the period of the food price crisis. The index hit an all-time high in February 2011 at 240 points. Between February 2005 and February 2011, food prices increased by 111%. The world food prices have since stabilised, albeit at a higher level.

Figure 14: FAO – Global food prices, January 2000-September 2015 (2002-2004=100)

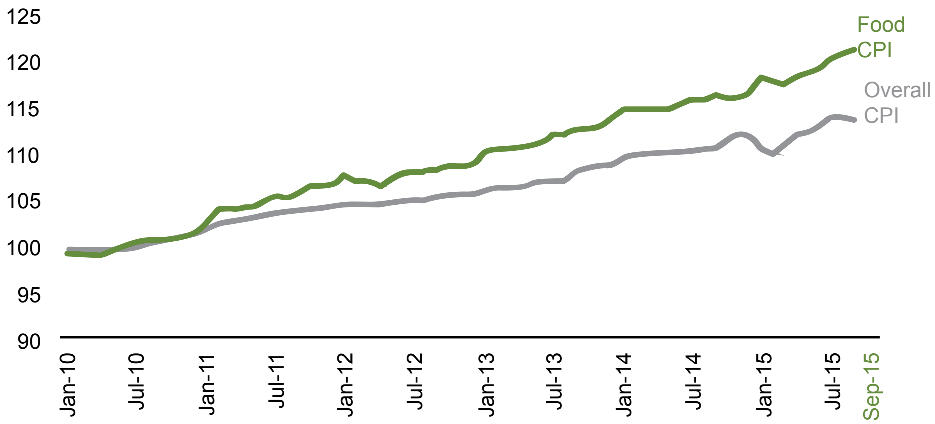


Source: CEIC

[33] CEIC

Meanwhile, the food price inflation in Malaysia has been consistently higher as compared to the overall inflation – see Figure 15. This is a concern for poor households as the proportion of their income spent on food is higher compared to more well-off households. The average Malaysian household spends RM444 or 20.3% of its total expenditure on food per month[34]. Thus, an increase in food prices would substantially shrink the purchasing power or the real income of poor households.

Figure 15: Malaysia – Consumer Price Index vs. Food Price Index (2010=100)



Source: CEIC

Non-trade factors affecting food prices

High food prices can be the result of non-trade factors. For example, natural disasters such as drought and floods could restrict food production and so increase the food prices. Higher input prices could have pass-through effects on the final food production and prices. For example, higher oil prices increase the cost of production for agriculture through higher fertiliser prices and logistic costs.

[34] DOS (2011)

Additionally, higher disposable income leads to demand for more expensive food products. As the population becomes richer, there is a tendency for dietary change and preference for protein-rich products. However, the production of protein-rich products such as meat and dairy products can be expensive, thus pushing their final prices. There could also be competing alternative use for agriculture products. For example, the rising demand for biofuel has led to cereals and vegetable oil being diverted from use as food or feed. The diversion of the US corn into the production of biofuels has increased world food demand for cereals and vegatable oils[35].

Responding to high prices via food-related trade measures

As mentioned above, there are non-trade factors that could affect food prices. Among others, issues such as environmental and socio-economic considerations could impact the global supply and demand of food. In addition, the price of food could be affected by foreign exchange issues. An example of the impact of foreign exchange on the domestic price of food is the case of Malaysia importing wheat from the US. In the event that the value of the Malaysian Ringgit drops significantly against the USD, the cost of imported wheat would rise.

In general, the pass-through effects of each policy option would need to be studied to determine the actual impact of specific policies on the domestic economy. Among the range of policy options available to governments in addressing high food prices, trade policies is one option. Governments for example, may respond to the high food prices by introducing food-related trade measures to address the supply and demand problems in the food production.

[35] HLPE (2011)

Imagine two countries – Country A and Country B. Assume that Country A is a key producing country and Country B is a high-income economy. Country B may be able to purchase the global food products at higher prices, thus pushing the global demand further up. The possible government responses which involve international trade policies include:

- Where there is a global shortage for a particular food item, such as grain, Country A may implement a higher tariff for exportation or a full export ban.
- Country A may also want to introduce agricultural policies that will contribute towards future global supply. Such policies may include measures such as subsidies and cheaper financing.
- Country B as the purchaser of Country A's products may introduce short-term measures to control domestic consumption, where possible. Country B may also introduce alternative products and provide tax relief or lower tariff for such products. Depending on the domestic policy of Country B, it may couple the import control with subsidy to make the products more affordable.
- Country B may also introduce other trade-related measures such as subsidies, preferential tariffs, and quotas to induce or protect domestic production. This however is subject to the availability of important resources such as arable land and suitable climate.

The cycle described above is consistent with a World Bank report which highlighted that the commodity price volatility and food security fears in 2009-2010 had resulted in additional trade restrictions on commodities imposed by 19 countries, many from South and East Asia. The World Bank also observed that grain exporters such as the Russian Federation, Egypt and Bolivia had reported 13 instances of export bans and restrictions in 2010 alone[36].

[36] World Bank (2011)

Additionally, the 2015 WTO Report on G-20 Trade Measures highlighted that the G-20 economies continue to introduce trade restrictions. Already, the G-20 economies have put in place 119 new trade-restrictive measures between mid-October 2014 and mid-May 2015. This equates an average of 17 new measures per month[37]. This number is comparable to the previous period (mid-May 2014 to mid-October 2014), when an average of 18 new restrictive measures were introduced per month[38]. These measures have affected trade for certain agricultural products – see Table 6 for examples.

Table 6: Trade restrictions on agricultural products 2015

Country	Trade Measures
Argentina	Updated list of reference values for the exports of natural honey, and garlic for certain specified destinations. Effective 9 April 2015.
India	Increase of the import tariffs on semi-milled or wholly milled-rice to 70%. Notified on 24 April 2015. Reimposition of the minimum export price (MEP) on the export of onions at USD250/ metric tonne FOB (RM909.5/metric tonne). Effective 7 April 2015.
Republic of Korea	Imposition of import tariffs (513%) on rice. Effective 1 January 2015.

