Malaysia's Trade Governance at a Crossroads

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Abbreviations

ADB	**Asian Development Bank**
ACIA	ASEAN Comprehensive Investment Agreement
AEC	ASEAN Economic Community
AFC	Asian Financial Crisis
AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area
AIF	Asian Institute of Finance
AMS	ASEAN Member States
APEC	Asia-Pacific Economic Cooperation
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of Southeast Asian Nations
ATISA	ASEAN Trade in Services Agreement
AUSFTA	Australia-US FTA
BITs	**bilateral investment treaties**
BNM	Bank Negara Malaysia
BPO	business process outsourcing
CAGR	**compound annual growth rates**
CETA	European Union-Canada Comprehensive Economic and Trade Agreement
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CUSFTA	Canada-US FTA
CWB	Canada Wheat Board
DSM	**dispute settlement mechanism**
ECJ	**European Court of Justice**
E&E	electrical and electronics
EFTA	European Free Trade Association
EO	export-orientation
EPF	Employees Provident Fund

ETP	Economic Transformation Programme
EU	European Union
FDI	**foreign direct investment**
FIC	Foreign Investment Committee
FTA	free trade agreement
GATS	**General Agreement on Trade in Services**
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GFC	global financial crisis
GIC	Government Investment Companies Division
GLC	government-linked company
GLCT	GLC Transformation
GLIC	government-linked investment company
GNI	gross national income
GPA	Agreement on Government Procurement
ICT	**information and communication technology**
ICTSD	International Centre for Trade and Sustainable Development
IHL	institute of higher learning
IIA	international investment agreement
ILO	International Labour Organization
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IP	intellectual property
IPRs	intellectual property rights
IS	import-substitution
ISDS	Investor-State Dispute Settlement
ISIS	Institute of Strategic & International Studies Malaysia
IWG	International Working Group of Sovereign Wealth Funds
KI	**knowledge-intensive**
KPI	key performance indicator
KNB	Khazanah Nasional Berhad
KTI	knowledge and technology intensive
KWAP	*Kumpulan Wang Persaraan (Diperbadankan)(KWAP)* / Retirement Fund (Incorporated)

LDC	**least-developed country**
LTAT	*Lembaga Tabung Angkatan Tentera*/Armed Forces Fund Board
LTH	*Lembaga Tabung Haji*
MAFTA	**Malaysia-Australia Free Trade Agreement**
MAS	Malaysia Airlines Berhad (formerly known as Malaysian Airline System)
MCMC	Malaysian Communications and Multimedia Commission
MFN	most-favoured nation
MIDA	Malaysian Investment Development Authority
MITI	Ministry of International Trade and Industry
MNC	multinational corporation
MOF	Ministry of Finance
MOF Inc.	Minister of Finance Incorporated
MPE	Ministry of Public Enterprises
MUSFTA	Malaysia-United States Free Trade Agreement
MyCC	Malaysian Competition Commission
MyIPO	Intellectual Property Corporation of Malaysia
NAFTA	**North American Free Trade Agreement**
NCA	non-commercial assistance
NCM	non-conforming measure
NDP	National Development Policy
NEM	New Economic Model
NEP	New Economic Policy
NFPEs	Non-Financial Public Enterprises
NIPP	National Intellectual Property Policy
NKEA	National Key Economic Areas
NT	national treatment
OECD	**Organisation for Economic Co-operation and Development**
OIC	Organisation of Islamic Cooperation
PCG	**Putrajaya Committee on High Performing GLCs**
PCT	Patent Cooperation Treaty
PEMANDU	Performance Management and Delivery Unit
PIA	Promotion of Investment Act
PIS	Priority Integration Sectors

PNB	*Permodalan Nasional Berhad*
PPP	public-private partnership
PTA	preferential trade agreement
R&D	**research and development**
RCEP	Regional Comprehensive Economic Partnership
ROO	rules of origin
RTA	regional trade agreement
SDR	**Special Drawing Rights**
SEDC	State Economic Development Corporation
SME	small and medium-sized enterprise
SNA	System of National Accounts
SOE	state-owned enterprise
SPS	sanitary and phytosanitary
STE	state trading enterprise
STRI	Services Trade Restrictiveness Index
SWF	sovereign wealth fund
TBT	**Technical barriers to trade**
TISA	Trade in Services Agreement
TM	Telekom Malaysia
TNB	Tenaga Nasional Berhad
TPA	Trade Promotion Authority
TPPA	Trans-Pacific Partnership Agreement
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
TTIP	Trans-Atlantic Trade and Investment Partnership
UK	**United Kingdom**
UKAS	Unit Kerjasama Awam Swasta / Public Private Partnership Unit
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNIK	*Unit Inovasi Khas*
US	United States
USSFTA	US-Singapore FTA
USTR	United States Trade Representative

WIPO	**World Intellectual Property Organization**
WTO	World Trade Organization

Malaysian Plan Documents

Five-year Development Plans

1MP	Fist Malaysia Plan 1966 – 1970
2MP	Second Malaysia Plan 1971 – 1975
3MP	Third Malaysia Plan 1976 – 1980
4MP	Fourth Malaysia Plan 1981 – 1985
5MP	Fifth Malaysia Plan 1986 – 1990
6MP	Sixth Malaysia Plan 1991 – 1995
7MP	Seventh Malaysia Plan 1996 – 2000
8MP	Eighth Malaysia Plan 2001 – 2005
9MP	Ninth Malaysia Plan 2006 – 2010
10MP	Tenth Malaysia Plan 2011 – 2015
11MP	Eleventh Malaysia Plan 2016 – 2020

Malaysia Industrial Master Plans

IMP1	Medium and Long-term Industrial Master Plan 1986 – 1995
IMP2	Second Industrial Master Plan 1996 – 2005
IMP3	Third Industrial Master Plan 2006 – 2020

1

Malaysia's Trade Governance at a Crossroads: An Overview

Pierre Sauvé[1]

BACKGROUND CONSIDERATIONS

This edited volume chronicles the latest developments in Malaysian trade and investment policy and situates them against the backdrop of a multiplicity of forces—political, economic and technological—reshaping the competitive landscape within which Malaysian traders and investors operate at the national, regional and global levels. Bringing together some of the country's leading experts in trade and investment governance, the volume provides readers with a detailed description of the evolving political economy of Malaysia's engagement with the world and the role assigned to trade and investment policy in guiding such engagement.

The past few years (and indeed months) have witnessed significant changes in the country's overall policy context. These appear likely to steer Malaysia in new directions on the trade front, as can be seen for instance in the newly elected government's professed desire to revisit various provisions contained in the recently agreed (but not yet ratified) Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) agreement[2].

The analysis on offer in this volume's seven chapters provides a timely account of where Malaysian trade and investment policy currently stands. It assesses the opportunities and challenges arising from the country's involvement in recent and ongoing negotiations of latest-generation preferential trade and investment agreements, dissects the policy choices made and the red lines encountered and reaffirmed in recent negotiations and advances conjectures on the political calculus likely to shape Malaysian trade policy in the years ahead.

Among the volume's main conclusions are that trade and investment policy will need to continue to play a central role, alongside stepped-up domestic reform efforts, in addressing the structural traits that weigh most heavily on the competitiveness of the Malaysian economy. Continued two-way trade and investment growth and the resulting increase in market contestability can help ensure that Malaysia escapes the 'middle-income trap' confronting countries at similar levels of development, scales up its firms' propensity to innovate, supplies the country's workforce with the skills required to move up the manufacturing value chain, diversifies its services offerings, promotes greater inclusiveness and enhanced job opportunities for women, and reverses what one chapter depicts as the 'premature domestication' of the country's sources of income growth (see Chapter 2).

Devoting particular scrutiny to Malaysia's participation in the recently completed CPTPP negotiations, by far the deepest and most ambitious preferential trade agreement (PTA) with which the country has been associated, the volume documents the extent to—and manner in—which the Malaysian Government was able to preserve coveted policy space in a number of areas in which the country has long harboured defensive concerns. These chiefly relate to the constraints the CPTPP could place on Malaysia's intellectual property regime, on the governance of its state-owned enterprises, as well as on the maintenance of preferential (i.e. discriminatory) practices in government procurement, issues to which the volume dedicates specific chapters (see Chapters 6 to 8).

Malaysia's Key Reform Priorities: What Role for Trade and Investment Governance?

In its latest survey of Malaysian economic prospects, the first since the major political developments arising from the country's recent general election, the World Bank Group offered a number of observations on the reform priorities that lie ahead and the overall context within which they are likely to proceed. Many of the most pressing challenges Malaysia confronts relate to domestic policies aimed at fulfilling citizens' aspirations expressed during the recent elections. These concern demands for improved governance, raising living standards, greater social inclusiveness and scaling up the resilience of Malaysian citizens through continued investments in human capital. Still, as a highly open economy, Malaysia needs to pay close attention to its external environment, take advantage of its favourable geography and factor endowments and invest in the growth dividends made possible by better trade and investment connectivity and deeper levels of regional integration. The latter are issues which several contributions to this book take up. Box 1 offers a short summary of the World Bank Group's depiction of Malaysia's forward-looking reform path.

Box 1. Malaysia: Overall Policy Context and Reform Challenges

Malaysia's economic fundamentals remain sound. As a highly open trade-oriented economy situated at the epicentre of the world's fastest growing region, Malaysia continues to benefit from strong global demand for its exports. Malaysia's underlying economic strengths, including a diversified economic structure, a strong external position, robust institutions, and significant natural resources and human capital endowments, remain unchanged.

Taking a longer-term perspective, Malaysia is on track to achieve its transition from an upper middle-income economy to a high-income economy within the next two to six years[3]. As Malaysia moves closer to achieving high-income country status, it is important to be aware of the broader aspects of development that are not captured by growth in the country's gross domestic product

(GDP). These include the distribution of economic gains across geographical regions and segments of the population, and the wider dimensions of societal wellbeing, including health, education and environmental sustainability. Moreover, Malaysia is moving towards the high-income threshold at a relatively slow pace (with slower growth in per capita income) than key comparator countries that have successfully made the transition in recent decades.

Malaysia is entering a new period that offers an opportunity to undertake bold structural reforms that will facilitate the achievement of sustained long-term growth. As Malaysia converges with high-income and developed economies, incremental growth will depend less on factor accumulation, which facilitated growth in the past, and more on raising the level of productivity to sustain higher potential growth. Thus, it is crucial to intensify the reform agenda to tackle key structural constraints to productivity growth and boost longer-term growth prospects. Policymakers should prioritise measures to address labour market constraints and distortions in output markets; improve the quality of education and vocational training; deepen regional trade integration and boost trade connectivity through continued reforms in trade facilitation; build innovation capacity and raise the competitiveness of small and medium-sized enterprises (SMEs).

Malaysia also needs to unlock the potential of the digital economy as a future driver of growth. While Malaysia does well in terms of the level of digital adoption by its government and citizens, the country lags behind international peers in terms of digital adoption by businesses, where Malaysia's performance is comparable to that of a lower middle-income country. The Digital Adoption Index, which measures the use of digital technologies by various agents in an economy, further reveals that Malaysia has limited international bandwidth and a smaller number of secure servers than its regional peers. Significant regional disparities persist between highly urbanised states and the rest of the country when it comes to the level of digital adoption by businesses. Furthermore, Malaysian consumers pay considerably more for access to high-speed broadband than consumers in other countries. These high costs of fixed broadband internet services are partly driven by a degree of market concentration that is significantly greater than that found in other countries.

The new environment creates opportunities for deeper reforms to strengthen institutions and governance, including enhancing public institutions, lifting public sector efficiency, confronting corruption, and improving transparency and citizen engagement. These reforms are crucial to support and sustain Malaysia's development path.

Source: Adapted from World Bank Group. 2018. *Malaysia Economic Monitor: Navigating Change*. Washington, D.C.: World Bank Group.

Managing Downside Risks

In managing its external environment, Malaysia needs to be alert to—and mitigate—possible downside risks. A few such risks are worthy of attention: some are more immediate and cyclical in character while others pose longer-term challenges of a more structural nature.

A first, shorter-term, risk is squarely macro-economic in character. It relates to the possibility of financial market disruption amid shifting monetary policy expectations in advanced economies as the exceptional measures taken by leading central banks in recent years in the aftermath of the global financial crisis (GFC) of 2008 – 2009 are progressively reversed. These could affect emerging economies, including Malaysia, through heightened financial market volatility, capital flow reversals and downward pressures on exchange rates.

A second source of risk relates to the rising tide of protectionist measures and retaliatory counter-measures recently enacted by major trading powers, the scope of which targets both trade and investment flows. Should such trends escalate further, they could trigger a loss of confidence that could dampen growth prospects at a time when such growth has shown encouraging signs of being more evenly balanced geographically and more inclusive than in the case of earlier recoveries. Protectionist measures pose important knock-on risks for countries, like Malaysia, that are heavily embedded in regional and global production networks by disrupting supply chains and the trade in intermediate goods and services that underpin them. If not properly circumscribed, the loss of confidence arising from mounting trade tensions is likely to spill over and translate into growth-dampening investor uncertainty.

Two additional risks likely to influence the contribution of trade and investment to Malaysia's growth can be discerned. One relates to the changing long-run relationship between trade and GDP, a phenomenon that most observers consider as having both a cyclical and a structural dimension[4]. The underlying determinants of this relationship comprise long-run changes in the commodity composition of trade (notably the end of the commodity super-cycle that came in the wake of China's ascendance as a manufacturing powerhouse), changes in the composition of output away from the more trade-intensive elements of GDP, such as investment, and towards consumption-based rises in aggregate demand (a 'domestication' trend which Chapter 2 documents in a Malaysian context), as well as the slowing pace and, in some cases, reversal of supply-chain dynamics. To the above political (e.g. mounting trade tensions) and economic (e.g. declining trade elasticity) forces one can also add the growing ecological imperative to consume—and thus grow or produce—locally to reduce carbon footprints. The above forces interact in ways that call into question Malaysia's ability to rely as much on externally driven growth in future as it has in the past.

A further structural risk, taken up by Aidonna Jan in Chapter 3, concerns the impacts of so-called 'New Industrial Revolution' (also referred to as 'Industry 4.0') involving the application of digital technologies such as advanced robotics, 3-D printing, artificial intelligence, big data and the internet of things, on patterns of trade and investment, employment and insertion into global value chains (GVCs).

Much of the media attention devoted to technological change tends to focus on disruption and the risks associated with new technologies and changing globalisation patterns. Governments need to anticipate ongoing changes as best as they can and address the costs that adjusting to rapid technological change entails. Some of these changes—the observed slowdown in trade, the shortening of value chains in some sectors, the heightened (technological) scope for reshoring production in innovation-rich ecosystems, the declining importance of labour costs as a locational determinant for investment, the impact technology exerts on income inequality—raise important questions regarding the feasibility of replicating past development and market integration strategies. But countries at all levels of development also need to better position themselves to take fuller advantage of

emerging opportunities. The overall impact of the New Industrial Revolution depends critically on what countries do to enable their firms and citizens to create and take up jobs and add value in the new, rapidly evolving, environment[5].

The trends described above portend potentially significant changes for existing and future patterns of cross-border trade and investment. New modes of value-chain governance are already emerging (e.g. larger numbers of smaller production locations closer to target markets rather than a few major locations, sophisticated centralised coordination and control of production processes), new types of investment (e.g. more investment in services), greater use of non-equity modes of international production and changes in investor behaviour (e.g. more fluctuations in output and flexible use of labour, more footloose production). Evolving firm-level production configurations will naturally affect patterns of intra- and inter-firm trade and investment in GVCs, increase cross-border trade in intermediates, especially intermediate services, increase cross-border data flows (and reliance on them), promote greater volumes of trade in bits rather than bulk, and heighten the intellectual property content of cross-border trade and investment flows.

Changes in the international production and trade networks of globally active firms, both multinational enterprises (MNEs) and, increasingly, SMEs, are affecting the economic imprint that foreign invested affiliates leave on host countries as well as the gains from trade for exporting nations and firms. While new technologies can open up important new opportunities for local firms to generate value and connect to regional and GVCs, they can also result in significant employment churning, shorten value chains (through technologically induced reshoring) and raise the technological threshold for SME participation in value chain production.

The changes brought about by the New Industrial Revolution, not least the ability of high-cost high-wage countries to recapture, through technologically advanced means, competitive advantages that have progressively shifted to developing countries in recent decades, and the potential for developing countries to participate in more sectors internationally, point to a significantly more contestable global market for attracting foreign direct investment (FDI). This has important implications for investment policy design, especially in developing countries, notably in terms of investment attraction,

facilitation and retention through improved business environments and strengthened investment promotion efforts. It also heightens the importance of policies targeting innovation and the vibrancy of SMEs. More specifically, as locational competition for efficiency-seeking FDI intensifies, investment promotion agencies (IPAs) will need to design efficient and effective incentives, supplier development programmes and aftercare services to increase MNEs' linkages to the host economy and retain FDI.

Because no country will escape such changes, particularly one as connected through value chains as Malaysia, the changes discussed above will require policy responses from Malaysian policymakers. It is likely that calls for liberalising imports of intermediate inputs (goods and services), reducing trade and establishment costs through trade and investment facilitation, establishing a fuller digital governance regime, strengthening levels of intellectual property protection, and enhancing the performance of IPAs will increase. All are issues that can be tackled more resolutely as part of Malaysia's trade and investment diplomacy.