Source: WTO (2015-c)

[37] The term G-20 is rather misleading as there are now 23 countries in the WTO list. They are Argentina, Bolivia, Brazil, Chile, China, Cuba, Ecuador, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru, Philippines, South Africa, Tanzania, Thailand, Uruguay, Venezuela, and Zimbabwe.
[38] WTO (2014-a)

Trade policy in response to a food crisis

The WTO has noted that export restrictions had played a major role in the food crises along with other trade measures such as tariffs and subsidies, as they had prevented the efficient global allocation of food. However, it still believes that "trade is part of the answer, not part of the problem[39]."

A government's policy response would differ depending on whether the country is a net importer or exporter for any specific food product. For example, a net food importer could respond to rising food prices by reducing import restrictions and tariffs, while a net food exporter could adopt increased taxes and restrictions on exports[40]. In addition, governments could also utilise policy options such as subsidies, the use of stocks to stabilise prices, and providing assistance to domestic farmers to mitigate the rise in food prices[41]. An example of the range of countries' trade policy responses to mitigate rising food prices during the 2007/2008 food crisis are shown in Table 7. The key policy responses used by these countries included price controls or consumer subsidies, increasing imports or relaxing restrictions on imports, and building domestic reserves/stockpiles. In the case of Malaysia, policy measures that were implemented included building reserves, maintaining price controls, and promoting self-sufficiency for key products.

[39] WTO (2011)
[40] ADB (2008)
[41] Ibid.

Table 7: Policy responses to the food crisis in selected Asian countries

Country	Malaysia	Indonesia	Thailand	Philippines	India	China
Reduce import duties		●			●	●
Increase supply using reserves		●	●			●
Build reserves/ stockpiles	●		●	●	●	
Increase imports/ Relax restrictions		●	●	●	●	
Raise export duties					●	●
Export restrictions		●			●	●
Price controls/ Consumer subsidies	●	●	●	●	●	●
Minimum support prices				●		●
Minimum export prices					●	
Assistance/ Subsidy to farmers				●		
Promote self-sufficiency	●			●		

Source: Reproduced from ADB (2008) as adapted and expanded from World Bank (2008) and various news articles.

Trade policy and food security

As mentioned above, food security is an important domestic and international issue to ensure that "people, at all times, have physical and economic access to sufficient, safe, and nutritious food to meet their dietary needs and food preferences for an active and healthy life."[42] The FAO has identified four dimensions to food security as shown in Table 8[43]. Table 8 also includes examples of trade measures that could impact the dimensions of food security. Food security as a policy goal represents only one aspect of food-related policies as other policies such as health issues would also be taken into consideration.

Beyond these food security issues, the interaction between food security policies and trade as a tool for development should also be considered. Although governments see the need to ensure domestic food security, the possible impact of these policies on other countries could be significant. For example, a developed country may have the resources to provide subsidies to its domestic producers to sell Product A at a low price. A poor developing country on the other hand may not be able to provide similar subsidies but still aims to export its Product A to developed markets. However, given that Product A is sold at a low price in the developed country due to the subsidy, the poor developing country would not be able to sell Product A to this developed country. Thus, the poor developing country's access to developed countries' markets could be restricted, therefore limiting the use of trade to facilitate developmental goals.

Developed countries that have faced such criticisms include the EU countries. The EU's Common Agriculture Policy (CAP) has been criticised for the impact of its export subsidies on other countries. For example, the EU provides export refunds that is a form of subsidy specifically designed to bridge the gap between higher EU prices and lower world prices[44]. A policy of this nature is clearly meant to favour domestic producers at the expense of foreign imports.

[42] FAO (1996)
[43] FAO (2008)
[44] EC (2015)

Table 8: Dimensions of food security and examples of trade measures

<table>
<tr><th>Dimensions of food security as identified by the FAO</th><th>Examples of trade measures</th></tr>
<tr><td>Physical AVAILABILITY of food:

• Addresses the supply side of food security and is determined by the level of food production, stock levels and net trade.</td><td rowspan="3">• Import and export restrictions could impact the supply of food available.

• Domestic and export subsidies could impact the level of food production.

• Price support could induce greater supply than market forces would permit.

• The liberalisation of financial services related to the agriculture and/or the food sector could impact domestic producers' access to finance and thus impact production.

• Import tariffs could increase the cost of food within the country.

• General trade measures that impact employment.</td></tr>
<tr><td>Economic and physical ACCESS to food:

• An adequate supply of food at the national or international level does not automatically guarantee food security at the household level.

• Concerns over insufficient access to food have led to a greater policy focus on income, expenditure, markets and prices in achieving the objectives of food security.</td></tr>
<tr><td>Food UTILISATION:

• Utilisation relates to the way the body makes the most of various nutrients in the food.

• Sufficient energy and nutrient intake by individuals result from good care and feeding practices, food preparation, diversity of the diet and intra-household distribution of food.

• This, in combination with good biological utilisation of food consumed, determines the nutritional status of individuals.</td></tr>
<tr><td>STABILITY of the other three dimensions over time:

• Even if an individual's food intake is adequate today, the individual is still considered to be food insecure if there is periodic inadequate access to food, thereby risking deterioration in nutritional status.

• Adverse weather conditions, political instability or economic factors (for example, unemployment, rising food prices) may impact an individual's food security.</td><td>An example of Malaysia's application of trade-related measures that is linked to food security issues is in the rice sector. Malaysia is seen to provide subsidies on the paddy rice to farmers, on the consumer price of rice, and on paddy fertilizers.</td></tr>
</table>

Source: Reproduced from FAO (2008) with examples adapted from the ADB (2008), WTO (2014-b)

Food-related trade measures: Sanitary and phytosanitary measures

While trade measures are important economic, social as well as political tools for the government, they are also one of the main contributing factors to the problem of rising food prices. Apart from tariffs, duties and subsidies, there are other trade measures including safeguards, ROO[45], safety and health measures and technical compliance to standards. Abuse of such measures can result in protectionist outcomes at various levels of the food production from seedlings right down to packaging and labelling.

An example of how such measures can become protectionist is the enforcement of the sanitary and phytosanitary (SPS) measures to protect human, animal or plant life or health – see Box 5 for more details. The EU enforces very high food standards as part of its SPS measures. In 2008, seafood products from Malaysia were banned from entering into the EU market due to their failure to observe the EU health standards including those on hygiene and food safety management. The ban was based on the EU's observation that Malaysian producers used contaminated ice from unhygienic ice factories and dirty landing jetties to store their seafood products. Fortunately, this had a rather happy ending – coincidentally and interestingly, the import ban was fully lifted in November 2010, a month after both the EU and Malaysia agreed to commence negotiations for a bilateral FTA[46].

Indeed, the EU-Malaysia case highlighted the thin line between genuine and protectionist SPS measures used as non-tariff barriers to trade. The EU standards for seafood products are comprehensive and highly technical. As a result, compliance becomes costly particularly to the developing countries such as Malaysia, where the fishery industry may not be as sophisticated as that in the EU. Then there are the other additional costs such as efforts to obtain the EU certifications and the administrative approvals for import permits into the EU.

[45] For more discussions on ROO, see Chapter 3
[46] EU Business (2010)

It is for this reason that the WTO addresses SPS measures. The WTO GATT Article XX allows governments to take trade measures in order to protect human, animal or plant life or health. These measures are allowed provided that they are not discriminatory and are not used as a form of disguised protectionism[47]. While countries may establish their own standards, these must be based on scientific evidence.

Currently, the global food safety standard is the *Codex Alimentarius*. However, the *Codex Alimentarius* is developed and administered by a group of developed countries based on the (high) standards enforced in their jurisdictions. Because of the gap between the developed and developing countries in terms of standards and processes, the application of such standards may create a technical gap between the suppliers in the developed countries and the suppliers from developing countries.

Box 5: What are sanitary and phytosanitary (SPS) measures?

Governments regulate food products to ensure that they meet the health and safety requirements. Governments also impose standards to prevent the spread of pests or diseases among animals and plants. These measures are known as the SPS measures. The word sanitary refers to human and animal health while the word phytosanitary refers to plant health[48].

Specifically, the WTO SPS Agreement defines SPS measures as any measure applied:

- To protect animal or plant life or health from risks arising from the entry, establishment or spread of pests, diseases, disease-carrying organisms or disease-causing organisms.
- To protect human or animal life or health from risks arising from additives, contaminants, toxins or disease-causing organisms in foods, beverages or feedstuff.

[47] GATT Article XX states “Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: (a) necessary to protect public morals; (b) necessary to protect human, animal or plant life or health …”

[48] WTO (1998-a)

- To protect human life or health from risks arising from diseases carried by animals, plants or products thereof, or from the entry, establishment or spread of pests.

- To prevent or limit other damage from the entry, establishment or spread of pests.

SPS measures could become barriers to trade particularly if the standards set by the importing country are unnecessarily burdensome and thus becoming a form of protection against imports. For example, the EU has lost an international dispute brought by the US regarding the former's prohibition on imports of meat and meat products derived from cattle where hormones had been used for growth promotion purposes. It was decided that the EU did not provide a risk assessment that reasonably supported the need for its SPS measure[49].

Compliance to the SPS measures can also be costly. In 1997, the EU banned fisheries exports from India on SPS grounds. Although this ban was subsequently lifted, Indian businesses had to invest in equipment and infrastructure to comply with the EU requirements. The cost of upgrading the production facilities was estimated at between USD250,000 (RM703,750) and USD500,000 (RM1.4m) per production unit. In fact, the Seafood Exporters Association of India stated that USD25m (RM70.4m) was spent on upgrading facilities to meet the EU requirements[50].

[49] WTO (1998-b)
[50] Das (2008)

Food-related trade measures: The Halal certification process

Despite these issues and gaps, Malaysia has been utilising the *Codex Alimentarius* for its Halal certification. The *Codex Alimentarius* Commission adopted the Codex General Guidelines for the Use of the Term 'Halal' in 1997[51].

Halal certification is considered a trade issue as it affects the export and import of food products (Box 6). Although the Halal standards per se may not restrict trade, the processes involved in obtaining the necessary Halal certification could be seen as a non-tariff barrier to trade. For example, if the inspection fees imposed are not seen to reflect the cost of inspection, trading partners may see this as unnecessarily burdensome. In addition, the audit process required to maintain Halal certification could also be seen to be unnecessarily costly.

Countries such as the US monitor the development of Halal standards in their export markets as it could affect their export of goods and services. The US has raised the issue of Halal standards with some countries, particularly with the Muslim majority countries, where it sees the implementation of the Halal standard as a trade barrier for importing food products into these countries. For example, the US has emphasised that Kuwait requires both a Halal food certificate and a health certificate to import meat into the country. In the case of Qatar, this requirement is applied for only beef and poultry products. The US has also stated that it is currently monitoring the development of Indonesia's Halal certification for pharmaceutical products[52].

[51] FAO (n.d.-b)
[52] USTR (2014)

Box 6: The Halal standard

The potential value of the global Halal food industry is estimated to range between USD600b (RM1.9t) and USD2.1t (RM6.6t)[53]. Cosmetics and personal care as well as pharmaceuticals are also seen to be key sectors that make up the global Halal market[54]. Apart from Malaysia, the Halal market is also important to meat exporting countries such as Australia, which is one of the leading exporters of Halal beef and lamb/mutton to more than 40 countries[55].

In Malaysia, the Department of Islamic Development Malaysia (JAKIM) is responsible for the Malaysia Halal Certification[56]. The Halal standard refers to a standard to assure Muslim consumers that specific food and services fulfil the Syariah law. Malaysia has different standards to address the production, preparation, handling, and storage of food; cosmetic and personal care items; pharmaceutical goods; and management system requirements for warehousing, retailing, and the transportation of goods and cargo chain services[57].

Currently, there is no single international Halal certification body. However, there are certification bodies at the municipal and country level as well as non-governmental organisations in various countries around the world. Examples of certification bodies outside Malaysia include the Adelaide Mosque Islamic Society of South Australia; the Australian Halal Authority and Advisers (AHAA); the Indonesian Council of Ulama (MUI); and the Qatar Supreme Council of Health, Department of Health Outlets and Food Control[58].

[53] MIDA (n.d.)
[54] PMO (2010)
[55] HDC (n.d.-a)
[56] HDC (n.d.-b)
[57] Ibid.
[58] JAKIM (2014)

Food-related trade measures: Patenting seeds and plants

Another area where trade policy interacts with food policy is the issue of IP. The patenting of plants is allowed in some developed countries such as the US, Australia, Germany, and France. The US for example, grants 20 years patent protection to any inventor who has invented or discovered and asexually reproduced a distinct and new variety of plant[59].