Thinking Counterfactually

Looking ahead, a key counterfactual question that emerges from the analysis on offer in this volume concerns the reform dividends that may have been forgone by virtue of Malaysia's largely successful quest to preserve policy autonomy in sensitive areas. The fact that the CPTPP, if ratified by the Malaysian parliament, would entail few if any changes to areas where the country has long maintained restrictive or discriminatory policy stances, may just as well be considered as a missed opportunity for enacting needed or long overdue reforms.

It is doubtful that the other two major regional integration schemes in which Malaysia participates—the Association of Southeast Asian Nations (ASEAN) and the Regional Comprehensive Economic Partnership (RCEP) linking the 10 ASEAN Member States to six neighbouring partners[6], to say nothing of the World Trade Organization (WTO), whose stalled Doha Development Agenda shows signs of lasting multilateral gridlock, will drive reforms as deep as those called for by the CPTPP. The fact that a number of this volume's contributions look favourably on the derogations and exceptions secured by the Malaysian authorities under the CPTPP highlights the cautious path

(and path dependency) of contemporary Malaysian tradecraft. At the same time, several chapters point out that desirable reforms in areas subject to CPTPP disciplines and commitments can progressively be enacted through unilateral means rather than through legally binding and enforceable treaty provisions. Time will tell how Malaysia makes use of the policy space it has managed to preserve.

STRUCTURE AND KEY FINDINGS OF THE VOLUME

In their chapter entitled **Introduction to Malaysia's Trade Policies** (Chapter 2), the authors, Nungsari Ahmad Radhi, Adibah Abdulhadi and Musaddiq Adam Muhtar explore Malaysia's trade policies by setting it against the broader canvas of the country's economy-wide context. Their analysis addresses the policy challenges deriving from the shrinking contribution of trade to aggregate demand. Between 2000 and 2016, the share of net exports in output (GDP) contracted by more than half, from 18.9% to 7.7%. While the value of Malaysian exports increased steadily over this period, it grew at a slower rate compared to imports, resulting in diminishing trade surpluses and a narrowed current account surplus.

Chapter 2 posits that the increased domestication—the rising share of consumption in aggregate expenditures—of the Malaysian economy observed since the Asian financial crisis implies that the nature of ongoing changes in the structure of the Malaysian economy should be better understood and that such an understanding needs to be incorporated into the country's Economic Transformation Programme (ETP) on which Malaysia's growth strategy rests. At a more micro level, Chapter 2 argues that strategies and policies regarding industrial development must provide inputs to—and colour—the formulation and execution of the country's trade policy, including the strategy on agenda setting, choice of competitiveness boosting partners and the delineation of negotiating red lines.

Nungsari *et al*. draw attention to the need for a transformation of the main sources of growth and the overall productivity of the economy as well as resulting distributional outcomes. Having started out as a commodity trading economy that acquired—largely through sustained levels of FDI—an export-oriented manufacturing sector, it

is unlikely in their view that the next phase of the Malaysian economy will be predominantly domestically-driven, all the more so given the relatively small size of the country's internal market. Chapter 2 recalls that domestic aggregate demand may similarly not be large enough to drive firm-level specialisation and economy-wide improvements in productivity. Consequently, the premature domestication of the economy needs to be urgently addressed by diagnosing the main constraints on the country's tradable industries in both the goods and services sectors.

With both factors of production—capital and labour—eschewing new sectors and business lines, Nungsari *et al*. observe that no new sources of growth and wealth creation have been generated in Malaysia in recent years. They bemoan the fact that the country's policymakers appeared mostly content to ride the recent commodity super-cycle rather than use its proceeds to effect needed structural change. As a result, a once vibrant trading economy lost its competitive vigour. With fiscal policy concerned more with the quantum than the quality of growth, the structure of the Malaysian economy, particularly the central question of its trade competitiveness, received inadequate attention.

Nungsari *et al*. point out that the incentive to innovate and engineer needed structural change was further dampened by steady inflows of low-skilled migrant labour into high-capital return and rent-seeking sectors, such as palm oil plantations and construction. Even the manufacturing sector today employs sizeable numbers of foreign workers, as does the service economy, particularly in the tourism and domestic help sectors. Sustained inflows of both foreign capital and labour over the past two decades have impacted the resource-based sector, which today constitutes an increasing share of Malaysia's export basket[7]. A further dimension of domestication has been the reduced contribution of FDI-based manufacturing to the country's net export performance, a trend that is suggestive both of a reduction of FDI into the sector and its inability to remain competitive in world markets.

The shift observed in the source of growth from external trade to domestic consumption that Nungsari *et al*. explore in Chapter 2 is particularly striking given that trade has always formed an integral part of the Malaysian economy. Expressed as a percentage of GDP, trade has consistently exceeded 100% since 1988—standing at 134.2% at the end of 2017—making Malaysia one of the most open economies in the world.

The macro-developments depicted above naturally have implications for Malaysia's trade policy stance. Nungsari *et al*. consider that trade policy should no longer be linked solely or primarily to FDI attraction aims but also to broader industrial development objectives and the transformation agenda of the economy. If, as the authors of Chapter 2 contend, the external sector is to remain a key feature and driver of Malaysian economic growth, the key question then becomes how trade and investment policy should be (re-)formulated to achieve the transformational objectives of the New Economic Model (NEM).

As it happens, Malaysia remains actively engaged in trade negotiations. Beyond the recently agreed CPTPP, it is currently pursuing bilateral negotiations with the European Union as well as with key regional partners within the ASEAN and RCEP frameworks. Mindful of enhancing its connectivity to regional and world markets, Malaysia also takes part in the Belt and Road Initiative promoted by the government of China. Such policy activism highlights the central importance assigned to trade—and thus to trade and investment agreements—in driving Malaysia's growth trajectory.

Still, Nungsari *et al*. question how successful Malaysia's trade and investment agreements have been in addressing the factors allegedly holding back the growth of the country's tradable sector. These concern, in their view, issues such as the shortage of skilled labour, the lack of incentives for downstream diversification, the continued high cost of certain aspects of doing business and limited success in developing modern tradable services, among others. There is little doubt that many of the above growth bottlenecks can be addressed through trade and investment policy and driven by latest-generation deep agreements alongside better formulated and implemented domestic policies.

For example, PTA obligations in the services sector can address barriers to accessing, including via outward FDI, key overseas markets. Securing the mutual recognition of professional qualifications is another case in point. Trade agreements are increasingly useful tools to facilitate cross-border flows of goods, services, capital and skilled workers. Furthermore, their signalling properties can do much to enhance the investment climate and how it is perceived by would-be foreign investors. Even with regard to skills and human capital enhancement,

typically the province of improved domestic policies, Malaysia could seek to emulate best regional practices, notably those of neighbouring Singapore, in internationalising through trade and investment ties the country's higher education and vocational training ecosystems.

In pondering the role that should be assigned to trade, Nungsari *et al*. recall that policy formulation should, first and foremost, be guided by domestic reform considerations, targeting issues that hold back the country's growth and development potential. The commitments made in trade agreements need to be—and be seen as—domestic responses to the external environment in order to achieve national objectives. Of course, like all policymaking, Nungsari *et al*. recall the political economy reality that trade policy is no exception when it comes to managing interest groups and confronting entrenched resistance to change. Such forces abound in Malaysia given the country's complex socio-economic realities. Ultimately, the intended outcome must serve as the key yardstick and, for Malaysia, that should be the structural transformation of the economy as defined by the NEM and the ETP. By expending much negotiating capital in preserving the *status quo* in areas where Malaysia tends to play defence, it is uncertain whether the country can derive the full reform dividends from its trade diplomacy.

Nungsari *et al*. argue forcefully that the Malaysian economy cannot reach the next phase of its development—one that is more productivity- and innovation-driven—while also addressing rising inequality, if it does not leverage regional and global resources and markets more resolutely. Trade policy should not just be linked to attracting more investment but also to achieving industrial development aims and the transformation agenda of the economy. Ultimately, the primary objective of Malaysia's trade policy should be clear: to increase the volume of trade and the contributions of net exports to GDP. Malaysian progress has historically been driven from its positioning as a small, open economy. For Nungsari *et al*., the way forward is to remain true to that strategy.

In **Recent Trends in Trade and Trade Agreements: Global Value Chains and Mega-Regional Agreements** (Chapter 3), Aidonna Jan Ayub and Intan Nadia Jalil provide readers with a succinct overview of one of the most salient trends in contemporary trade and investment governance—the emergence of international production networks or GVCs, assessing their relevance to Malaysia. This shift in trade production and in patterns

of cross-border investment, which has seen growing trade in intermediate goods and services, encapsulates the concept of GVC. The fragmentation of production made possible by global or regional corporate strategies, sustained (often unilateral) trade and investment liberalisation and sourcing patterns, has allowed firms, particularly from developing countries enjoying cost or other locational advantages, to enter into cross-border production-sharing by specialising in one or a few stages of the production process. Key GVC hubs include China, the United States (US), Germany, Japan, South Korea and Chinese Taipei. Malaysia is linked to most of these economies through an intricate web of trade and investment relationships. Aidonna Jan and Intan Nadia note that the country is integrated into regional value chains, with a level of GVC participation that is higher than the global average. Malaysia's insertion into GVCs tends, however, to be at a lower level than that predicted by its income level, with stronger upstream links in the GVCs in which it participates. This means that the country tends to import foreign inputs to produce the goods and services that it exports rather than supplying intermediate inputs to other producers in the value chain. Such a trend predominates in the computer and electronic industry (also known as the electrical and electronic or E&E industry), followed by the food and beverage and chemical sectors. Malaysia sources its inputs chiefly from Japan, China and the US, the world's leading GVC hubs.

The fact that links in global or regional value chains arise in countries typically characterised by differing levels of development whose velocity of trade and investment ties are rapidly increasing has naturally fuelled demand for a new framework of trade and investment rules beyond those provided by the WTO. This demand partly explains the sharp rise in the number of PTAs whose substantive remit has broadened significantly as instruments of GVC governance, extending to areas such as competition law and policy, cross-border investment, procurement, technical standards, and transparency in goods and services markets alike.

A further major determinant of ascendant preferentialism is the persistent deadlock of the Doha Round, which has prompted many WTO Members, particularly leading developed countries, to turn to PTAs as a means of 'exporting' standards and governance practices to their trading partners in the GVCs they anchor. One notable means of doing so has involved the negotiation of so-called 'mega-regional'

agreements, plurilateral accords such as the CPTPP or RCEP accounting for a significant share of cross-border commerce. Most such agreements feature novel provisions going further than (so-called WTO-plus)—or not found in (so-called WTO-extra)—current global trade rules. In turn, given the economic weight of mega-regional agreements in global trade, commitments made in them can become building blocks for future WTO rules and commitments.

The rise and spread of the GVC phenomenon is thus forcing a rethink of the optimal architecture and substance of modern trade and investment agreements and the scope that may exist to address the multiplicity of vertical policy silos long characteristic of trade diplomacy. The development of GVC-friendly policies needs to address three strategic issues—how and where along the chain to enter GVCs; expanding and strengthening GVC participation; and turning such participation into sustainable development trajectories. Trade and investment agreements, particularly PTAs, can be useful tools to address these issues by facilitating trade and investment in goods and services and the spread of intellectual property-fuelled innovation in a seamless, horizontal, manner.

Chapter 3 chronicles developments in Malaysian trade policy over time. Like many other countries, Malaysia transitioned from membership of the General Agreement on Tariffs and Trade (GATT) to the WTO at the end of the Uruguay Round, a process marked by the progressive opening of the country's economy beyond merchandise trade. Beginning with the Malaysia-Japan Economic Partnership Agreement (MJEPA), Malaysia subsequently embarked on the second phase of its post-Uruguay Round trade diplomacy—that of bilateral (preferential) trade agreements featuring market access commitments beyond those agreed to at the WTO, but still based on the WTO template of trade in goods and services, intellectual property rights (IPR) protection and trade-related investment measures (i.e. WTO-plus but not WTO-extra PTAs).

Aidonna Jan and Intan Nadia note that Malaysia has now entered the third phase of its trade diplomacy by committing to agreements that contain provisions which go above and beyond those committed to at the WTO and in first-generation PTAs. These include both the CPTPP and RCEP, as well as negotiations with the European Union (EU) towards a comprehensive bilateral PTA, which were put on hold in integration ties with the member states of the European Free Trade Association[8].

The authors of Chapter 3 note that one reason why countries such as Malaysia have shown a readiness to take on deeper (WTO-plus and WTO-extra) commitments in agreements such as the CPTPP is to 'lock-in' or lend greater external visibility to ongoing domestic reforms, particularly those that are difficult to implement due to internal political impediments. The signalling properties of participating in mega-regional compacts may be particularly strong for a country like Malaysia that competes fiercely with regional neighbours to attract and retain efficiency-seeking, export-oriented, FDI for which an accommodating trade policy and complementary domestic regulatory framework need to be in place.

Of the mega-regionals involving Malaysia, Aidonna Jan and Intan Nadia note that the CPTPP stirred up by far the most controversy, partly due to the breadth and depth of WTO-plus and WTO-extra issues incorporated into the agreement and the sheer weight of the US as a trading partner to all participating countries (in the initial Trans-Pacific Partnership Agreement (TPPA) negotiations). Despite the withdrawal of the US, the commitments and rules agreed under the CPTPP do not differ greatly from those embedded in the TPPA, except for specific provisions and commitments (23 in total) that have been suspended from the scope of selected CPTPP chapters, namely those dealing with trade-related IPRs, investment and state-owned enterprises (SOEs). There is little doubt that the general outcome of the CPTPP was strongly influenced by the US as part of the initial TPPA negotiations.

Aidonna Jan and Intan Nadia question how the CPTPP as a deep agreement entered into by four (out of ten) ASEAN Member States (AMS) with non-ASEAN countries will impact the principle of ASEAN Centrality that has guided ASEAN integration for decades, which is also enshrined in the RCEP negotiations, an ASEAN-led effort to support and promote GVCs in the region among economies with close (and growing) trade and investment ties.

Aidonna Jan and Intan Nadia caution that although RCEP and other mega-regional agreements can simplify regional trade and investment governance by reducing the prevailing 'spaghetti-bowl' of rules and by promoting greater doses of trade cost-reducing regulatory convergence, trade governance is still optimally pursued under the auspices of the WTO on a most-favoured nation (MFN) treatment basis. Yet this is

only possible if meaningful progress can be made—and much needed governance reforms agreed—at the global level, an outcome that is far from certain at a time of mounting trade tensions between the WTO's largest Members.

Anticipating the oft-expressed concerns regarding the policy fragmentation arising from the rapid growth of preferential trade and investment agreements, Aidonna Jan and Intan Nadia usefully recall that as countries engage in negotiating rules that cover a broad range of new issues of significance to key partner countries, plurilateral norms, particularly those relating to behind-the-border issues, show an increasing tendency to be implemented on a non-discriminatory (i.e. *de facto* MFN) basis. This translates into the incipient multilateralisation of preferential rules. Experience shows that negotiated advances registered across large enough canvasses can indeed serve useful (and welcome) multilateral aims.

Chapter 3 devotes considerable attention to a question posed in the preceding chapter regarding the effectiveness of Malaysia's competing integration paths. Its authors recall that the RCEP and CPTPP include many of Malaysia's leading trade and investment partners, except for the US (ranked 3rd), Taiwan (6th) and Hong Kong (9th). Both RCEP and CPTPP partners rank among Malaysia's top 35 trading partners, except for Cambodia (52nd) and Laos (106th) for RCEP; and Chile (55th) and Peru (59th) for CPTPP. Some CPTPP and RCEP partners are thus clearly of greater importance to Malaysia than are others. However, in assessing the importance of the above ties one needs to take account of the existing network of PTAs signed by Malaysia with several RCEP and CPTPP members—whether through an ASEAN+1 agreement or a bilateral PTA. Care will be needed to ensure that the benefits of signing trade agreements with the same trading partners will not be watered down under the RCEP.

In terms of Malaysia's investment relationship with mega-regional partners, Aidonna Jan and Intan Nadia point out that RCEP countries cover the largest share of Malaysia's FDI inflows and outflows. This owes principally to the importance of Malaysia's two-way FDI relationship with China. CPTPP countries made up 8.9% of Malaysia's total FDI inflows in 2017, and 9.8% of total FDI outflows. RCEP countries on the other hand made up 12.5% of total FDI inflows and 11.7% of outflows. As Chinese investments have become more

significant for Malaysia in recent years, notably in the context of the Belt and Road Initiative, the investment provisions contained in RCEP will likely become the leading policy instrument to manage Malaysia's bilateral ties with China, a theme Aidonna Jan returns to in Chapter 5.

While RCEP will, as noted above, mainly consolidate existing ASEAN+1 PTAs, the CPTPP seeks to extend commitments relating to WTO-plus and WTO-extra issues. Chapter 3 draws attention to three key differences between the scope and coverage of the RCEP and that of the CPTPP. Firstly, the CPTPP covers a much wider range of areas than does RCEP, including many not found in more 'traditional' PTAs, such as issues relating to labour and environmental standards. Second, even in the more 'traditional' areas covering market access, the CPTPP generally features stricter or more ambitious requirements. One such example is the CPTPP's reliance on a negative-list approach for services and investment commitments as opposed to RCEP's reliance on a WTO-GATS-like hybrid approach to scheduling market access and national treatment commitments also found in the ASEAN Framework Agreement on Services (AFAS).