The controversy surrounding the patenting of plants is that once an inventor obtains the patent, the inventor has the right to prevent farmers from saving and reusing seeds from a previous harvesting season. This means that a farmer who uses seeds that have been patented is forced to buy the seeds again for every crop season instead of saving some of the seeds produced naturally by his crops and using it for the next crop season. This also means that any research based on the patented plant that leads to a new product would require the consent of the patent holder[60].

Monsanto, a Fortune 500 company based in the US, has sued farmers who have saved and replanted seeds obtained from plants which were cultivated from the seeds bought from the company. Since 1997, Monsanto has filed at least 145 lawsuits in the US[61]. The US is observed to grant strong IP rights to plant breeders. In comparison, countries such as France and Germany explicitly allow anyone to use plants that contain patented material for further breeding[62].

The trade dimension for the issue of patents on plants is that US FTAs for example, are known to include the commitment to make patents available for inventions on plants and animals. Indeed this was the case for the US-Morocco FTA. Specifically, Article 15.9.2 of the US-Morocco FTA states that "Each Party shall make patents available for the following inventions: (a) plants, and (b) animals." This means that any country that signs an FTA with the US may be pressured to allow for the patenting of plants and animals in their national IP laws.

[59] USPTO (n.d.)
[60] Louwaars et al. (2011)
[61] Monsanto (n.d.)
[62] Louwaars et al. (2011)

Conclusion and future work for the Khazanah Research Institute

While governments may have the political and legal rights to provide for the basic needs of their population through the implementation of their food policies, such measures may also be providing potentially unfair advantages to their domestic agriculture and food industries. Governments need to balance between enforcing measures that are necessary for the sustainability of their countries and managing their cross-border effects so as not to result in protectionist, beggar-thy-neighbour policies. Unfortunately, the line separating these is fine, and at times invisible, as highlighted in the various food-related trade measures in this chapter.

We are currently undertaking research on a larger scale on the food sector, looking at other government policies that may affect the sector and its production activities.

Box 7: Trade and food: For more information go to …

Introduction to WTO rules on standards and safety

The WTO website explains the types of measures that can be imposed to protect human, animal or plant life or health. These are standards to address:

- Food safety and animal and plant health and safety – SPS measures.

- Product standards – technical regulations and standards also known as TBT measures.

More information can be found on the following website:
http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm

Monitoring reports on G-20 countries' trade and investment policy measures

These two reports monitor the developments in G-20 countries on new measures imposed that affect trade and/or investment. They are prepared by the WTO (on trade) and the OECD/UNCTAD (on investment) respectively. The concept behind these reports is to provide transparency in the discussion to encourage G-20 countries to continue to resist implementing protectionist policies and to promote global trade and investment, particularly since the 2007/2008 global financial crisis.

More information can be found on the following websites:
- https://www.wto.org/english/tratop_e/tpr_e/trade_monitoring_e.htm

- http://unctad.org/en/Pages/DIAE/G-20/UNCTAD-OECD-reports.aspx

CHAPTER 03

TRADE AND REGIONAL INTEGRATION

CHAPTER 3

TRADE AND REGIONAL INTEGRATION

Why is this important?

As Malaysian citizens, we are also citizens of ASEAN, a regional integration arrangement (RIA) comprising ten Southeast Asian countries. This chapter serves as an introduction to the proposed Regional Comprehensive Economic Partnership (RCEP) Agreement, also known as the ASEAN+6 FTA. This chapter also refers to the Trans-Pacific Partnership Agreement (TPPA), an agreement between 12 countries in the Asia Pacific region. It is important for us to understand and appreciate the process of regional integration, as there will be rules created and commitments made through these FTAs, which will affect our daily lives.

Introduction

Despite the continued scepticism on the role of ASEAN in the Asian region, the regional group has been able to bring its trade partners together to negotiate a mega or super FTA – the RCEP Agreement. Meanwhile, 12 countries from the Asia Pacific region, including Malaysia, had recently concluded the TPPA negotiations. These two mega FTAs are seen to be in competition to become the foundation agreement of an FTA covering all the Asia Pacific Economic Cooperation (APEC) countries, known as the Free Trade Area of Asia Pacific (FTAAP). Table 9 explains the basic details of these two mega FTAs.

Table 9: Mega FTAs and Malaysia

	TPPA	RCEP
Name of agreement	Trans-Pacific Partnership Agreement	Regional Comprehensive Economic Partnership Agreement
Number of countries	12	16
Countries involved	Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US, and Vietnam	ASEAN Member States (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) ASEAN FTA partner countries (Australia, China, India, Japan, New Zealand, and South Korea)
Population (2014)	806 million people	3.47 billion people
GDP (2014)	USD27.98t (RM91.56t)	USD22.58t (RM73.90t)
Percentage of world trade (2014)	25%	28%

Source: IMF (2015), CEIC

Background on ASEAN

ASEAN was established on 8 August 1967 as part of an effort to promote political stability and regional peace. This was a cap to a rather tumultuous decade as some of its founding Member States were involved in various territorial and political disputes. The Member States recognised the importance of economics in achieving their regional objectives. This was encapsulated in the first article of the 1967 Bangkok Declaration, the first ASEAN instrument that established the association,

> *"… 1. To accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South-East Asian Nations; …"*

Ten years after the establishment of ASEAN, the Member States signed the ASEAN Preferential Trade Arrangements on 24 February 1977 in the Philippines. Unfortunately, this early attempt at trade liberalisation in the region was a failure as most of the Member States chose to remain protective of their domestic markets by excluding many sensitive goods from tariff liberalisation.

In 1992, the Member States made another attempt to liberalise the regional trade in goods by adopting the Framework Agreements on Enhancing ASEAN Cooperation and the Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area. Member States were more ambitious and committed to establish the ASEAN Free Trade Area (AFTA) fifteen years from 1992. Apart from the liberalisation of trade in goods, the Member States were also keen to liberalise their trade in services. Harnessing the progress made on integrating ASEAN as an economic bloc, a key development in the integration process of ASEAN came forty years after its establishment.