In addition to differences between the scope and coverage of these two mega-regional agreements, the CPTPP broke new ground by featuring a chapter dedicated specifically to GVCs (entitled 'Competitiveness and Business Facilitation'). This clearly marks a rule-making response to the emerging GVC trends described earlier in this chapter. Equally path-breaking are the disciplines agreed for SOEs, a topic taken up by Wan Khatina in Chapter 8.

As a participant in both the RCEP and TPPA/CPTPP negotiations, and as an AMS, Aidonna Jan and Intan Nadia recall how Malaysia confronts two competing policy challenges. On the one hand is the challenge of deepening its ties both with its ASEAN neighbours (in realising the integrated production aims of the ASEAN Economic Community) and with China, its largest regional partner. On the other hand, Malaysian policymakers have in recent years repeatedly emphasised the importance of 'not being left-out' of an agreement of the CPTPP's magnitude in the context of shifting domestic reform priorities. It remains to be seen how the newly elected government will confront these twin challenges.

On balance, Aidonna Jan and Intan Nadia submit that Malaysia may well derive greater longer-term benefits from RCEP than from the CPTPP. This is so for several reasons. For one, the RCEP market is geographically more relevant for Malaysia given its centrality to ASEAN, and it is therefore key to reducing transaction costs for businesses and investors with priority partners. RCEP can also provide enhanced access for Malaysian products in the key markets of China and South Korea, neither of which are CPTPP signatories but where sizeable tariff protection remains compared to the markets of other advanced CPTPP nations. RCEP can be further expected to complement ASEAN's quest to form a single production base within the mosaic of regional value chains, which Malaysia can leverage in enhancing the value-added of its own manufacturing and service sectors. RCEP further affords the enticing prospect of larger two-way trade and investment flows with India, with which Malaysian trade and FDI ties have so far been suboptimal.

Chapter 3 concludes by considering an important looming threat on the GVC horizon that could significantly disrupt existing patterns of trade and investment and sources of comparative advantage. This threat stems from the accelerated pace at which disruptive technologies such as advanced robotics, 3D printing and artificial intelligence are advancing. These technologies hold the potential to significantly alter the international division of labour ushered in by the GVC revolution over the past few decades, a period that has seen unprecedented convergence in income levels between developed and developing countries. Disruptive technologies increasingly endow firms with the technological means to customise products, in multiple locations, and closer to consumers. These forces may interact in ways that lead to a substantial shortening of supply chain trade and a commensurate reduction in the velocity of trade in intermediate products and of FDI flows. Such developments are unlikely to be kind to countries, firms or workers who are technological laggards. In turn, this highlights the rising importance of domestic policies that reinforce the innovation capacities of firms and workers. Governments, including that of Malaysia, will need to be highly flexible and creative in navigating such a new trade and investment environment, one that will rely more heavily on the movement of information (data), services and knowledge than on that of physical goods.

In the **Services Sector Reforms in Malaysia** (Chapter 4), Rokiah Alavi assesses the contribution made by Malaysia's tertiary sector and trade in services to the country's development path. As with most middle-income countries, services play a prominent role in the Malaysian economy, accounting for 53.6% of aggregate output and supplying three in five (59.9%) jobs at the end of 2017.

Despite the growing contribution of the service sector to the economy, Malaysia continues to incur deficits in its services account. Since 2010, the increase in outbound travel expenditure—i.e. Malaysian tourists travelling and spending abroad—has outpaced that of inbound travel expenditure, watering down the travel industry's contribution to the county's services trade balance. The growth of the Malaysian service sector has in recent years been predominantly fuelled by domestic demand rather than the outward expansion of Malaysian service firms in overseas markets. Wholesale and retail trade, the single largest source of spending in services, contributed 34.6% of service sector output in 2017. Such trends underscore the domestication narrative developed by Nungsari *et al*. in Chapter 2 and point to persisting concerns over export competitiveness in services, itself a probable reflection of the generally tentative attitude towards market opening and the maintenance of important restrictions that Chapter 4 documents.

An upper middle-income country aspiring to reach developed country status by 2020, Malaysia has seen successive governments devise a series of strategies and reform blueprints to make the country an internationally competitive producer of high-technology manufactured goods, the success of which hinges to a considerable degree on the ability to transform Malaysia as a regional hub for selected knowledge-intensive services.

The shift in policy emphasis towards knowledge and technology intensive industries in Malaysia has had tangible impacts on the growth of output and trade in knowledge-intensive (KI) services, resulting in a doubling of the value-added of KI service industries over the 1997 – 2012 period. Finance is the largest sector within the KI services industry and has been the top contributor to the expansion of KI services in the country. Since the late 1990s, Malaysian authorities have placed a greater emphasis on developing Islamic finance, with the aim of

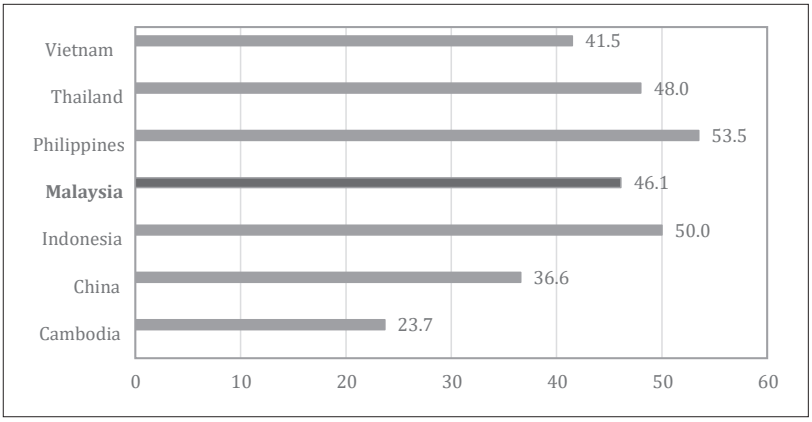
becoming a leading player globally. It is notable that the financial sector's share in total KI services value-added has declined significantly in recent years, owing to the expansion of other sectors, such as telecommunication and health services. Such signs of KI diversification are welcome in an economy many view as being at risk of falling into the middle-income trap.

Chapter 4 notes that education and health services, including health-related tourism services, are two other service sectors that have received a determined policy push and benefited from various government support measures over the past two decades. Private healthcare services have experienced sustained growth in response to the government's active promotion of health-related tourism.

Still, despite evidence of the increasing 'servicification' of the Malaysian economy, the share of the country's services exports remains marginal globally, accounting on average for 0.8% of aggregate services trade over the 2005 – 2017 period. The concern lingers that the key sources of Malaysian services exports remain unduly traditional in character, comprising mainly travel and transport services as opposed to more modern business and professional services. Rokiah observes that while the trade performance of the country's KI services has been improving domestically, it has yet to live up to expectations in terms of translation into a globally competitive export offer. Chapter 4 recalls in this regard that Malaysian exports of business services grew at a much slower pace than those of other countries, among which Brazil, China, India, the Republic of Korea, and the US as well, more ominously, as those of regional competitors in the Philippines and Singapore. If left unchecked, such a lagging performance may deprive Malaysia of an important locational determinant for KI industries and greater insertion in global or regional value chains.

Chapter 4 further recalls how Malaysia's service sector remains subject to strong protection in selected areas. Rokiah considers that progress in eliminating trade and investment restrictions remains inadequate, an assessment that appears broadly shared in the literature devoted to Malaysia's service sector reforms. It is notable for instance that Malaysia, like all its ASEAN brethren, stood on the side-lines of Geneva-based talks on the (currently stalled) WTO-plus plurilateral Trade in Services Agreement whose aim was to trace the new frontiers of services trade governance in an age of cross-border production networks.

Figure 1. Services Trade Restrictiveness Index, Malaysia and Selected Regional Partners (latest available figures)



Source: World Bank, *Services Trade Restrictiveness Index* (http://iresearch.worldbank.org/servicetrade/).

Chapter 4 recalls how the Malaysian Government itself (Ministry of International Trade and Industry, MITI) has acknowledged the country's failure to meet the market-opening thresholds foreseen under the AFAS. Figure 1 shows how Malaysia's services regime ranks among the more restrictive ones regionally[9]. Various types of barriers still exist in the Malaysian service sector despite the country's participation in numerous unilateral and negotiated liberalisation initiatives at the bilateral, regional and global levels. These include measures such as statutory or constitutional limitations on foreign equity participation, restrictions on land ownership, and domestic impediments to professional or labour mobility.

On closer inspection, Rokiah notes that Malaysia maintains major restrictions in Mode 1 (cross-border trade) and Mode 3 (commercial presence), while Mode 4 (movement of service suppliers) appears virtually closed with limited opportunities to enter and operate, mirroring practices obtaining in the country's main trading partners. She further notes how Malaysia's policy approach towards FDI in services is far more restrictive than that applying in manufacturing.

Rokiah notes that Malaysia's highly protected service sectors are deemed strategic and/or economically sensitive. They are, accordingly, areas where domestic reforms tend to be sticky and resisted by domestic interests. Confronted with such political economy challenges, Rokiah argues that participating in trade agreements offers a ready-made solution enabling Malaysian decision-makers to anchor needed domestic reforms and overcome domestic resistance to change by mobilising lobby groups in support of contentious reforms. Malaysia's decision to participate in the TPPA and subsequent CPTPP negotiations, despite their known controversial elements, signalled in her view the previous government's affirmed desire to leverage external pressure to drive the domestic reform process. Whether such a policy stance will be maintained under the new government remains an open question.

Taking stock of the depth of market opening in services agreed under treaty-based instruments, Rokiah confirms the far greater degree of liberalisation achieved by the CPTPP relative to what Malaysia has committed to under the GATS, AFAS and in other PTAs. Chapter 4 draws particular attention to CPTPP-induced negotiating advances in electronic commerce, an emerging issue area in which treaty-based governance has hitherto been embryonic but where stepped-up performance is likely to prove essential to Malaysia's transition towards high-income status.

Digital governance illustrates a paradox that is all too common in Malaysian policymaking, with determined domestic policy initiatives directed towards unleashing the full force of the digital revolution for Malaysian firms and consumers sitting uneasily alongside the more cautious prosecution of the country's trade policy (see Box 2).

Box 2. Reaping the Benefits of the Digital Revolution in Malaysia

It is essential that Malaysia continues to implement efforts to unlock the potential created by the emergence of the digital economy if it is to successfully achieve high-income country status. The intensifying need for Malaysia to achieve higher levels of productivity increases the imperative for adopting and making greater use of digital technologies, including for trade purposes. Malaysia needs to take measures to ensure high levels of digital

adoption by a full range of economic agents, including businesses. It also requires the development of the proper infrastructure and market for high-speed connectivity, preparing the workforce with the right skills to leverage the digital economy and implementing the right policies to drive the country's digital transformation.

One of Malaysia's major achievements is the high rate of digital adoption by its people and the government. The government has made considerable efforts to provide basic internet access to its citizens, with the proportion of the population connected to the internet (mostly through mobile networks) matching the levels found in many developed countries. The government has also achieved a high level of digital adoption, comparable with many high-income economies, reflecting the significant investment it has made in modernising and digitising its systems and processes.

Malaysia has also made significant strides in establishing a supportive ecosystem for digital entrepreneurship. A range of institutions, including the Malaysian Digital Economy Corporation (MDEC), the Malaysian Global Innovation and Creativity Centre (MaGIC) and Cradle, have been established to attract investments, provide incentives, facilitate financing and offer training and opportunities to start-up firms. Malaysia's funding ecosystem functions relatively well in terms of supporting firms at the early entrepreneurial stages.

Nonetheless, the gains from the digital economy cannot be expected to accrue automatically, and challenges remain. The level of digital adoption by Malaysian businesses lags behind that of international peers and is closer to that of lower middle-income countries. There is also a marked disparity in the level of adoption by businesses between regions and sectors and between firms of different sizes. This is largely due to the relatively high cost and low quality of fixed broadband internet services. To address this, promoting intensified competition in the fixed broadband internet services market is crucial. In addition, developing an environment of confidence and trust is essential to build a vibrant e-commerce ecosystem.

This can be achieved through a number of means, including establishing a secure and seamless e-payment infrastructure, improving data accessibility and strengthening cybersecurity risk policies and laws. Additionally, the government should continue to build on its various initiatives to develop human capital, including working with the private sector to ensure that graduates have the

appropriate skills needed to capitalise opportunities in digital entrepreneurship. Concurrently, attention needs to be given to the *analogue* components of digital economy, namely, rules, skills and institutions. Malaysia should continue to implement measures to address these challenges if it is to unlock the full potential of the digital economy and thereby achieve its aspirations of becoming a high-income economy.

Source: Adapted from World Bank Group. 2018. *Malaysia Economic Monitor: Navigating Change*. Washington, D.C.: World Bank Group.

The CPTPP chapter on Electronic Commerce aims to facilitate the free flow of data across borders and eliminate barriers to the electronic transmission of goods and services across borders. Strongly influenced by the commercial interests of leading market players, particularly from the US, the agreement's e-commerce provisions, which underwent no change following the withdrawal of the US from the TPPA, run counter to existing Malaysian practices imposing restrictions on local content for data storage and maintaining a high level of data privacy protection. Considering the limited scope that exists to reserve existing non-conforming e-commerce-related measures under the CPTPP's negative list approach, Rokiah is of the view that Malaysia may need to engage in significant domestic policy revisions in complying with CPTPP disciplines on e-commerce.

Rokiah believes that Malaysia still has a way to go if it is to achieve its stated objective of becoming a regional hub for services and a world-class service provider. In her view, the sector as a whole continues to face several challenges and obstacles that need to be resolved through policy intervention aimed at creating a more conducive and business-friendly environment that would facilitate structural shifts towards an efficient, technologically-driven and KI economy. In most cases, barriers result from restrictive domestic regulations, the prevalence of SOEs whose reform is often challenging as well as closed or discriminatory *Bumiputera* procurement practices that hinder reform efforts and hold back the competitiveness of the domestic service industry. That Malaysia's service sector is still strongly protected suggests that the country may not have fully leveraged its participation in international negotiations as an anchoring complement to ongoing domestic reforms.

Chapter 4 contends that Malaysia has little choice but to undertake comprehensive domestic regulatory reforms and enhance complementary socio-economic conditions—particularly as regards education, freedom of speech, gender equality and quality of life indicators—which would support the development and competitiveness of its service industry, reverse rising income inequality and help the country achieve its 2020 aims. Regulatory reforms can only be effective if the country's policymakers and stakeholders gain an in-depth understanding of the industry at the sectoral and disaggregated levels, a clearer knowledge of the industry's competitive strengths and weaknesses, and a better sense of the market failures calling for informed policy interventions. As ever, deep reforms require strong political will, more effective inter-agency coordination and decisive leadership in political and business circles. All have arguably been in short supply in Malaysia in recent years.

Rokiah argues that Malaysia is still grappling to better understand the supply capacity, competitiveness and ultimate interests of its service economy. Historically, the primary concern of the country's timid trade and regulatory officials has been the extent to which Malaysia would be able to retain needed regulatory policy space when engaging in international negotiations. But policy space for what ends? Heightened external pressures brought about by engagement in deep trade and investment agreements can prove useful for the government to break the prevailing reform deadlock and address restrictive and unduly burdensome regulations, an outcome that would not be possible under purely domestic reform endeavours. Malaysia's participation in the CPTPP and RCEP can and should be viewed in such a manner, as the reform pressures resulting from participation in mega-regional constructs that define new frontiers in trade and investment governance promise important benefits for businesses and consumers alike. It may also contribute to putting an end to the oligopolistic rents enjoyed by some interest groups and SOEs in the country.

In **International Investment Agreements: Challenges and Opportunities for Malaysia** (Chapter 5), Aidonna Jan Ayub reflects on the forces (re-) shaping Malaysia's evolving policy framework on foreign investment, an area of international rule-making for which no multilateral order exists despite a dense network of international investment agreements (IIAs). Malaysia has entered into 70 such agreements to date. Sixty

of these are stand-alone agreements focusing chiefly on investment protection issues, known as bilateral investment treaties (BITs), while the remainder are investment chapters embedded in the country's PTAs, the latest of which is the CPTPP. Close to half of Malaysia's IIAs, especially its BITs, were negotiated in the 1990s, predating the more recent phase of IIA rebalancing that has come in the wake of ascendant judicial activism (and controversy) on the investor-state dispute settlement (ISDS) front[10].

Aidonna Jan discusses the contentious nature of investment treaty-making, pointing to ISDS provisions, which empower foreign investors to challenge host government laws and policies through international arbitral means in instances of alleged treaty breaches, as the main source of mounting policy controversy. The chapter discusses what IIAs are and what they portend for key stakeholders in Malaysian public policy formulation. For the most part, this involves consideration of defensive concerns linked to potentially non-trivial financial liabilities arising from adverse arbitral rulings and the perceived threat that ISDS is seen to pose for the sovereign right to regulate in pursuit of legitimate public policy objectives. Like many other emerging countries, Malaysia has in recent years become an important source country for outward FDI rather than solely a home/destination country. This entails far-reaching attitudinal changes towards IIAs, as countries whose firms become important outward investors abroad stand to benefit from the higher standards of investment protection afforded them under IIAs. While IIAs expose host country governments to potential ISDS litigation, their reciprocal nature means that Malaysian investors also enjoy access to treaty provisions when investing in selected countries abroad. Malaysian investors have, not surprisingly, made increasing use of the ISDS provisions found in (all of) its IIAs, initiating arbitral proceedings as claimants more often than they have acted as respondents over alleged breaches of IIA obligations.