In 2007, ASEAN Leaders agreed to the creation of the ASEAN Community by 2015 – see Box 8 below for a general background on the levels of economic integration. This commitment was incorporated into the 2007 ASEAN Charter based on an accelerated time table, bringing forward the integration process by five years from the earlier planned ASEAN Vision 2020. It should be noted that the ASEAN Community does not only refer to addressing economic issues but also security and cultural issues.

Briefly, the ASEAN Community will consist of three pillars:

- The ASEAN Economic Community (AEC), which has the goal of a regional economic integration by 2015.

- The ASEAN Political-Security Community (APSC), which aims to promote shared responsibility for a comprehensive regional security.

- The ASEAN Socio-Cultural Community (ASCC), which aims to undertake cooperation on regional human development, thus, improving the quality of life for the ASEAN population.

Box 8: Regional integration

There are many different reasons for countries to establish and participate in RIAs. The most common reasons include to promote political objectives such as to secure peace and to ensure stability as highlighted in the case of ASEAN and the EU. Many of the existing RIAs have expanded their objectives and functions over time – the most ambitious objective for an economic integration is to become an economic union.

Figure 16 illustrates the various levels of economic integration while Table 10 briefly explains the level of commitments and examples of economic integration arrangements that have been established so far. The ASEAN Member States envisaged for the current economic integration arrangement to move from a narrower scope of free trade area to become a common market.

Figure 16: The levels of economic integration

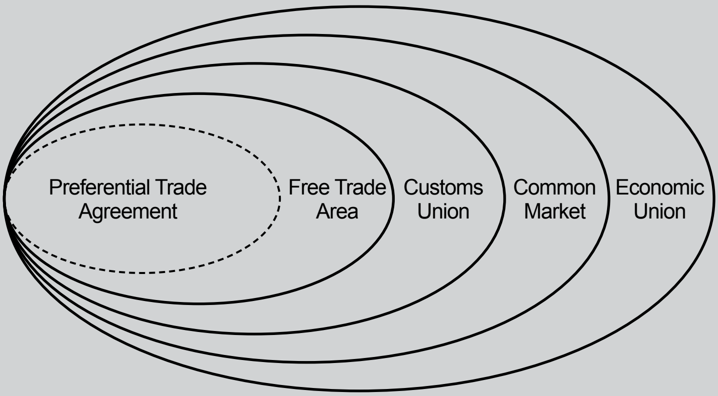


Table 10: Types of trading arrangements

Type	Level of integration	Examples
Preferential trade agreements	Members have lower trading barriers among themselves. Coverage is often restricted to a portion of the actual trade flows and is frequently non-reciprocal.	Developing Eight (D-8) PTA[63]
Free trade area	Members reduce barriers to trade (typically starting with tariffs) among themselves but determine external trade barriers against non-FTA Members independently. Over time, often barriers to trade are reduced but not necessarily completely free of national barriers.	NAFTA AFTA
Customs union	Members eliminate trade barriers among themselves and adopt a common external trade policy against the rest of the world.	MERCOSUR, SACU
Common market	Members eliminate trade barriers among themselves, adopt a common external trade policy, and remove impediments to movements of factors of production (such as labour and capital) across Member countries.	East Afican Community
Economic union	Members move beyond the common market to unify their fiscal and monetary policy.	EU

Source: Adapted from Martyn (2001)

[63] The Group of Developing Eight (D-8) comprises eight Islamic countries – Bangladesh, Indonesia, Iran, Malaysia, Egypt, Nigeria, Pakistan, and Turkey.

ASEAN Economic Community (AEC)

As explained above, the ASEAN Community includes the AEC as one of its three pillars. The AEC aims for ASEAN to become:

- **A single market and production base** by promoting and enabling free flow of goods, services, investment and capital as well as labour within the region.
- **A highly competitive economic region** through the adoption of laws related to competition policy, consumer protection, IPR, and e-commerce.
- **A region of equitable economic development** through developing SMEs and other cooperation initiatives within the region.
- **A region fully integrated into the global economy** by maintaining the 'ASEAN centrality' in ASEAN's external economic relations (such as through ASEAN-plus agreements). The AEC also works towards the enhanced participation of ASEAN businesses in global supply networks[64].

Multiple FTAs with the same trading partners

Malaysia has multiple FTAs with the same trading partners as Malaysia could have agreements with one country or with a group of countries. For example, the 'ASEAN centrality' concept does not prevent the Member States from implementing their national economic policies, such as the trade policies. As such, the ASEAN Member States are free to negotiate and enforce bilateral FTAs with their trading partners. In some cases, this has resulted in the overlap of FTAs. For instance, Malaysia, Singapore, and Thailand each has a bilateral FTA with Australia. As ASEAN Member States, these countries had also negotiated with Australia for an ASEAN-level FTA, which culminated in the signing and enforcement of the ASEAN-Australia-New Zealand FTA (AANZFTA).

[64] ASEAN (2008)

Furthermore, all ASEAN Member States are also participating in the currently negotiated RCEP, which also involve Australia. In addition, Malaysia and Singapore are also part of the recently concluded TPPA negotiations that also include Australia. Despite the overlaps, the scope and coverage of these agreements may differ for the different levels, bilateral and regional. See Table 11 for the details of Malaysia's overlapping bilateral and regional FTAs.

Table 11: Malaysia's multiple FTAs with its trading partners

FTA	Status	Does Malaysia have another FTA with the same trading partner?[65]
Malaysian FTAs		
Malaysia-Japan	In force	✓
Malaysia-Pakistan	In force	
Malaysia-US	Abandoned	
Malaysia-Australia	In force	✓
Malaysia-New Zealand	In force	✓
Malaysia-Chile	In force	✓
Malaysia-India	In force	✓
Malaysia-Turkey	In force	
Malaysia-EU	Ongoing negotiations	
Malaysia-EFTA	Ongoing negotiations	
TPPA	Concluded negotiations	✓
ASEAN FTAs		
ASEAN-EU	Suspended	
ASEAN-Japan	In force	✓
ASEAN-Korea	In force	✓
ASEAN-India	In force	✓
ASEAN-China	In force	✓
ASEAN-Australia-New Zealand	In force	✓
ASEAN-Hong Kong	Ongoing negotiations	
RCEP	Ongoing negotiations	✓

Source: Adapted from MITI data

[65] FTAs include agreements that have been signed, enforced or are currently being negotiated.