Over the years, Malaysia has experimented with both import-substitution and export-orientation (EO) strategies. Foreign firms have played a key role in the growth and diversification of the Malaysian economy, particularly in Malaysia's EO phase. Liberal ownership rules and pro-MNC policies have contributed towards strong waves of FDI inflows since the 1970s. This has set Malaysia's investment policy on

a more liberal track when compared to the country's more cautious trade policy stance. However, as noted in Chapter 4, openness towards FDI is significantly greater and more uniform in manufacturing than in service industries.

Chapter 5 explains that determining how best to use IIAs as a policy tool requires striking a balance between the cost of negotiating and upholding IIA obligations and the possible benefits that IIAs bring to a country and its investors, both domestic and foreign. The sharp rise in ISDS cases since the late 1990s has alerted host governments to the extent of the 'bite' that IIAs can exert on domestic policymaking. How useful are IIAs in the first place as policy tools? Reviewing the literature on the relationship between IIAs and FDI, Aidonna Jan reports that the empirical findings are largely inconclusive. The more granular approach adopted in more recent studies focusing on different types of FDI (market- vs efficiency- vs natural resource- or strategic asset-seeking) and the depth and nature of the substantive norms found in IIAs point to (modest) positive synergies between IIAs and induced FDI activity. There is also evidence suggesting that PTAs, which embed investment rules in a dynamic trading relationship, induce a greater FDI response than do BITs focusing more narrowly on investment protection divorced from GVC-fuelled trade and investment linkages. While drawing definitive policy rules of thumb from available empirical work is problematic, the evidence reviewed by Aidonna Jan tends to show that IIAs do provide a measure of stability for foreign investors through factors such as de-risking business conditions, enhancing investment climates, locking-in ongoing reforms and signalling the direction of future ones.

The rise in ISDS litigation and the size of some arbitral awards do however require vigilance[11], all the more so as the measures challenged under IIAs fall under the purview of ministries and government agencies that may have only limited knowledge of the scope of IIA obligations and the ways in which unduly arbitrary regulatory decisions or processes may be deemed tantamount to the indirect expropriation of an investment.

Several emerging countries have recently reassessed their policy approaches to IIAs, particularly older ones, in the light of trends depicted in Chapter 5, notably rising IIA judicial activism and the sustained growth of FDI outflows. Some countries have terminated

their IIAs, others have developed new templates seeking greater balance between the rights and obligations of investors and host country governments. Others, including Malaysia, have opted for a middle path, preferring incremental over wholesale change or treaty denunciation. Malaysia's approach has indeed been to continue to engage in IIA negotiations while at the same time tweaking the contents of its IIAs to secure the desired balance between investor rights and policy space for the government.

Aidonna Jan depicts the CPTPP as illustrative of Malaysia's chosen policy path. Seen by many as the most ambitious PTA signed by Malaysia thus far, Malaysia has all at once chosen to widen the scope of its IIA commitments in some instances (by agreeing to deeper sectoral liberalisation than that prevailing within the ASEAN Comprehensive Investment Agreement) while also limiting the scope of obligations in other areas subject to CPTPP disciplines (for instance by denying the ability of foreign investors to challenge tobacco control measures). Meanwhile, cognisant of the need of its own investors abroad, the CPTPP has set a new benchmark for the level of investment rule-making Malaysia is willing to bind itself to. Aidonna Jan argues that this new standard will impact all of Malaysia's future IIAs. It will also make it harder to maintain or grant protection to sectors that have now been opened under the CPTPP.

Aidonna Jan cautions against considering the CPTPP as the only game in town. Despite being less ambitious substantively, the RCEP will provide a rule-making anchor underpinning the Malaysia-China investment relationship. This is of considerable significance given the rising importance of two-way FDI ties. Similar considerations emerge with respect to the ongoing bilateral talks between Malaysia and the EU, whose Member States account for the single largest share of FDI inflows into Malaysia and whose new investment template features an investment court and appeals procedure that depart significantly from the ISDS model of investment litigation.

In **Between Regulatory Reforms, Trade Liberalisation and Technology Dependence: Intellectual Property Challenges in Malaysia** (Chapter 6), Ida Madieha Abdul Ghani Azmi explores one of the most contentious issues in contemporary trade governance for emerging economies endowed with increasing innovative capacity such as Malaysia—

that of determining where best to place the intellectual property (IP) protection cursor with a view to maximising the country's development aims. Exploring the role IP plays in the country's cross-border trade and investment activity, the chapter reviews the policy initiatives put in place to enhance the creation and diffusion of IP in Malaysia and depicts the country's recent performance using various IP metrics. Despite positive trends observed in patent filings, particularly by publicly-funded research institutes and universities[12], trademark applications of local origin and publications by Malaysian researchers in leading scientific publications, Malaysia is still largely a net technology user. This is attested by the country's trade statistics, which reveal a widening deficit on the payment of royalties and receipts of income linked to IP usage. Ida Madieha ascribes the country's unsatisfactory performance on IP creation to the inadequate level of gross expenditures devoted to research and development activities. A closer look at key trends in Malaysia's IP performance leads the author to conclude that although Malaysian IP shows signs of increasing indigenisation and the amount of local IP is growing, the aggregate amounts remain too low to be considered as embodying a major offensive trade interest.

Chapter 6 further discusses the relevance and probable impacts on Malaysia's copyright (i.e. content) and pharmaceutical industries of various WTO-plus and WTO-extra IP disciplines advocated most forcefully by the US in the TPPA negotiations. The choice of these two sectors is justified by the vocal opposition they generated in many circles on two main grounds: access to knowledge and access to medicines. The contentious IP provisions at play concerned, among others, strengthened means of copyright enforcement, the adjustment and extension of patent terms, the nature of protection afforded for new medical use, data exclusivity and biologics. The highly contentious nature of these issues, which proved divisive even among the TPPA's developed country members, ultimately prompted their suspension from the CPTPP's IP chapter, making this the chapter of the CPTPP that differed most from the contents of its TPPA predecessor. The arguments put forward by Ida Madieha suggest unequivocally that Malaysia's development trajectory would have been ill-served by the adoption of IP standards better attuned to the needs and offensive priorities of one specific TPPA Party rather than the regional grouping as a whole.

Ida Madieha's chapter concludes by raising a series of important questions to which definitive answers are difficult to provide at a time when the CPTPP has yet to enter into force. These include the following:

- In what ways can the CPTPP's IP provisions improve Malaysia's participation in global and regional value chains in innovation-rich sectors?
- Can the CPTPP help to accelerate Malaysia's move up the value chain in sectors deemed as priorities for the country's development?
- Can the regulatory reforms arising from compliance with the CPTPP's IP provisions create a legal environment conducive to boosting the growth of Malaysia's priority sectors?
- Can such reforms provide added incentives for local companies to gain a competitive advantage over rival firms?

Although a PTA of the CPTPP's magnitude may be expected to confer substantial economic advantages to Malaysia's manufacturing and service sectors, especially for production and exports, Ida Madieha believes that little can be said with any certainty in relation to IP rights. Owing to the suspension of what would have represented a number of IP-related negotiating red lines, the CPTPP chapter does not depart radically from the evolving range of treaty-based IP norms Malaysia has had to comply with since the end of the Uruguay Round. This once more begs the counterfactual question of whether Malaysia's successful preservation of IP-related policy space serves the country's need to steer itself in more innovation-intensive directions.

As Malaysia moves from high-volume, low-cost, products to knowledge- and innovation-based goods and services, Ida Madieha argues that the country's policymakers entrusted with IP policy formulation must ensure that Malaysia's greater need for technology acquisition is not unduly hampered by TRIPS-plus standards increasingly embedded in latest generation PTAs. Unless Malaysia focuses more resolutely on developing local innovations, products and services that can be inserted into higher value-adding regional and global value chains (GVCs), in her view there is little in the CPTPP's IP provisions that appears *prima facie* supportive of such a policy aim. Malaysia can no longer compete on cost grounds in manufacturing owing to the emergence of competitive low-cost manufacturing locations in its immediate neighbourhood and beyond. Ida Madieha deems it unlikely that the

CPTPP's IP provisions will enhance Malaysia's competitive advantages vis-à-vis such competitors. At the same time, strengthened IP provisions may, alongside enhanced investment protection standards, help to attract the type of FDI that Malaysia increasingly targets from those more advanced manufacturers that prefer a jurisdiction which maintains stronger and more predictable standards of IP protection.

The economic development of Malaysia has long been influenced by government procurement policies embedded in long-term national policies. As in all countries, public expenditure is typically directed to infrastructure projects such as the building of schools, universities, hospitals and transport networks. The Malaysian Government has also undertaken various infrastructure developments which are considered as high-capital investments by the private sector, such as in the areas of civil aviation, telecommunications, water, and other transportation services. The Malaysian Government has also used procurement to develop rural areas, not only in terms of providing infrastructure but also to offer economic opportunities to economic agents operating in the country's more remote areas. Government procurement has also assumed a central role as a tool for social harmony. The multi-racial character of Malaysian society has indeed long justified dedicated policy approaches for economic development purposes, particularly where income gaps between social or ethnic groups have been at the root of lingering tensions and social disharmony throughout the country's history. In addition to using government procurement for development and socio-economic purposes, the Malaysian Government has also employed it as a tool of macro-economic management, most recently when the country faced the consequences of the 2008 – 2009 global financial crisis, which saw the government introduce two stimulus packages aimed at mitigating the effect of the crisis on the Malaysian economy.

In **Government Procurement in Preferential Trade Agreements: Key Considerations for Malaysia** (Chapter 7), Junaidi Mansor tackles the political economy of reform of what is arguably one of the most sensitive policy domains in Malaysian trade diplomacy, one it had always shunned prior to the negotiation of the TPPA/CPTPP. Malaysia broke historic new ground by agreeing to open its hitherto heavily protected and discriminatory government procurement regime when negotiations of the TPPA were concluded in 2015. The TPPA legal text, which later became the CPTPP without changes to its text on

procurement-related matters, shows that Malaysia was able to carve out major aspects of its domestic procurement regime by securing exceptions on the three fronts that were most contentious when the talks began—developmental, socio-economic and *Bumiputera*-related policies[13]. As with the discussion of SOEs (see this book's concluding chapter) and IP-related questions (see Chapter 6), such a negotiated outcome must raise the counterfactual policy question of whether a useful reform opportunity has yet again been missed. Simply put, are Malaysia's longer-term growth and development prospects, and its quest to achieve developed-country status—always and everywhere best served by preserving the *status quo*?

Junaidi's description of the CPTPP legal text identifies the key issues and challenges faced by Malaysia in opening up its government procurement market in a trade policy setting. Such challenges can be viewed as falling into four broad categories—economic, legal, trade-related and socio-economic needs. Of course these challenges are not unique to Malaysia. No country in the world, including the most forceful advocates of procurement liberalisation, operates a fully open public procurement regime.

While Malaysia was able to address its core concerns through the numerous exclusions and exceptions foreseen under the CPTPP procurement chapter, Junaidi recalls that the agreement was concluded in a unique environment where the geopolitical and economic contexts, notably the widespread recourse to procurement preferences made by several prominent TPPA countries in responding to the global financial crisis of 2008 – 2009, proved favourable to Malaysia's quest to preserve its procurement policy space.

Considering the most recent political changes in Malaysia and the newly elected government's expressed political desire to maintain protective practices, Junaidi suggests that Malaysian procurement policies may be open to renewed challenge. This is because different trading partners, notably the EU whose own procurement market is vast and open under single-market rules, may have varying expectations and demands. In addition, the negotiating approach of some PTA trading partners, in demanding that the baseline for negotiations be PTA-plus in nature, could mean that such a baseline might amount to an upward 'ratchet effect'.

Recalling how WTO-like procurement disciplines embedded in trade agreements place limits on a government's space to assign non-economic or efficiency-departing objectives to procurement policies, such as poverty, inequality, unemployment and social development, Junaidi argues that governments need not necessarily adopt PTA disciplines fully. While it remains true that the overall objective of trade agreements is to promote better overall allocative efficiency through progressive market liberalisation, this does not necessarily mean that socio-economic and other developmental issues can or should be ignored or assigned a lower policy priority. Chapter 7 describes how recognition of the innately competing clash of policy objectives confronting procurement negotiations is addressed in government procurement disciplines. This is done in a number of ways, including: (i) the scope and coverage of trade agreements, both in terms of substantive provisions and their jurisdictional reach (e.g. national vs subnational coverage); (ii) text-based carve-outs; and (iii) country-specific negotiated exclusions.

The multiple sources of breathing or policy space afforded by trade agreements can facilitate the continued implementation of various preference-granting objectives by signatory governments in the procurement field. However, the extent to—and manner in—which such options can be used depends on negotiations, for instance with the members of the WTO's Government Procurement Agreement (GPA) and GPA-acceding countries, and between trading partners within PTAs. The ability to secure the various opt-outs on offer can also vary depending on the level of skills and expertise of negotiators, the intensity (and at times proximity) of the trade relationship between partners, as well as the nature and level of commitments already made by existing Parties.

Junaidi argues that the objectives of economic efficiency and getting the most value from government procurement can be pursued through unilateral means wholly outside the realm of trade agreements, be it the WTO or within PTAs. The policy rationales for regulating government procurement span both economics and the law. These typically feature objectives such as value for money, transparency and anti-corruption. While such aims commonly underpin trade agreements, none formally require treaty instruments to be pursued with rigour and can just as easily be embedded in domestic regulatory frameworks subject

to local judicial enforcement. A number of developed countries, notably Australia and New Zealand, have long practised broadly open procurement regimes without being members of the WTO's GPA. Membership of the latter only assumes heightened attractiveness once domestic interests seek enlarged and predictable terms of access to foreign procurement markets.

Chapter 7 goes on to note that the extent of public procurement access secured under the CPTPP may well be somewhat of a mirage, and considerably less than it appears at first sight. This, he believes, is likely in the case of the procurement markets of the more developed CPTPP Parties, such as Australia, Canada and Japan, where effective access may be much curtailed due to the highly contestable nature of such markets and the superior competitiveness of historic, first-mover, suppliers, both domestic and foreign, including from third parties such as the US or China.

Given the inevitable high political costs and rent-seeking interests involved in procurement liberalisation, the Malaysian Government must take into consideration the readiness of Malaysian companies to participate competitively in the government procurement markets of its key trading partners. Attention must also be given to geographical considerations, as distance can easily impede the efficiency and cost-competitiveness of goods supplied on a cross-border basis. The equation may be different for services, given the greater scope for supplying services remotely over digital networks or through an established presence in the target market (but which can also entail significant search and establishment costs, especially for SME suppliers).

While Malaysia is an important player in the global and (especially) regional trading environment, Malaysian suppliers are still predominantly domestic, with minimal participation in overseas procurement markets. Moreover, none the markets in Malaysia's immediate periphery, notably within ASEAN, are subject to procurement disciplines. The CPTPP may thus provide Malaysian suppliers with an opportunity to become more competitive by expanding abroad, starting with the markets of the three other AMS that have signed the mega-regional pact. At the same time, the most recently elected government may be expected to continue to place emphasis on using procurement preferences to lend support to indigenous industrial development efforts. Junaidi feels that attempting to do so will represent a challenging balancing act for the country's policymakers.

The inclusion of government procurement disciplines in trade agreements has proven a challenging policy matter for many countries, including Malaysia. The limited number of WTO GPA signatories and the constrained nature of additional commitments made even by developed countries under the GPA together with the rejection of the Singapore issue addressing transparency in public procurement, all attest to the sensitivities that surround the treatment of government procurement in trade diplomacy. At the same time, one can observe that countries are more successful in negotiating on government procurement bilaterally or plurilaterally among 'like-minded partners', as was illustrated by the TPPA/CPTPP experience. The complex interlinkages between governance, politics and attractive market access opportunities lie behind the observed policy sensitivities and may well offer a compelling rationale for limited *negotiated* traction in procurement liberalisation. Countries show a greater readiness to engage in unilateral domestic reforms of their procurement regimes, notably through the United Nations Commission on International Trade Law (UNCITRAL) Model Law, where market access issues do not arise as they do under trade agreements[14].

Chapter 7 concludes by arguing that the TPPA/CPTPP experience may inform the substance of future trade rule-making through its clear recognition of the need for developing countries to secure procurement policy space while accepting liberalising standards and processes. The CPTPP, representing as it did an interesting sample of the world economy, showcased the ability of modern trade agreements to preserve needed development policy space for developing country signatories. This is something the WTO GPA has arguably not done as well, with clear implications for its stalled membership other than recently-acceding countries. The question thus arises of whether the TPPA/CPTPP approach represents the 'new normal' that subsequent PTAs will replicate, which in turn could influence the future path of WTO rule-making on procurement.