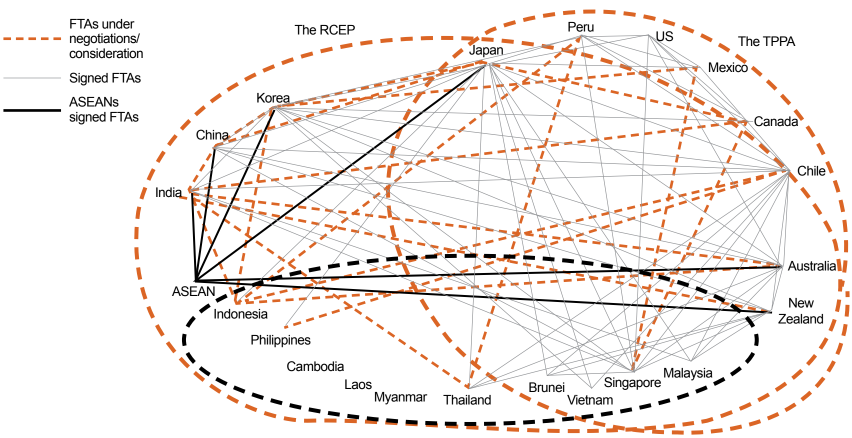
The complex mix of FTAs

The proposed RCEP negotiating countries are already familiar with working with ASEAN and its Member States as there are currently separate ASEAN-level FTAs, also known as the ASEAN+1 (plus one) FTAs, with Australia, China, India, Japan, New Zealand, and South Korea (see Table 11). However, the earlier FTAs are of varying level of commitments and integration.

For example among the ASEAN+1 agreements, the ASEAN-China FTA, the ASEAN-India FTA and the ASEAN-South Korea FTA committed countries to the liberalisation for trade in goods and trade in services, as well as for investment. The AANZFTA is the most comprehensive of all existing ASEAN-based FTAs as it incorporates a wider range of commitments including on the MNP, e-commerce, IP, and competition, apart from the usual liberalisation for trade in goods and trade in services.

The proposed RCEP aspires to consolidate all these previous commitments and more. Figure 17 illustrates the trade relationships between all the RCEP and the TPPA countries. Specifically, Figure 17 illustrates the current bilateral relationships between ASEAN as a trade bloc and the six non-ASEAN RCEP countries as well as the relationships between each ASEAN country with non-ASEAN RCEP countries.

Figure 17: The complexity of key FTAs signed or are being negotiated/considered in the RCEP area



Needless to say it is a complex arrangement of FTAs! The black oval at the bottom of Figure 17 represents ASEAN as a trade bloc. As mentioned previously, ASEAN as a trade bloc already has an FTA with each of the six non-ASEAN RCEP countries – represented by the black lines between ASEAN and its six trading partners.

Meanwhile, individual ASEAN Member States have also signed or are currently negotiating/considering bilateral FTAs with other RCEP and TPPA countries. As shown in Figure 17, the orange and black lines and ovals represent the relationships between the individual countries. For example, there have been calls for China and India to negotiate an FTA. China already has bilateral FTAs with ASEAN, Australia, New Zealand, Singapore, and South Korea, while Japan already has bilateral FTAs with Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, as well as Australia and India.

In addition to the ongoing RCEP negotiations, seven RCEP countries were also part of the recently concluded TPPA negotiations. These countries are Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam. The participation of these seven countries is a clear indication of the geopolitics in the region – a need to manage relationships with two key economies with a strong presence in the region.

The geopolitics of key economies participating in one FTA negotiations and not the other cannot be ignored. Specifically, the US is a member of the TPPA which does not include China. China on the other hand is part of the RCEP negotiations which does not include the US. This means that both ASEAN and its individual Member States need to balance the perception of whether they favour the US over China or vice versa. This balancing act could impact the economic, political, and security ties between the countries and within the region. To illustrate efforts by China to assert its dominance in the region, Box 9 explains China's new aggressive stance in negotiating FTAs.

In addition to managing the geopolitics of the region, Malaysia also has to generally manage the expectations of trading partners that are negotiating FTAs with Malaysia. This is because Malaysia's commitments to one trading partner in past FTAs would impact the expectations of all trading partners negotiating FTAs with Malaysia. In essence, the existing FTAs between any of the RCEP countries can affect the negotiations of this agreement, as the existing FTAs could become the base or minimum level of commitments for future FTAs.

Box 9: Enter the dragon: China's new aggressive stance in negotiating FTAs

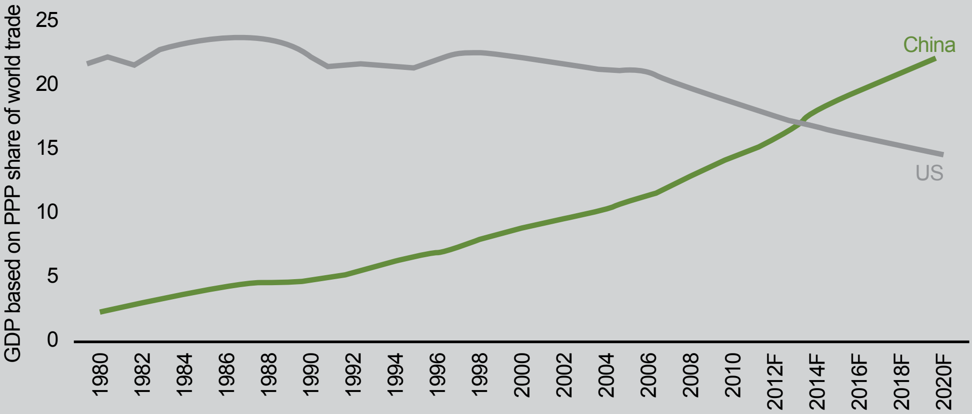
This box article highlight China's new aggressive stance in negotiating FTAs. In June 2015, China signed the China-Korea FTA and the China-Australia FTA. These came at the heel of the 2014 APEC Summit in Beijing when the APEC Leaders pledged to pursue free and open trade and investment. China was seen as the driving force to kick start the process to establish the FTAAP, which if ever concluded and enforced, will be the largest free trade area in the world, easily surpassing the currently negotiated mega FTAs, the TPPA and the Transatlantic Trade and Investment Partnership (TTIP) areas.