The TPPA/CPTPP was most assuredly a game-changer for Malaysia as it sets the benchmark for future negotiations in the procurement area. Other major trading partners, such as the EU or China, are likely to expect the bar to be set at the level of the CPTPP. From here on, Malaysia may wish to consider the efficiency gains that continued efforts at procurement liberalisation may generate, not least in ratcheting up the competitiveness of domestic suppliers and their ability

to gain a larger share of foreign procurement markets. Above all, the recent experience has shown that doing so need not entail the dramatic loss of regulatory sovereignty that many had feared. The challenge now is for Malaysia not only to prepare itself for progressively greater international disciplines on its government procurement regime, but also to take active steps to enhance the competitiveness of domestic suppliers that will face increasing competition at home and abroad.

Looking ahead, Junaidi is doubtful that preserving the country's protective procurement regime will get Malaysia where it needs to be in a more globally contestable environment. Above and beyond this, greater policy attention needs to be paid to the overall, economy-wide, and good governance benefits that contemporary trade agreements can bring to the Malaysian economy and its citizens rather than focusing on procurement matters in an unduly defensive and stand-alone manner.

This volume concludes with a discussion of what, alongside government procurement and demands for WTO-plus levels of trade-related IP protection, represented one of the most sensitive issues arising from Malaysia's participation in latest generation PTAs—that of incipient disciplines targeting the potentially anti-competitive conduct of SOEs in international commerce. The central role historically assigned to the state throughout Malaysia's development has involved a dense network of SOEs found in many key sectors of the economy, from extractive industries to manufacturing as well as many services such as banking, airlines and various utilities. Heading into the TPPA negotiations and facing the affirmed desire of the US and other developed country governments to break new ground in disciplining SOE conduct, Malaysian officials harboured genuine fears that such disciplines might unduly constrain the ability of the country's SOEs to pursue and implement their stated development and nation-building aims.

In **Emerging Rules for State-Owned Enterprises: Chapter 17 of the CPTPP** (Chapter 8), Wan Khatina Nawawi explores the ramifications of the pioneering SOE disciplines brokered in the TPPA and subsequently embedded in the CPTPP, assessing what such disciplines entail for Malaysian state conduct and the extent of policy space Malaysia managed to retain under them.

Chapter 17 of the TPPA (and now the CPTPP) was one of the more difficult chapters for Malaysia to negotiate and agree to as the subject matter constituted one of its negotiating red lines from the outset. Yet, as with all other issues subject to acute domestic political sensitivities, Malaysia was able to gain the concessions and flexibilities it sought from the ten other signatory Parties for some of its commitments in the CPTPP Chapter 17 annex (see Box 3).

Wan Khatina's chapter recalls that Malaysia was already a party to other international trade agreements featuring SOE-related provisions, although most of these were of a soft law nature or not subject to dispute settlement provisions when framed as hard law undertakings. SOE rule-making precedents were set in a number of bilateral and regional PTAs, and can also be found under various agreements of the WTO. However, the breadth and depth of SOE disciplines found in the TPPA/CPTPP are by far the most comprehensive and ambitious undertaken by Malaysia to date.

Chapter 8 asks whether (and if so, how) the SOE disciplines incorporated into CPTPP Chapter 17 represent a new direction for Malaysia's SOE governance and whether the precedent set in the mega-regional agreement will condition Malaysia's acceptance of—and possible demands for—similar disciplines in future PTAs? A further question addressed here is how such disciplines and commitments fit into the existing national regulatory and governance landscape of Malaysian SOEs?

Chapter 8 serves a useful pedagogical purpose by devoting extensive attention to the development of SOEs and of SOE governance in Malaysia, recalling the historic contribution that SOEs have made to the country's growth since independence, one that allows Malaysia today to harbour legitimate aspirations to achieve developed country status within the next few years. Describing the different types of SOEs currently in existence in Malaysia and the multiplicity of sectors in which such firms operate, Wan Khatina reviews the multi-layered regulatory and governance mechanisms applied to Malaysian SOEs. Chapter 8 recalls the various national measures aimed at regulating such enterprises, including self-regulation via the Government-linked Companies Transformation Programme (GLCT), domestic regulations and governance via golden shares, sector-specific regulations, as well as Bursa Malaysia rules applicable to publicly listed companies (including publicly listed SOEs).

Before focusing attention on how the CPTPP broke important new ground while also offering Malaysia the flexibility it sought, Chapter 8 recalls the various international SOE-related commitments that Malaysia has undertaken to date and focuses on commitments made in the country's PTAs. It does so by situating Malaysia's (pre-CPTPP) PTA practice against the SOE disciplines found in the PTAs of Australia, the EU and the US.

Wan Khatina's core conclusion is that the entry into force of CPTPP Chapter 17 will change the existing regulatory and governance landscape for Malaysian SOEs and influence the country's future SOE-related commitments. This is so because Chapter 17 of the CPTPP departs markedly from the SOE rules incorporated in previous PTAs in terms of the depth and breadth of its scope. Chapter 17 takes a broad approach in disciplining SOEs when they engage in cross-border trade and investment in goods and services alike. Such obligations are pro-competitive in character, requiring SOEs to adhere to the non-discrimination principle for their commercial activities (for example, with regard to cross-subsidies within different SOE activities), to act solely in accordance with commercial considerations in their purchase or sale of goods or services, and to refrain from engaging in anti-competitive conduct (defined to include abuse of dominance and monopolistic conduct). Such provisions echo those found in the PTA templates of Australia, the EU and the US.

Box 3. SOE-related Policy Flexibilities Agreed in Chapter 17 of the CPTPP

Non-application of CPTPP Chapter 17: Chapter 17 may exclude some SOEs either at the scope level or the non-conforming measure (NCM)-level. The scope-level exclusion was incorporated into the main text of the chapter whereas the NCM-level exclusion was incorporated into the country annexes of the chapter. Unless stated otherwise, the scope level provides a blanket exclusion for the SOEs concerned. Chapter 17 of the CPTPP excludes:

- SOEs operating at the sub-national level—state-level SOEs in the case of Malaysia;
- Sovereign wealth funds and independent pension funds at the scope level; and
- The procurement decisions of SOEs.

Meanwhile, the NCM level allows CPTPP signatories to maintain *existing* non-conforming SOE-related measures. However, other substantive provisions in the chapter, notably on transparency, apply to covered SOEs.

Listing of existing non-conforming measures (NCMs): CPTPP signatories preserved the ability for some of their SOEs to continue to undertake activities which would otherwise be inconsistent with Chapter 17 obligations. To do so, however, signatories must provide detailed information the nature of non-conforming measures in country-specific annexes appended to Chapter 17. Parties may subsequently eliminate NCMs when they are ready and willing to do so. Malaysia's NCM list includes measures in the oil and gas, agriculture, and investment and asset management sectors; as well as certain policies such as the *Bumiputera* policy, the small- and medium- sized enterprise (SME) policy, and the economic development policy for Sabah and Sarawak.

Exemptions linked to SOE size: Chapter 17 of the CPTPP provides exemptions for 'smaller' SOEs, defined as those with annual revenue deriving from their commercial activities of less than SDR500m in any one of the three previous fiscal years. Such SOEs are only obliged to meet certain but not all Chapter 17 provisions.

Phased sequencing of CPTPP obligations: The CPTPP is a North-South PTA linking Parties with starkly different levels of economic development. This implies that some signatories may require more time to comply with agreed rules and commitments. Beyond the flexibilities noted above, Malaysia (like Vietnam) was given five years from the CPTPP's entry into force to complete and make public the list of its covered SOEs.

Temporary exemptions from the CPTPP Dispute Settlement Chapter: Benefiting from the explicit assent of its CPTPP partners, Malaysia exercised the flexibility accorded to signatories under CPTPP Chapter 17 by exempting the SWF Khazanah Nasional Berhad from the agreement's dispute settlement provisions for two years from the treaty's entry into force in light of pending SOE reform-related legislation.

Source: Wan Khatina in Chapter 8.

However, Chapter 17 of the CPTPP goes beyond traditional competition rules in addressing general governance issues for SOEs, such as the transparency of their governance structure and operational conduct. Importantly, the SOE disciplines of the CPTPP depart from the traditional manner in which competition-related disciplines have hitherto been treated in PTAs by making them explicitly subject to the agreement's dispute settlement provisions (found in CPTPP Chapter 28) in instances of non-compliance.

Wan Khatina notes that the many exclusions and flexibilities carved into the main body of Chapter 17 and of the annexes listing country-specific exceptions (non-conforming practices) offer proof of the delicate balancing act that negotiating such disciplines represented, both because of their sensitivity across many countries (and not only Malaysia) and also their sheer novelty. Both characteristics are prone to culminate in outcomes imbued with significant doses of regulatory precaution. In the end, Wan Khatina considers that Chapter 17 did achieve a proper balance between the setting of meaningful (and novel) good governance principles for SOEs while showing flexibility in operationalising the chapter's provisions among signatories characterised by considerable diversity in levels of economic and institutional development and capacity. Box 3 describes the various flexibilities and their relevance to Malaysia. Determining whether such a balancing act was successful will, however, only prove possible once the chapter is fully implemented.

From a Malaysian perspective, Chapter 17 of the CPTPP adds a new and more demanding layer to the domestic and international regulatory mechanisms and instruments already governing Malaysian SOEs. Malaysian SOEs currently report to their shareholders (including the government), to various regulators such as the Securities Commission, Bursa Malaysia and the Central Bank, as well as to multilateral organisations such as the WTO Committee that oversees subsidy practices and the International Working Group for Sovereign Wealth Funds established pursuant to the adoption of the Santiago Principles governing SWFs. Once Chapter 17 is in force, the Malaysian authorities would also have to report to the CPTPP-established Committee on State-Owned Enterprises and Designated Monopolies, comprising government representatives of each Party.

In enforcing CPTPP Chapter 17, the government of Malaysia will need to ensure that its SOEs undertake activities that are consistent with the provisions of the chapter, as any major inconsistency could result in recourse to the CPTPP's dispute settlement provisions under Chapter 28. Chapter 8 describes how this could prove costly and reputationally damaging for both the Malaysian Government and the SOEs concerned. Additionally, Malaysia will need to undertake some reforms, including in regard to the development of SOE reform legislation, prior to the CPTPP's entry into force.

Meanwhile, Malaysia's other (non-CPTPP) trading partners are likely to consider the country's SOE-related commitments under CPTPP Chapter 17 as offering the basis for negotiating any new SOE-related provisions in future PTAs. As discussed in Chapter 3, Malaysia is currently negotiating the RCEP with other AMS, Australia, China, India, Japan, New Zealand and South Korea, as well as a comprehensive bilateral PTA with the EU. In the case of RCEP, Australia, Japan and New Zealand were also signatory Parties to the CPTPP. In a 'maximum' case scenario, Malaysia's non-CPTPP partners can be expected to seek CPTPP parity in regard to SOE-related provisions. Given that several of Malaysia's key non-CPTPP partners feature important SOEs, the country's traders and investors may also see benefit in replicating CPTPP disciplines in third party agreements so as to level the playing field and contain the potentially anti-competitive privileges bestowed on foreign SOEs.

In her concluding remarks, Wan Khatina notes that negotiating SOE disciplines in both the TPPA and CPTPP has taught important policy lessons to an emerging country like Malaysia. Reports that Thailand and Indonesia are considering CPTPP membership add in her view to the salience of Chapter 17 rules. Meanwhile, the implications of the recent general elections in Malaysia and the desire expressed by the newly elected Prime Minister to reopen certain aspects of the CPTPP prior to its ratification by the Malaysian parliament introduce new uncertainty into what has been a decade-long rule-making journey. Whatever the outcome of the above developments, Chapter 8 recalls how implementing Chapter 17 of the CPTPP will bring change to the existing domestic regulatory and governance landscape for Malaysian SOEs while also influencing the nature and scope of future SOE-related obligations assumed by Malaysia in its PTAs with third countries.

Endnotes

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[2]See "PM Urges TPP 'Renegotiation'." *New Straits Times*, June 6, 2018.

[3]Malaysia's gross national income (GNI) per capita stood at USD9,650 in 2017, or USD2,405 below the threshold level of USD12,055 that the World Bank currently sets to define high-income country status. The latest World Bank staff projections suggest that Malaysia's GNI per capita is likely to exceed the defined threshold at some point in the period from 2020 to 2024.

[4]See Constatinescu, C., A. Mattoo and M. Ruta. 2015. "The Global Trade Slowdown: Cyclical or Structural?" *IMF Working Paper* 15/6, Washington, D.C.: International Monetary Fund. See also Constantinescu, C., A. Mattoo, and M. Ruta. 2016. "Does the global trade slowdown matter?" *Journal of Policy Modelling* 38 (4): 711–22.

[5]For fuller discussion of the trade and investment policy implications of the New Industrial Revolution and its associated technological disruption, see International Trade Centre, OECD, UNCTAD, World Bank Group and WTO. 2018. "Trade and Investment Aspects of the New Industrial Revolution." Background Note for the G20 Trade and Investment Working Group, Argentina Presidency 2018, 24 April.

[6]Australia, China, India, Japan, New Zealand and South Korea.

[7]Among manufactured goods, electrical and electronic (E&E) products are Malaysia's leading export item. In 2000, E&E exports represented more than half (58.8%) of Malaysia's total merchandise exports. While the industry's share of aggregate merchandise exports had continued to rise between 2000 and 2017, its growth has been substantially less than that of petroleum and gas, palm oil and rubber. By 2017, E&E exports accounted for 28.4% of total Malaysian merchandise exports.

[8]EFTA member countries are Iceland, Liechtenstein, Norway and Switzerland.

[9]The World Bank's Services Trade Restrictiveness Index (STRI) database provides comparable information on services trade policy measures for 103 countries, five sectors (telecommunications, finance, transportation, retail and professional services) and key modes of services delivery (cross-border trade, commercial presence and movement of natural persons). The database collects—and makes publicly available—*applied* services trade policy information assembled in a comparable manner across a sample of 79 developing countries and 24 OECD countries. STRI measurements vary from 0 (fully open services regimes) to 100 (fully closed). An index level below 25 is generally

deemed to connote a relatively open services regime, while an index of 50 and above denotes a services regime characterised by a high degree of restrictiveness. Malaysia's overall level of policy restrictiveness in services places it among the more closed members of ASEAN.

[10]Citing UNCTAD data, Chapter 5 notes that 114 countries have been respondents to one or more known ISDS cases to date, from a total of 817 known ISDS cases since 1987.

[11]Chapter 5 reports that the average ISDS claim size and the highest known damages awarded would respectively make up 2.6% and 78% of Malaysia's central government revenue in 2017.

[12]Chapter 6 reports that the share of Malaysian patents granted to foreigners decreased from 92.3% in 2003 to 87.6% in 2015. Growth in the number of patents granted to local innovators related principally to R&D conducted within Malaysian institutes of higher learning and government research institutes.

[13]In addition, Malaysia successfully secured transitional clauses for the following measures: (i) procurement funded by an economic stimulus package in response to a severe nationwide economic crisis implemented within 25 years after entry into force of the CPTPP; and (ii) delayed application of the prohibition of offsets for a period of twelve years following the date of entry into force of the CPTPP.

[14]Smaller and developing countries are more open to adopt or follow the UNCITRAL Model Law. The list of countries is available at http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/2011Model_status.html

2

Introduction to Malaysia's Trade Policies

Nungsari Ahmad Radhi, Adibah Abdulhadi and Musaddiq Adam Muhtar

ECONOMIC BACKDROP OF MALAYSIA IN RECENT HISTORY

The launch of the New Economic Model (NEM) in March 2010, right after the global financial crisis (GFC) was a timely initiative. Like the 1997/98 Asian financial crisis (AFC), the GFC represented a watershed for the Malaysian economy. The NEM Report itself noted that Malaysia's growth trajectory flattened after the AFC (National Economic Advisory Council 2010). Malaysia, along with other nations in the region, was unable to sustain the rates of growth it had achieved in the decade prior to the AFC in the following decade (Larson *et al*. 2016). This was despite bullish commodity markets—the 2000s commodity super-cycle that peaked in 2008 and has declined markedly since 2014 (Baumeister and Kilian 2016, Erten and Ocampo 2013). Unfortunately, this has associated countries such as Malaysia and Thailand with a phenomenon dubbed 'the middle-income trap' (Eichengreen *et al*. 2013), a term applied to countries that are squeezed between low-wage producers and highly skilled, fast-moving innovators (Flaaen *et al*. 2013).

The economic recovery from the AFC and the subsequent aspiration to economic transformation was not achieved riding the commodities boom. Fulfilling the same imperatives now, at the trough of that cycle, is even more challenging as the Malaysian economy continues to depend heavily on natural resources. With the exception of oil and gas, the primary industries in Malaysia are colonial legacies that have seen changes in ownership but remain largely in the production stage of the value chain and their exports constitute a major part of Malaysia's external trade.

Box 1. The New Economic Model (NEM)

The NEM was introduced in 2009 at the peak of the GFC. The premise of the policy was that although Malaysia's economy was growing, it was caught in a middle-income trap. The income growth post-AFC had been markedly slower and private investment had not reached the same level as it had before the crisis. The economy had not gone beyond an input-driven model nor been able to rely on value creation based on productivity growth through innovation and technological upgrading.

The model identified issues that had contributed to the middle-income trap. They included excessive government involvement in the economy through government-linked companies (GLCs), low or inadequate value-added of exports, over-reliance on unskilled foreign labour, lack of innovation and widening income disparities.