On 7 October 2014, the IMF announced that China had overtaken the US to become the world's largest economy, a distinction held by the US since 1873. One can say that the year of the horse had been a somewhat exciting year for China in terms of its economic activities.

The spotlight on China's international trade

China overtaking the US in terms of economic and trade sizes had been a matter of time. In 2011, the IMF projected for China's share of output to the world total to surpass those of the US and the EU by 2016. The October 2014 announcement by the IMF revealed that China had succeeded to do so two years earlier than forecasted. Figure 18 highlights that China's estimated GDP based on purchasing power parity (PPP) is now estimated to be 17% of the world total, marginally higher than the US at 16%. By 2020, the IMF is forecasting China's share to be higher at 19% (the US: 15%).

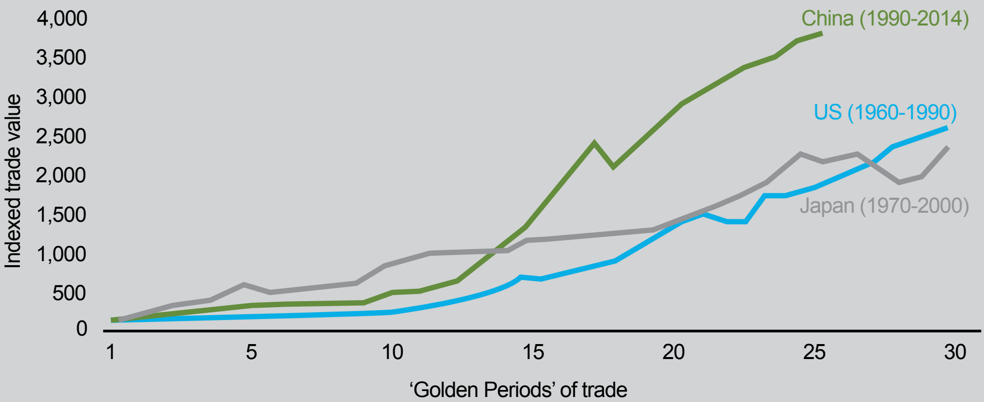
Figure 18: China overtakes the US in terms of economic size



Source: IMF (2015)

China also managed to grow its trade a lot faster than the other two major trading countries, the US and Japan. Figure 19 highlights that both the US and Japan have similar sedate trade value trajectories while China's trade value seems to have increased exponentially during their respective 'Golden Periods' of trade.

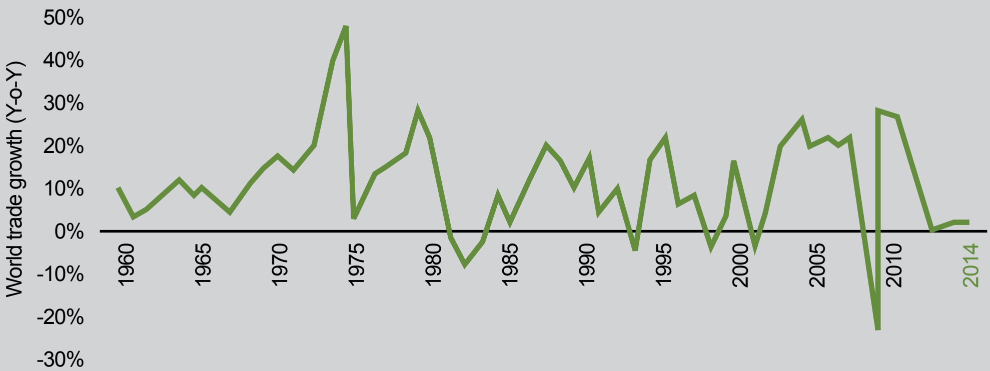
Figure 19: Trade value for the US, Japan and China during their 'Golden Periods' of trade



Source: CEIC

The question is now whether China's J-curve trade growth is sustainable. Already there are concerns that both the US and China are dragging down the overall global trade and income – see Figures 19 and 20. The 2014 trade growth remained virtually unchanged from the previous year at 1.8%. This was lower than the average annual growth of 8.6% between 1994 and 2014 and well below the pre-crisis level (1987-2007 average trade growth was 9.7% year-on-year, Y-o-Y)[66]. Trade economists attributed this slowing down to structural rather than just cyclical factors especially as regards China's position and role in the international production.

Figure 20: Slowing growth for world trade



Source: CEIC

A quiet but busy dragon: Negotiating FTAs to gain market access

China needs to secure greater market access for both its factors of production, notably natural resources, and its labour intensive manufacturing exports, which may face high tariffs in their export markets. One way to do this is to negotiate international trade agreements with its trading partners.

China's participation in the international trade negotiations has been relatively recent. It acceded to the WTO on 11 December 2001, after 15 years of protracted negotiations. As with many other WTO Members, China also

[66] CEIC

pursued a multi-track trade policy by not just limiting its trade commitments to the multilateral trading system of the WTO, but also negotiating and enforcing FTAs on both regional and bilateral bases. In the past, China's FTAs did not receive as much international coverage and interest as compared to those of the US, the EU, and even Japan. Despite this, China has been quietly but actively negotiating, concluding, and enforcing FTAs with its selected trading partners.

Its first FTAs were with Hong Kong and Macau in 2003 and it has since concluded and entered into force FTAs with other countries including ASEAN, Australia, Chile, Costa Rica, Iceland, New Zealand, Pakistan, Peru, Singapore, South Korea, and Switzerland. Currently China is negotiating FTAs with the Gulf Cooperation Council (GCC) countries, Norway and Sri Lanka. It is also negotiating a trilateral FTA with both Japan and South Korea. China is also currently one of the countries negotiating the RCEP, together with ASEAN, Australia, India, Japan, New Zealand, and South Korea. It is also studying the feasibility of negotiating FTAs with India and Colombia.

The FTAAP: The US or the Chinese model?

Both China and the US are competing to provide the FTA model for the future FTAAP. They have different philosophies in negotiating FTAs:

- **No one-size-fits-all versus template-based:** China's FTAs are designed and negotiated with specific objectives – as such it does not adhere to the template-based approach favoured by the US. For example, its FTAs with Hong Kong and Macao underscored the privileged and comprehensive relationship between the Mainland and these economies. Both China's FTAs with Chile and Peru incorporated extensive provisions on mining and mining cooperation while its FTA with New Zealand focused on agricultural commitments. Meanwhile, the US would always demand for its FTAs to include chapters such as the IPR, Competition and Government Procurement Chapters. For China, there is no specific Competition Chapter in the China-New Zealand FTA but there is one in the China-Switzerland and China-Iceland FTAs.