To address the above challenges, the NEM envisioned economic reforms and structural changes that would enable the country to break out of the middle-income trap. The old model of resource exploitation and low-cost advantages can no longer be relied on for further growth. Thus, to re-energise the economy, there must be a change in the current way of doing business.

The NEM proposed transformation based on three principles: high income, inclusivity and sustainability. Among others, it aimed for income per capita to reach between USD15,000 and USD20,000 by 2020, for private investment to constitute 20% of gross domestic product (GDP) (which was the level pre-AFC), for more targeted assistance to households in the bottom 40% of the income distribution, a more equitable and merit-based system, better fiscal discipline and greater environmental protection.

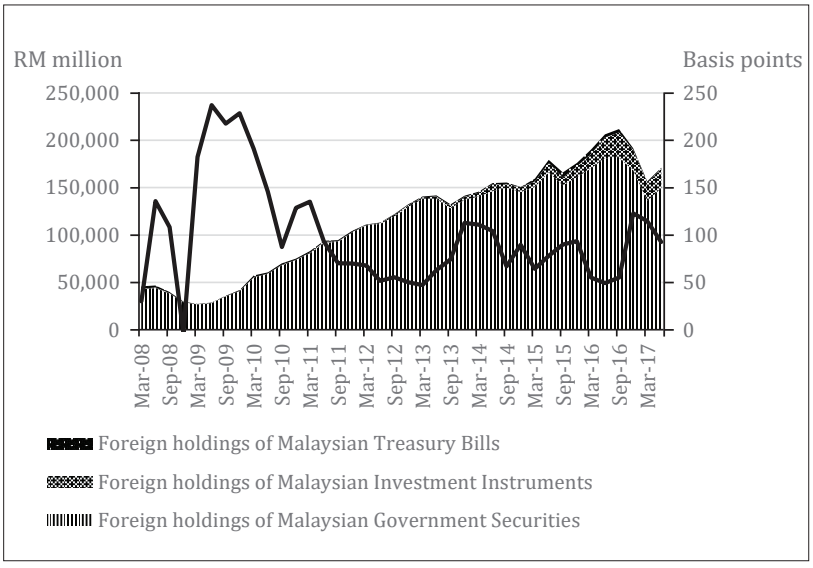
Eight Strategic Reform Initiatives were proposed to this end: re-energising the private sector, developing a quality workforce and reducing dependency on foreign labour, creating a competitive domestic economy, strengthening of the public sector, transparent and market friendly affirmative action, building the knowledge base infrastructure, enhancing the sources of growth and ensuring sustainability of growth. The NEM does not identify national champions or any specific industries to be developed, but instead focuses on nurturing a business ecosystem favouring the emergence of competitive and innovative firms, while promoting the orderly market exit of inefficient ones.

The policy recognised that because its proposals call for substantial structural changes, there will be opposition from those who benefitted from the status quo, such as businesses in protected industries, beneficiaries of subsidies and employers of foreign labour. The NEM was one of the four initiatives proposed by the government at that time. The other three were 1Malaysia, the tenth Malaysia Plan and the Government Transformation Plan.

Source: National Economic Advisory Council (2010).

The GFC did not affect Malaysia the way the AFC did, but unconventional policy decisions taken in the United States (US), European countries and later on in Japan resulted in loose monetary policies (near zero or negative interest rates) and the massive injection of liquidity into financial markets (quantitative easing). This generated a massive inflow of capital into emerging markets such as Malaysia, altering the prices of capital and credit in a distortionary manner (Bank Negara Malaysia 2015, 2017b). Spreads between 10-year government bond yields and Bank Negara Malaysia's Official Policy Rate (OPR) fluctuated violently as Malaysia experienced hot money inflows and outflows (Bank Negara Malaysia 2014). This resulted in several episodes, such as the 'Taper Tantrum' episode of May to August 2013, where uncertainty over the timing and magnitude of the quantitative easing scale-back led to large capital outflows, or after the 2016 US presidential elections led to expectations of tightening US monetary policy, again causing large capital outflows (see Figure 1).

Figure 1. Foreign Holdings of Malaysian Government Bonds Spread between 10–Year Malaysian Government Bond Yields and OPR

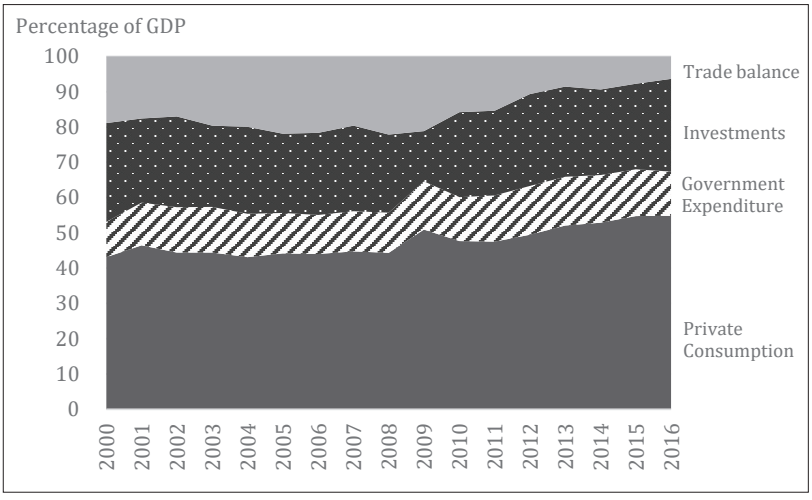


Source: CEIC Data (n.d.)

One clear pattern that emerged after the GFC was a slowdown in global trade as the fast-growing emerging economies of China and India moderated their growth rates, which were already affected by the slowdown in the US and Europe. This created another cycle of demand contraction that dampened the commodity markets which, in turn, affected commodity exporting countries, among which were the BRIC economies[1] that had fuelled both global trade and growth. This has clearly had an impact on Malaysia.

As in many other countries, an emerging pattern in Malaysia's macroeconomic structure is the shrinking contribution of trade to aggregate demand (see Figure 2). Between 2000 and 2016, net exports as a percentage of GDP contracted by more than half, from 18.9% to 7.7%. While Malaysia's exports have continuously increased throughout this time period—with the exception of 2008, when both exports and imports contracted—they have done so at a slower rate than imports, resulting in diminishing trade surpluses over the same period. This, in turn, has narrowed the country's current account surplus.

Figure 2. Malaysia's GDP Composition by Expenditure

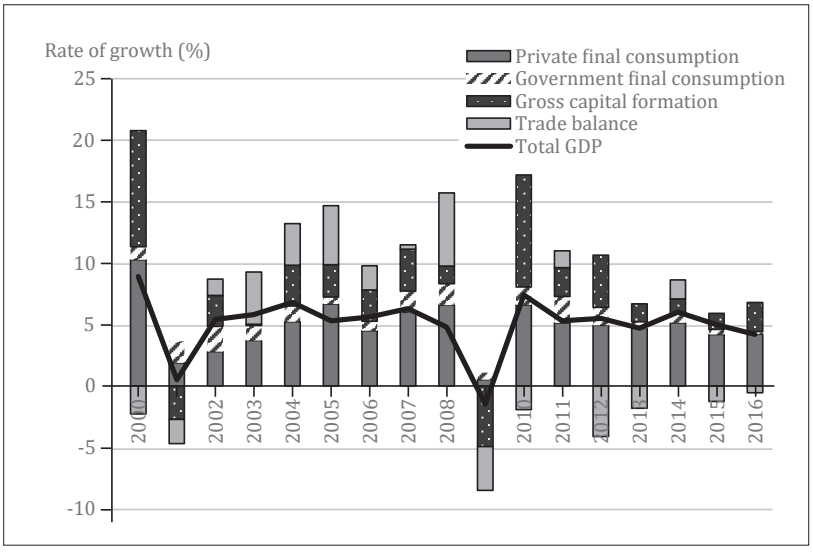


Source: CEIC Data (n.d.)

With diminishing net exports, domestic final consumption is increasingly driving the growth of Malaysian GDP, particularly post-GFC (see Figure 3). In 2016, nominal GDP grew by 4.2%. Breaking down this growth rate, government and private final consumption collectively grew by 4.3% while gross capital formation grew by 2.6%. On the other hand, net exports shrank dramatically between 2014 and 2016, from a 1.5% growth in 2014 to –1.3% in 2015 before tapering off to –0.9% in 2016, following a global trade slowdown. The economic downturn caused by the GFC, which also witnessed a decrease in the contribution of trade to GDP, was partly mitigated by increased spending by government and households.

This increased level of final consumption can partly be attributed to the loose monetary policy stance maintained in Malaysia and globally. In nominal terms, the compound annual growth rates (CAGR) of private and government final consumptions between 2000 and 2016 were 9.6% and 9.5%, respectively, compared to 0.9% for net exports. Clearly, the sources of Malaysian economic growth have become increasingly endogenous. The diminishing role of trade in driving the economy is interesting because Malaysia's total trade-to-GDP ratio is one of the highest in the world. In 2017, Malaysia's trade-to-GDP ratio was 136%, compared to a world average of 88% (Bank Negara

Figure 3. Malaysia's GDP Growth by Expenditure



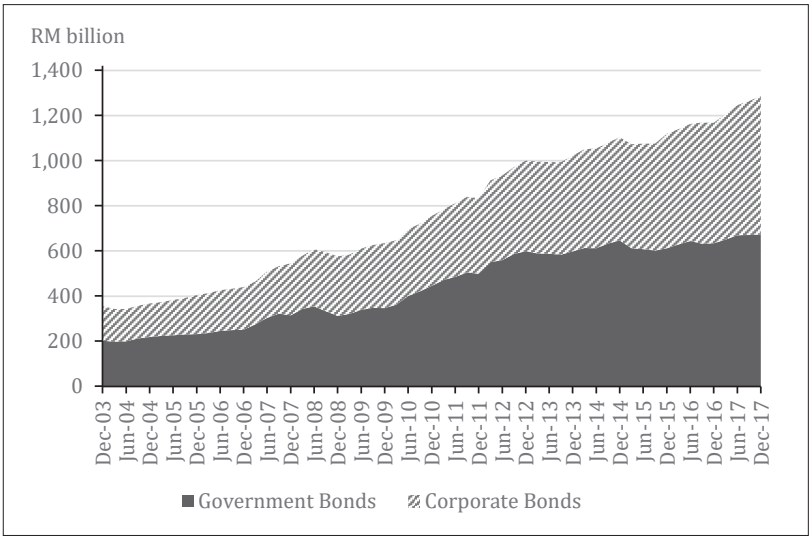
Source: CEIC Data (n.d.)

Malaysia 2017b). Thus, even when the contribution of trade to growth is declining, trade still plays a key role in the economy. Diminishing net exports point to a shift in the economic structure of the country and its engine of growth, something that should be better understood, especially in the formulation of trade policy.

The expansion of consumption expenditures by both households and the government was accompanied by credit expansion and budget deficits, respectively. This debt-induced consumption is unlikely to prove sustainable in the long run. In the case of government borrowing, it also crowds out much needed private investment. Government and government-guaranteed debt dominate the Malaysian debt markets. As of December 2017, Malaysian government bonds made up 52.3% of the total Malaysian bond market (see Figure 4).

Such dependence on debt-based consumption is not sustainable. Malaysia will not be able to rely on domestic demand to generate sustained growth as it does not have sufficient market size to drive specialisation (Hummels *et al*. 2001), economies of scale and gains from productivity improvements at the firm level (Melitz 2003), which are needed for firms to be globally competitive. Small open economies

Figure 4. Composition of Malaysia's Bond Market

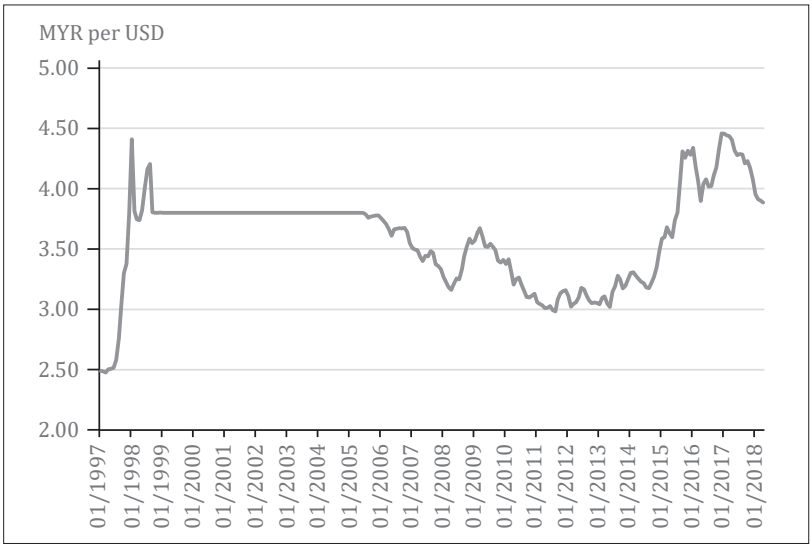


Source: Asian Development Bank (2017).

experience better economic growth relative to economies under autarky; domestic firms are able to leverage international markets to cater to a larger set of consumers while experiencing efficiency and productivity gains through robust international competition. Thus, trade has been and will always be an integral component of the Malaysian economy.

Debt-based consumption by both government and households boosted aggregate demand in the past decade. However, in the post-GFC world, policies of maintaining low interest rates and easy money are not only unsustainable and ineffective, they also introduce vulnerabilities that extend beyond the real economy. As noted earlier, the aftermath of the 2016 US presidential elections led to expectations of large fiscal expenditures to boost growth, giving the Federal Reserve reasons to normalise monetary policy and curb inflationary pressures in the economy. This led to large capital outflows from Malaysia, putting significant pressure on the RM-USD exchange rate, which reached historical lows (see Figure 5). Such a situation is detrimental to an economy that imports a lot of goods and services. The policy focus should thus be on building the competitiveness of the tradable sectors of the economy rather than targeting growth numbers *per se* and

Figure 5. RM–USD Exchange Rate, 1997–2017



Source: CEIC Data (n.d.)

achieving targets through pro-cyclical fiscal policy. Stronger linkages and coordination between trade, macroeconomic and development policies should therefore be the focus of Malaysian policy in the future.

Even before the GFC, Malaysia was active in preferential trade agreements (PTAs), both bilaterally and regionally, fuelled in part by the prolonged stalemate in the World Trade Organization (WTO)'s Doha Development Agenda. The Japan-Malaysia Economic Partnership Agreement was signed in 2006, followed by bilateral PTAs with Pakistan, New Zealand, India, Chile and Australia. At the regional level, the Association of Southeast Asian Nations (ASEAN) has signed PTAs with China, Japan, South Korea, India, Australia and New Zealand. Malaysia signed the Trans-Pacific Partnership Agreement (TPPA) (now the Comprehensive and Progressive Trans-Pacific Partnership agreement following the withdrawal of the US from the TPPA) and is currently negotiating PTAs with the European Union (EU) and other regional partners such as the Regional Comprehensive Economic Partnership (RCEP) which is a proposed PTA between ASEAN and the six neighbouring states with which it has existing PTAs, namely, Australia, China, India, Japan, New Zealand and South Korea.

In light of the domestication of the economy since the AFC, this chapter argues that the changing nature of the Malaysian economy must be better understood and that such an understanding needs to be incorporated into the ongoing Economic Transformation Programme (ETP), in particular the growth strategy of the Malaysian economy. At a more micro level, strategies and policies regarding industrial development must then provide input to and colour the formulation and execution of the country's trade policy, including the strategy on agenda-setting and the choice of PTA and multilateral negotiations.

The national transformation imperative does not just cover the growth dimension of the NEM. It also requires that there be a transformation in terms of what are the main sources of growth and the overall productivity of the economy as well as resulting distributional outcomes. Having started out as a commodity trading economy that acquired—largely through sustained levels of FDI—an export-oriented manufacturing sector, it is unlikely that the next phase of the Malaysian economy will be a predominantly domestic-driven one. Thus, trade policy should not be linked solely to FDI attraction aims but also to broader industrial development objectives and the transformation agenda of the economy. If the external sector is to

Box 2. Economic Transformation Programme

One year after the inception of the NEM, the government launched another initiative called the Economic Transformation Programme (ETP). The ETP acknowledged that Malaysia's recent economic performance had been rather sluggish. Malaysia was stuck in the middle-income trap; it could no longer compete with other emerging countries that have cost advantages in producing high-volume, low-cost products and, at the same time, it was not yet able to move up the value chain and compete with high-income countries.

The ETP aimed for the country to reach the high-income mark of USD15,000 of gross national income (GNI) per capita by 2020, which would require an average of 6% growth per year. To achieve this, the ETP identified twelve National Key Economic Areas (NKEAs): oil, gas and energy; palm oil and rubber; financial services; tourism; business services; electrical and electronics; wholesale and retail; education; healthcare; communications

content and infrastructure; agriculture; and the Greater Kuala Lumpur region.

The NKEAs were selected based on the size of their contribution to the GNI. The geographical area of Greater Kuala Lumpur was selected separately from the industry NKEAs. It was included because the area accounts for one-third of Malaysia's GDP and because "a thriving Kuala Lumpur is vitally important to the health and performance of the overall economy".

The ETP prides itself on being an action-based, instead of a concept-based, plan. Its inception report states that it is "focused on actions and not concepts. The ETP contains well-developed and specific ideas and actions to grow each of the NKEAs, rather than broad statements of intent."

For each NKEA, the ETP identifies initiatives which are separated into two categories: entry point projects and other business opportunities. The former refers to projects that "should generate big results fast". Each initiative, in turn, would identify potential investors and would develop the implementation plans and funding requirements. The ETP envisioned that these initiatives would be primarily led by the private sector. To assess the progress of the implementation of the programme, key performance indicators are set for each NKEA which would then be monitored by a new unit established under the Performance Management and Delivery Unit (PEMANDU) of the Prime Minister's Department.

The government's role in the ETP is as a facilitator by promoting investments through, among others, marketing, tax breaks, soft loans, and grants; developing high-skilled human capital; improving the business environment; and building communication and logistics infrastructure. Industries that had been identified as part of the NKEAs would receive prioritised public investment and policy support in resolving disputes and bottlenecks. Thus, the ETP shifted the government's focus and policy reform efforts towards the needs of the NKEAs.

While the ETP used some of the vocabulary from the NEM, its approach is different. Unlike what its name would suggest, the ETP does not aspire to a change in the economic structure (other than an increase in the rate of growth), but instead aims for the preservation of the status quo. Its initiatives seek not so much to change the incentive structure that governs the economy but rather

to further support existing industries to become bigger so as to be globally competitive. In some fundamental ways, this disconnect between the structural reforms objectives of the NEM and the quest for growth of the ETP represented a missed opportunity for Malaysia.

PEMANDU and ETP reformed how things are done by focusing on doing 'more of the same' to achieve the growth targets, while the NEM advocated changes in what the economy does—a transformed production function and one that also addresses distributional issues. This lack of cohesion and the pursuit of growth targets has led to a trade policy that lacks the strategic perspective of using policy incentives and PTAs as tools for economic transformation. As an example, there seems to be an absence of a grand strategy in negotiating PTAs, clear objectives of what incentives the economy wanted, what were the trade-offs, what should be the sequence of negotiations, and how international institutions will be used to achieve the country's objectives in any bilateral or multilateral platforms.

Source: Adapted from Economic Transformation Programme (2010).

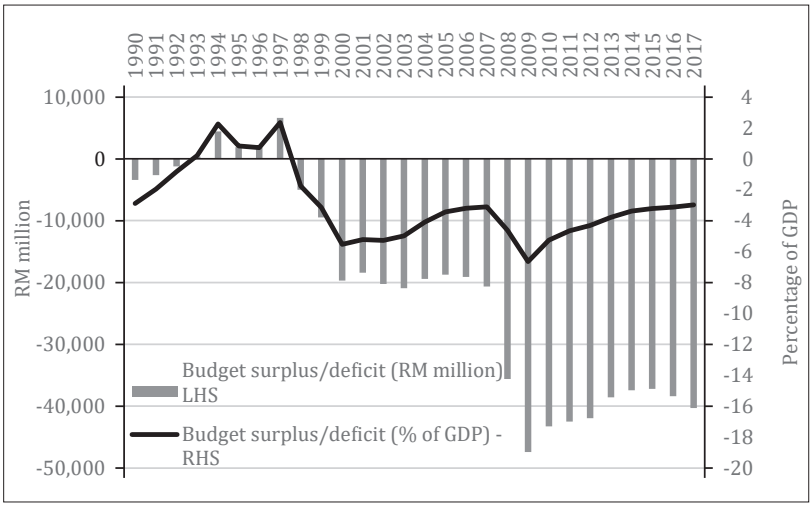
remain a key feature and driver of Malaysian economic growth, how should trade policy be formulated to achieve the transformational objectives of the NEM?

The following section further elaborates the central thesis that the sources of growth have become more endogenous and relates this to the question of both capital and labour flows affecting incentive structures for economic transformation. It looks at the dual nature of the Malaysian economy and how the structure of trade has changed while the process of domestication was taking place. This is followed by a section that explores backward linkages arising from specific aspects of trade and industrial policies—particularly on provisions in PTAs—to the broader policy objective of economic transformation. The final section concludes by linking the trends in growth and development highlighted in the previous sections to questions about the future of Malaysian trade policy.

MACROECONOMIC IMPACT FROM ECONOMIC DOMESTICATION

The premature domestication of the Malaysian economy occurred while the country was experiencing robust growth. Since the AFC, the economy has contracted twice, in 2001 and 2009, amidst declining overall growth. Therefore, this can either be seen as the relative contraction of net exports or a reflection of the fact that the growth of domestic demand was higher relative to overall growth. In truth, there was a mix of the two and the economic structure itself evolved over the entire period. Global trade did go down post-GFC as both producing and consuming economies contracted. The economic slowdown also affected the demand for commodities, effectively halting the long commodity bull run that started at the turn of the century—the commodity super-cycle. Thus, trade in both commodities and manufactures contracted, negatively affecting Malaysia's net export position. This contraction in external demand was compensated through increases in both public and private consumption expenditures made possible through debt financing.

Figure 6. Malaysia: Budget Surplus and Deficits of the Federal Government



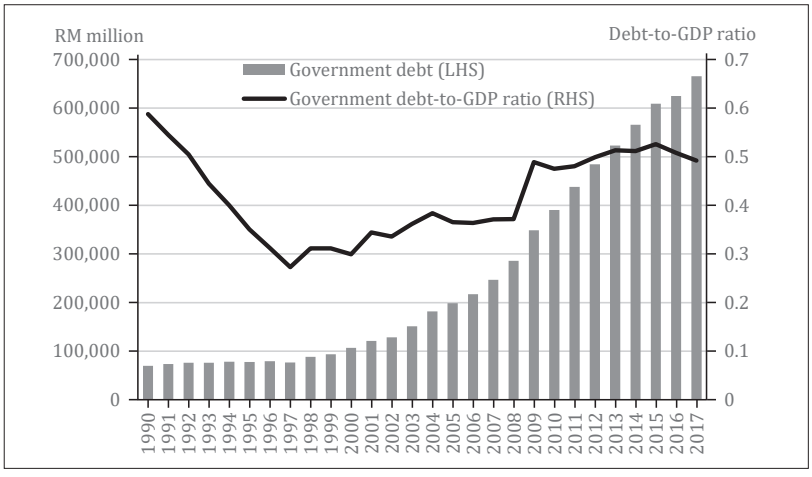
Source: CEIC Data (n.d.)

Malaysia's pro-cyclical fiscal stance, which began during the post 1997/98 AFC, continued during the post-GFC period, beginning with the stimulus package introduced in 2009, which saw the country's budget deficit reach almost 7% of GDP (see Figure 6). Recourse to growth targeting meant that deficit spending continued even after the peak of the crisis in 2009. Fiscal discipline was wanting.

As noted earlier, the immediate aftermath of the GFC saw liquidity flowing eastwards and into emerging Asian economies. Emerging market sovereign debts became a favoured asset class during this period as international investors searched for yield in a low interest world. Demand pushed bond prices up, lowering borrowing costs for emerging economies, leading to an expansion in general government gross debt. Malaysia ran deficits of more than 4% of GDP between 2008 and 2012, and the government continues to struggle to reign in its deficit. A further consequence of foreign-sourced borrowing was the strengthening of the Malaysian Ringgit itself.

The Ringgit-denominated debt of the federal government exploded from 37.2% of GDP in 2008 to 48.9% just a year later (see Figure 7). By the end of 2017, the figure stood at 49.2% or an absolute amount of RM666 billion. The debt of the federal government has increased at a compound rate of 11.5% since 1998. Besides direct debt, the government has also

Figure 7. Federal Government Ringgit–denominated Debt

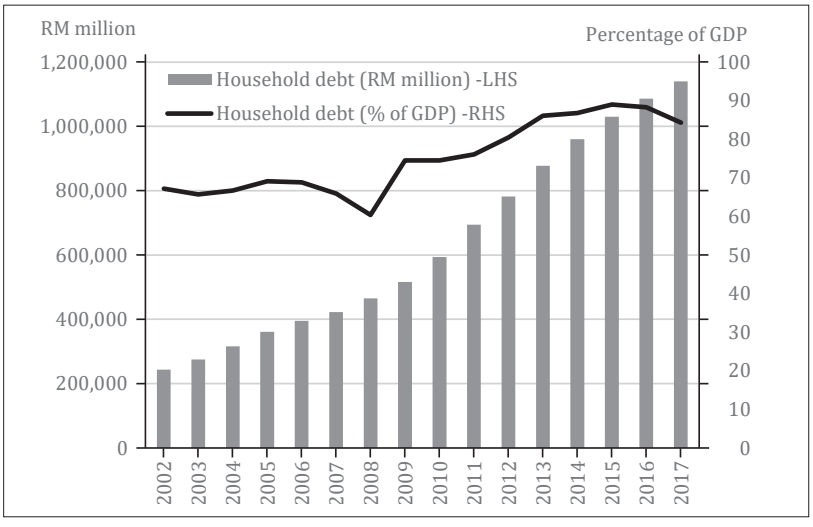


Source: CEIC Data (n.d.)

incurred contingent liabilities through guarantees issued on various public projects implemented via public–private partnership models that raised funds in the capital markets. Some of these liabilities, in the form of government guarantees to government entities, depended on the government for repayment and servicing. Major infrastructure projects, such as the Light Rail Transit, Mass Rail Transit and the Pan Borneo Highway, were financed by government guarantees that imposed long-term financial obligations on the government, translating into expenses for future government budgets. Fiscal consolidation has been made more difficult by such long-term commitments.

While foreign inflows went into sovereign debt instruments, local liquidity targeted households, especially consumption credit, car and housing loans. Consumption credit to households was also extended by the non-banking sector mainly through cooperatives, cooperative banks and money lenders, both licenced and illegal lenders. These are mostly personal loans used for consumption expenses. This easy availability of credit at attractive rates fuelled household consumption while also increasing household indebtedness. Since the onset of the GFC, household debt as a percentage of GDP has soared by almost 50%, from 60% in 2008 to 84% in 2017 (see Figure 8). This trend can also be seen in other countries in the region: from 2010 to 2017,

Figure 8. On the Rise: Household Debt in Malaysia, 2002–2015



Source: CEIC Data (n.d.)

South Korea's household debt-to-GDP ratio shot up from 77% to 98%, Thailand's household debt-to-GDP ratio grew from 53% to 78% and Singapore's household debt-to-GDP increased from 47% to 72% (Bank for International Settlements 2017). In nominal terms, household debt increased at a rate of 11% between 2002 and 2017. This level of government debt-to-GDP ratio places Malaysia alongside economies such as Brazil (57.4%), New Zealand (59.3%), Poland (53.5%) and the Philippines (49.4%) (World Bank n.d.).

The government, on the other hand, dominated the capital markets with its continuous deficits—a classic case of 'crowding out'. The share of private investment in GDP dropped from around 20% before the 1997/98 AFC to the low teens. If it were not for heavy capital investments in the oil and gas sector during the commodity boom period, the share of private investment would have been smaller. The period since the GFC also saw the rising inefficiency of fiscal policy as fiscal multipliers contracted significantly[2]. Thus, despite the prolonged deficits, accumulated public investments over the period did not induce private investments the way they had in the past.

The lack of fiscal discipline since the AFC is a manifestation of many factors. If such a lack of discipline is not reversed, the problem becomes not so much one of affordability but rather one of the way fiscal policy is looked at and applied. Fiscal policy has remained steadfastly unidimensional, the expenditure side serving as a 'filler' for aggregate demand to achieve a growth target. Both allocative and productive efficiency of public expenditures were largely ignored which, over time, dulled the impact of public expenditures. At the same time, stepped-up borrowing was made easier by the cyclical rise in commodity prices and capital flows from developed markets.

It was not until an abrupt collapse in oil and gas prices of over 50% from their peaks that serious fiscal consolidation started. Subsidy rationalisation began in earnest and the introduction of the Goods and Services Tax (GST) in the second quarter of 2015 was an attempt to broaden the tax base. By this time, Malaysia's current account surplus had dwindled to a single digit percentage of GDP while quantitative easing in the US continues to be wound down. Under such circumstances, there will be an increased need for greater amounts of foreign liquidity to finance the continuing deficits and tightened liquidity conditions are likely to raise the cost of future borrowing.

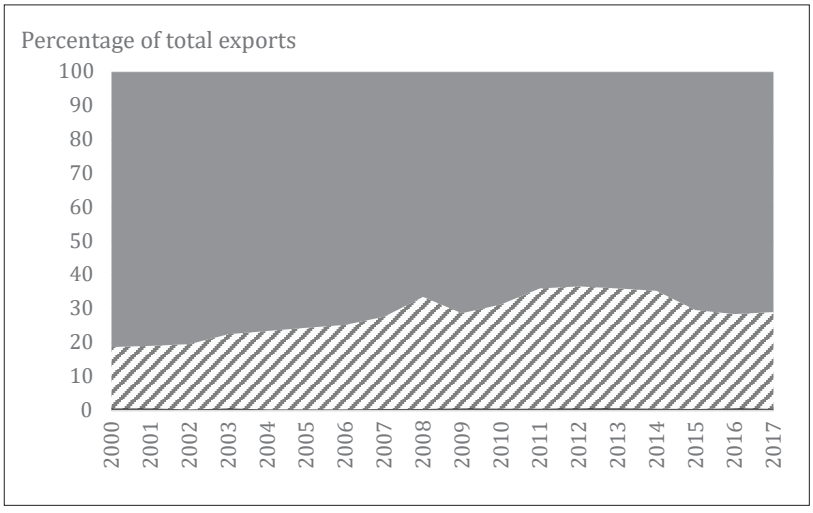
The real opportunity cost of the last 17 consecutive years of deficit spending, and the consequential rise in indebtedness levels, is that no new sources of growth have emerged from the commodity windfall. A once vibrant trading economy lost its competitive vigour in a world that saw increased globalisation and the growth of cross-border trade and investment during the same period. Fiscal policy, meanwhile, was more concerned with the quantum rather the quality of growth. The structure of the economy, particularly the central question of Malaysia's trade competitiveness, was not given adequate attention.

The incentive to innovate and effect needed structural change was also dampened by the influx of low-skilled immigrant labour into high capital returns and rent-seeking sectors such as plantation and construction. Even the manufacturing sector today employs sizeable numbers of foreign workers as do service sectors such as hotels, restaurants and households (domestic help). According to the World Bank, there were 2.1 million registered immigrants in Malaysia at the latest count (World Bank 2015). These numbers are likely to rise by another 30% – 40% if undocumented workers are included, making up an estimated 15% of Malaysia's workforce.

Despite being an open trading economy, sustained inflows of both foreign capital and labour over the past two decades have impacted the Malaysian economy in a manner that has domesticated the economy. This is so because neither of these factors of production went into new sectors or create new businesses—thus generating no new sources of growth and wealth creation. This raises important questions of policy choices and the incentives they offer. In particular, it raises the broader issue of policy coherence, between the country's trade and investment policies on the one hand and its overall developmental objectives on the other.

The next section examines how the structure of trade has changed over the period as the economic structure itself changed and became more domestically-oriented.

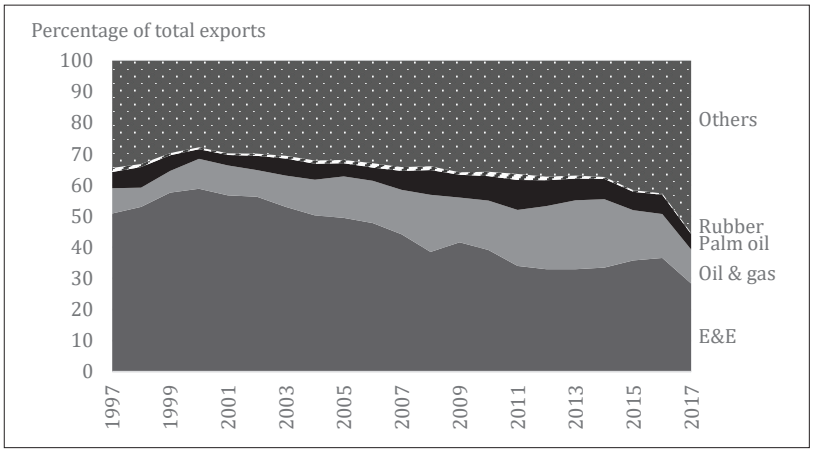
Figure 9. Malaysia's Export Composition by Product Category[a]



Note: [a] Exports of Manufactured Goods, Machinery and Transport Equipment and Miscellaneous Manufactured Articles and Chemicals are grouped as Manufactures. Exports of Food, Animals, Live Animals, Vegetable Oils, Fats, Beverages, Tobacco, Inedible Crude Materials and Mineral Fuels are grouped together as Resource-Based.

Source: CEIC Data (n.d.)

Figure 10. Malaysia's Export Composition by Selected Product Categories



Source: CEIC Data (n.d.)