- **Early harvest versus single undertaking:** Unlike the US and most of the other countries which tend to negotiate their FTAs on a single undertaking approach, China negotiated some of its FTAs on a piecemeal or early harvest basis. This means that instead of negotiating all the chapters in the FTAs concurrently, China went on a phased approach, negotiating one key chapter after the other. Examples are its FTAs with ASEAN, Pakistan, and Chile. China negotiated the Trade in Goods Agreement first before moving on to negotiating the Trade in Services Agreement with Pakistan. As compared to the early harvest approach favoured by China, it is relatively easier to seek trade-offs between chapters in the single undertaking negotiations.

- **Progressive versus competitive liberalisation:** As with most developing countries, China also favours progressive liberalisation, that is, opening up the domestic markets in phases. Apart from allowing for flexibility in commitments, progressive liberalisation also allows for a longer adjustment period to changes in the markets. The US and the EU especially favour competitive liberalisation as they usually demand very deep and diverse range of commitments from their FTA partners. Indeed, the US has emphasised for the TPPA to be a '21st century FTA' with an expansive range of liberalisation expected from the TPPA Members.

Conclusion

China looks ready to take on the US, the EU, and Japan in the business of negotiating FTAs. This should be interesting as developing countries have so far been on the lookout for a developing country FTA model – can China provide guidance for such a model? Equally important to negotiating trade agreements such as the FTA, is working on international investment agreements (IIAs). At the 2014 World Investment Forum organised by the United Nations on Conference on Trade and Development (UNCTAD), both developed and developing countries called for reform in the IIAs especially as regards their dispute settlement mechanism. Will China want to lead the work in this area as well?

Currently, the US was seen to have led the negotiations for the TPPA while China is one of the countries negotiating the RCEP. Malaysia, together with Brunei, Singapore, and Vietnam are part of both FTAs. The US method promotes consistency and comprehensiveness while the Chinese method promotes flexibility in commitments. As such, the rest of the APEC Members need to decide which of these two methods would work best for their national economies as well as APEC as a whole. Countries also need to consider how these FTAs will affect the negotiations at the multilateral level. Indeed, failure to give careful consideration on the modality may result in protracted and costly negotiations.

RCEP + AEC = ↑ complexity, or …

Meanwhile, the RCEP are targeted to substantially conclude negotiations in 2015, although based on previous experiences, the conclusion target dates are usually 'moving target dates' rather than hard deadlines. It is likely that the RCEP negotiations will conclude after the AEC is established. If this happens then the non-ASEAN RCEP countries may be able to push the ASEAN Member States to extend whatever liberalisation that the latter have committed to under the AEC to the non-ASEAN RCEP countries for the RCEP.

However, if the AEC has yet to reach all its goals for the establishment of an economic community at the time the RCEP is concluded, the non-ASEAN RCEP countries may demand for the AEC to have similar baseline as the RCEP. Whichever way, it can get complicated for ASEAN and its Member States.

Potentially adding to the complexity is the agreement by the RCEP countries that the existing ASEAN+1 FTAs will continue to exist even after they have signed and enforced the RCEP[67]. If the details in the agreements are not clear, then businesses or investors may practice forum shopping between the various agreements.

[67] In some cases, commitments in the latest FTA take precedence and the older FTA becomes void.

… greater harmonisation of rules = ↓ costs of doing business

Depending on the final details and commitments, businesses could benefit from the RCEP. Each of the existing FTA aims to liberalise trade by reducing and eventually eliminating tariffs for goods. The (country of) origin for the goods is important to indicate whether they qualify for the preferential tariff treatment under the specific FTA. In trade parlance, this is known as the ROO. Identifying the country of origins for unprocessed products such as fresh fruit and vegetables is a relatively straightforward process. However, imagine a computer and all the components that make up the computer. The country of origin of each component in a manufactured product needs to be identified according to specific ROO in order for a company to prove that it should be able to enjoy the benefits of specific FTAs. The process becomes more complicated for manufactured products.

Each FTA has its own ROO. It can be both complicated and complex for the businesses when there are many FTAs with different ROOs. Which one of these would apply? The proposed RCEP could potentially solve part of this problem by applying a common ROO for all the countries to the agreement. Hence, businesses could save on their costs of doing business within the RCEP and TPPA areas, respectively.

Promoting better global value chains (GVCs)

The ability to lower the cost of doing business between the RCEP or between the TPPA countries could allow for stronger GVCs for sectors in these countries. Put into context, the RCEP is an opportunity to enable an easier flow of goods between the RCEP countries.

The RCEP could also allow for an environment where decisions on the location of production processes could be less about the inability to enjoy preferences contained in specific bilateral FTAs and more about the fundamental cost structures of operating in a country within the RCEP area.

Conclusion and future work for the Khazanah Research Institute

The negotiation of the RCEP and the conclusion of the negotiations on the TPPA are ambitious steps towards integrating the economies of many countries. It is too early to tell whether these agreements will succeed in adding value to businesses and the economies in the region. The political will and economic benefit have to be strong to incentivise the countries to open up their markets and to agree to rules that bind their trade regimes. Unfortunately, FTAs are mostly painfully negotiated agreements – and we expect the RCEP to be of no exception.

We are currently working on a book to highlight the new issues in FTAs and FTAs negotiations. In fact, we have always monitored the progress and development of FTAs negotiations and enforcement as their commitments can be far-reaching, affecting other domestic policies as highlighted in the previous chapters.

Box 10: Trade and regional integration: For more information go to …

Asia Regional Integration Centre (ARIC)

The ARIC website provides economic monitoring and analytical papers on regional cooperation and integration in the Asia and the Pacific regions.

More information can be found on the following website:
http://aric.adb.org/

Malaysia's trade agreements

The MITI website provides overviews and detailed information on Malaysia's FTAs. The website also provides information on WTO issues related to Malaysia.

More information can be found on the following websites:
- FTA information: http://fta.miti.gov.my/
- WTO information:
  http://www.miti.gov.my/index.php/pages/view/2456?mid=134

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