STRUCTURAL CHANGE IN THE ECONOMY AND EVOLVING NATURE OF TRADE

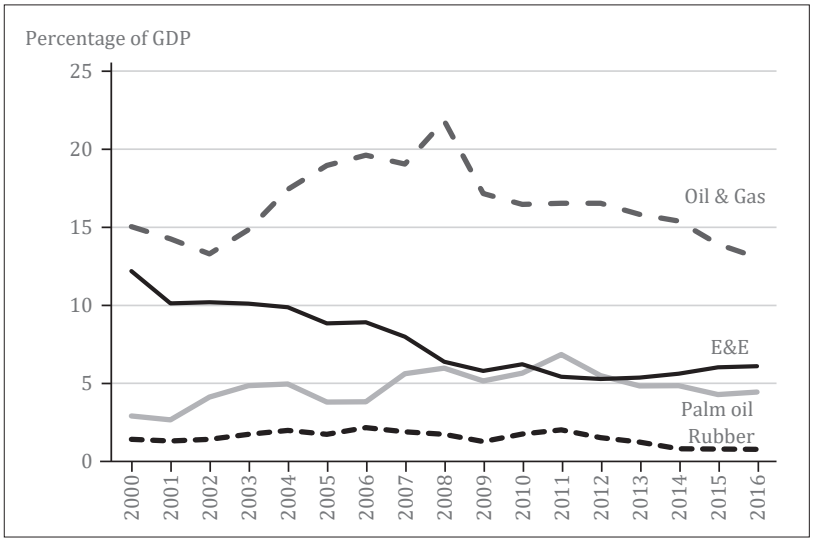
While net exports as a percentage of GDP have shrunk over the last decade and a half, exports of resource-based products grew substantially (see Figure 9). Between 2000 and 2016, the export value of resource-based products more than tripled, rising annually by 7.7% on average. In 2000, they made up 17.9% of total exports. By 2017, the figure had grown to 28.2%. As a result, resource-based products constituted an increasing share of Malaysia's export basket.

Malaysia's main resource-based exports consisted of oil and gas, palm oil, and rubber. In 2000, they collectively constituted 13.4% of Malaysia's total merchandise exports (see Figure 10). By 2013, the figure had increased to its highest proportion since the AFC at about 30.2%, before dropping sharply to 16.2% in 2017 against the backdrop of a commodity price collapse. In nominal terms, the CAGR of the export values of oil and gas, palm oil, and rubber were 6.4%, 8.5% and 1.5%, respectively. These figures indicate that during the commodity boom years, it was the palm oil and oil and gas sectors that were primarily driving the growth registered in resource-based trade.

The growth of manufactured exports on the other hand lagged behind that of resource-based products. Between 2000 and 2017, it grew at a CAGR of 4.7% annually, a level below that of overall GDP during the same period (5.1%). As a result, its share of total merchandise exports dwindled by 9.8 percentage points, from 81.3% to 71.5% during the same period.

Among manufactured products, electrical and electronics (E&E) products are Malaysia's leading export item. In 2000, E&E exports represented more than half (58.8%) of Malaysia's total exports. While the industry's share of aggregate merchandise exports had continued to rise between 2000 and 2017, its growth has been substantially less than that of petroleum and gas, palm oil, and rubber. By 2017, E&E made up only 28.4% of total merchandise exports.

Figure 11. GDP Share of the Oil and Gas[a], E&E[b], Palm Oil, and Rubber Industries



Notes: [a] Oil and Gas industries comprise Crude Petroleum & Condensate; Natural Gas; Refined Petroleum Products; and Chemicals & Chemical Products.

[b] E&E comprises Machinery & Equipment; Office, Accounting & Computing Machinery; Electrical Machinery & Apparatus; and Radio, TV & Communication Equipment.

Source: CEIC Data (n.d.)

Table 1. Structure of the Malaysian Economy

		Capital	
		Domestic	Foreign
Market	Non-tradable	I Government services Non-tradable services (utilities, construction, real estate, etc.) Domestic manufacturing (consumer expenditure)	II Imported consumer goods Financial services
	Tradable	III Resource-based industries (palm oil, petrochemical, rubber, etc.) Tradable services (tourism, healthcare, etc.)	IV FDI-driven manufacturing

Source: Illustration by Authors.

Structural changes in the composition of Malaysia's exports were also reflected in the country's GDP (see Figure 11). In 2000, activities related to the E&E industry constituted 12.2% of GDP. By 2017, this figure had declined by half to 6.1%. On the other hand, the GDP share of the palm oil industry increased from 2.9% to 4.5% during the same period, while that of the rubber industry decreased from 1.4% to 0.8%. The GDP share of the oil and gas industry was more volatile; in 2000, it stood at 12.9%, peaking in 2009 at roughly one-fifth of total GDP (21.8%). There was then a sharp drop in the year after, followed by a gradual decline. By 2016, it stood at 13.1% of GDP.

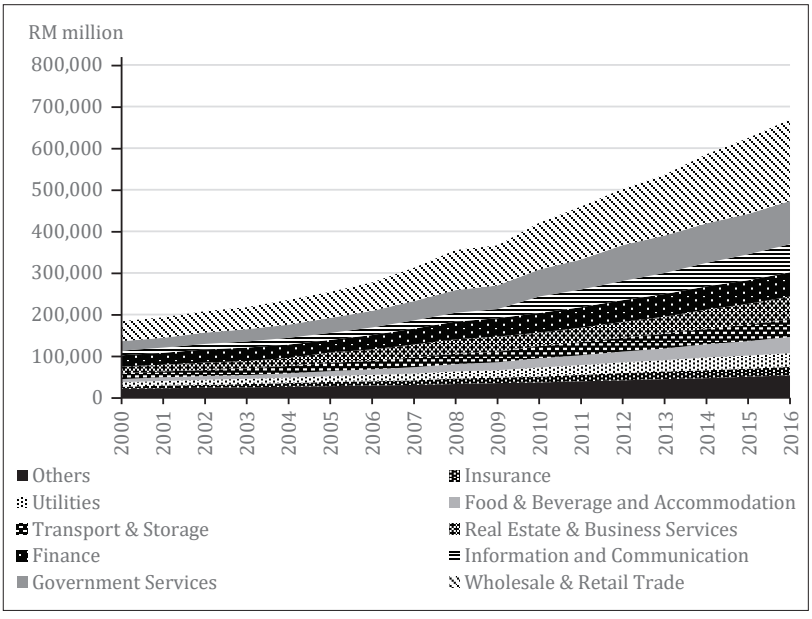
The manufacturing sector and the resource-based sector represent a unique demarcation of Malaysia's tradable economy (see Table 1). The tradable manufacturing sector is largely FDI-driven and is generally disconnected from the rest of the economy. By contrast, the resource-based sector is driven by local investments and is more connected to the domestic sector as compared to the tradable goods sector.

Another dimension of domestication is the reduced contribution of FDI-based manufacturing to the country's net export performance, a trend that is suggestive both of a reduction in FDI into the sector and of the sector's inability to remain competitive in world markets. Changes in the composition of Malaysia's export basket can partly be explained by terms of trade effects that shifted in favour of the country's resource-based industries and to the detriment of the E&E industry. The expansion of resource-based industries was driven, in part, by rising external demand from the emerging economies which needed the raw materials for their manufacturing activities (Mohamed Rizwan *et al*. 2014). These emerging economies include countries such as China, India and Vietnam.

It is also quite telling that rubber-based industries did not grow as fast as the oil and gas sector. Malaysia, which accounted for 32% of the world's natural rubber production in 1988, has shifted emphasis to palm oil, other crops and non-agricultural investments. It produced only 6% of the world's rubber by 2016 and is no longer the world's major producer of natural rubber (IHS Markit 2017). Consequently, Malaysia did not reap the benefits of rises in natural rubber prices that were themselves driven by demand for downstream products, a market segment in which Malaysia does not have a significant presence.

At the same time, Malaysia's E&E sector did not upgrade itself fast enough. The low value-added assembly part of the value chain has faced mounting competition from China and Vietnam, whose abundance of cheap labour implied a greater ability to attract investment in assembly-related activities (World Bank 2014). Another possible explanation for the sedate growth of E&E exports is that most firms in Malaysia specialised in manufacturing products that have not experienced rapid growth in consumer demand. Most ASEAN countries, including Malaysia, specialised in the manufacture of hard disk drives, computer central processing units and assembled printed circuit boards. China, Taiwan, and South Korea, on the other hand, have a larger presence in the mobile computing segment, which has experienced far greater growth in consumer demand (World Bank 2014). Thus, these combined factors created an environment that simultaneously rewarded resource-based industries while dampening the growth prospects of the E&E industry.

Figure 12. Composition of Malaysia's Services Sector



Source: CEIC Data (n.d.)

Beyond dwindling net exports, the premature domestication of the Malaysian economy points towards further structural change in the composition of the economy characterised by the gradual expansion in the share of the services sector. The share of services in Malaysia's GDP increased from 49.3% in 2000 to 53.6% in 2017 (see Figure 12). The Malaysian services sector is, by and large, domestically-oriented. Its growth can be largely attributed to wholesale and retail trade[3], which in turn, was supported by domestic consumption. In 2017, this sector collectively constituted 34.6% of services sector output.

Despite the growing contribution of the service sector to the economy, Malaysia continues to incur deficits in its services account (Bank Negara Malaysia 2017c). Payments to foreign service providers, particularly for technical and engineering services, have also increased to complement domestic technical expertise and consultancy management services, particularly for projects that use more complex technologies. On the other hand, services that register surpluses in the current account have been gradually declining. Since 2010, the increase in outbound travel expenditure—i.e. Malaysian tourists travelling and spending abroad—has outpaced that of inbound travel expenditure, watering down the travel industry's contribution to the surplus. Thus, the growth of the Malaysian service sector was fuelled by domestic demand rather than the outward expansion of Malaysian service firms in overseas markets, further underscoring the domestication of the economy.

The shift in the source of growth from external trade to domestic consumption is intriguing because trade has always been an integral part of the Malaysian economy. Trade as a percentage of GDP has consistently exceeded 100% since 1988, making Malaysia one of the most open economies in the world. It is important for a country's industrial and trade policies to reflect its underlying economic reality and developmental stage. As a relatively small, open economy, Malaysia has always been reliant on an export-led growth engine (Koen *et al*. 2017). Given the relatively small size of its internal market, it is unclear how long domestic demand can continue to drive the Malaysian economy. Moreover, domestic aggregate demand may simply not be large enough to drive firm-level specialisation (Hummels *et al*. 2001) and economy-wide improvements in productivity

(Melitz 2003). Consequently, the premature domestication of the economy needs to be urgently addressed by diagnosing the main constraints weighing on the country's tradable industries, in both goods and services.

In the case of the E&E industry, the government has been providing numerous incentives, such as tax breaks, to promote the industry. E&E was also re-emphasised in the ETP and was identified as one of the twelve NKEAs. Yet, the growth of the E&E industry has been sedate, and the level of value-added of the industry has not improved substantially nor have domestic linkages, with less than 40% of inputs used by E&E multinational corporations (MNCs) in Malaysia sourced from domestic suppliers (World Bank 2014). What are the factors constraining the growth of the Malaysian E&E industry? One of the major hurdles identified is the shortage of skilled labour, particularly engineers (Kharas *et al*. 2010).

Currently, the E&E industry relies heavily on low-wage foreign labour, especially for assembly-related activities. In order to move up the value chain, the Malaysian E&E industry needs to concentrate less on assembly-related activities and more on higher value-added activities such as research and development, design, and logistics. To achieve this, the role of skilled labour is vital. The government attempted to address the shortage of skilled labour, at least in the E&E cluster in Penang, by conferring a Multimedia Super Corridor status to Penang in 2006 which, among others, allowed firms to import skilled foreign workers to support their operations. However, the shortage of skilled labour remains an important constraint to value-addition and innovation (Kharas *et al*. 2010).

The issue of labour shortages is also faced by the palm oil industry which is heavily reliant on low-wage foreign labour, particularly for labour-intensive activities at the plantation level (Ramli *et al*. 2011). The palm oil industry is concentrated at the upstream level, which involves activities at the plantation, extraction and basic refinery levels. The lack of substantial downstream diversification translates once more into inadequate value-addition. Given that Malaysia faces a shortage of land for palm oil plantations, it is questionable how long the industry can depend on upstream activities to generate growth. Mechanisation of field jobs, which can reduce labour requirements at the plantation level, has yet to be substantially implemented (Ramli *et al*. 2011).

One possible reason for the failure of the palm oil industry to upgrade its position in the value chain is the fact that the rents deriving from upstream production are exceptionally high. Thus, the incumbent local palm oil companies have limited incentives to develop downstream capacities, which are riskier and require significantly more capital.

Apart from the shortage of skilled labour and mechanisation, other factors hamper the growth of Malaysia's tradable sector, one of which is the high cost of doing business relative to that in other countries in the region. For example, the World Bank reports that the time taken to adhere to documentary compliance requirements for a company to export is 10 working hours in Malaysia, compared to only 5 in Turkey, 2 in Singapore and 1 in South Korea (World Bank 2017). On top of this, the time taken for border compliance for exports is 48 working hours in Malaysia, compared to 16 in Turkey, 13 in South Korea and 12 in Singapore.

Another factor is Malaysia's dependence on imported services to support its tradable sector. These include transportation, insurance, finance, business support services and logistics. As previously noted, Malaysia is a net importer of services. Moreover, the service sector in Malaysia is concentrated in traditional industries such as travel and construction rather than modern industries such as healthcare, professional and business services, which are more readily tradable, including through remote supply (World Bank 2014).

As noted above, Malaysia continues to be actively engaged in trade negotiations, having recently agreed to the CPTPP and is pursuing negotiations with the EU as well as its key regional partners within RCEP. It is also taking part in international initiatives such as the Belt and Road Initiative[4]. This highlights the importance of trade—and thus of trade policy—in driving economic growth to the country and the world. Accordingly, the question that arises is how successful have Malaysia's trade agreements been in addressing the factors that are hampering the growth of the country's tradable sector? More directly, how has Malaysia's trade policy addressed issues such as the shortage of skilled labour, the lack of incentives for downstream diversification, the high cost of doing business and limited success in modern tradable services, among others?

LINKING TRADE POLICY WITH GROWTH AND DEVELOPMENT

One of the common justifications for negotiating PTAs is their efficacy in promoting trade and attracting greater volumes of inward FDI, which in turn, would stimulate the growth of the economy and increase welfare. In formulating both multilateral and preferential trade policies, it is important to be more fully aware of the issues faced by the country's tradable sector, as highlighted in this chapter's previous sections. Some of the factors hampering the growth of the tradable sector, such as the shortage of skilled labour and the high cost of doing business, can potentially be addressed through trade and investment policy and through better formulated domestic policies.

For example, PTA obligations in the services sector could potentially address barriers to accessing key markets overseas, including the recognition of professional qualifications. Trade agreements could also be a useful tool to facilitate cross-border flows of goods and capital. Shaping trade and FDI policy would also require a stocktake of what a country has in terms of its main endowments and comparative advantages. These perspectives would inform negotiating objectives on what a country would want to protect and promote through its engagement in trade and investment negotiations. Given that PTAs could potentially pose a substantial cost to the nation (Goldberg and Pavcnik 2004), from terms of the commitments made and the cost of undertaking the negotiation process, to the potential economic impacts of the liberalisation measures, an important question to ask is how successful have Malaysia's PTAs been in promoting trade?

The formulation of trade policy should be guided by domestic considerations. Identifying Malaysia's changing needs would include working within Malaysia's obligations under international trade agreements, including topics covering international investment law, intellectual property rights, government procurement and the services sector (these obligations are discussed further in the following chapters). Nevertheless, trade agreements are often used as vehicles for policymakers to push for domestic reforms. For example, in the case of Japan, the TPPA (now CPTPP) was seen as a key element of Prime Minister Shinzo Abe's strategy to stimulate domestic economic growth (Schoen 2016). However, using such an approach means that it is often

difficult to backtrack on commitments made. Using trade agreements to push for domestic reforms implies that there is a deliberate influence of domestic policies on trade policy.

In addition, an assessment of geopolitical considerations must play a key role in determining Malaysia's trade policy objectives. Does Malaysia want to be seen as a leader in trade openness in the region? Or would it be more strategic if it were to join a coalition of countries that seek to achieve certain aims? If so, which specific regional partnerships would most benefit Malaysia's interests?

Trade and investment agreements brokered at the international level have the same effect as domestic rules in the sense that they define incentive mechanisms for both domestic and foreign firms. Current bilateral or regional PTAs that are negotiated and concluded are template-based. The main structure of the agreements tends to be similar, with differences lying in the details of country-specific commitments and exceptions. To this end, current PTAs tend to include chapters that are meant to facilitate trade such as those on customs administration, investment and technical barriers to trade. These commitments should be derived from trade policies that are domestic responses to the external environment in order to achieve national objectives. However, like any other areas of policymaking, trade policy is no exception when it comes to managing interest groups and facing resistance to change. Ultimately, the intended outcome is the final yardstick and for Malaysia, that should be the structural transformation of the economy as defined by the NEM and the ETP.

Malaysia's structural transformation agenda requires the adoption of trade and investment policies geared towards reversing the premature domestication trends that have taken root, more markedly, after the GFC, but gathering steam since the 1997/98 AFC. This was illustrated in the previous sections. Arguably, the Malaysian economy cannot reach the next phase of its development—one that is more productivity-driven—while also addressing rising inequality if it does not leverage global resources and markets. The question is how to link these commitments and opportunities that arise from PTAs to industrial development strategies and the broader economic development policies of the country. A further important question is that of timing and sequencing: the more logical sequence is to use the negotiation table in trade agreements to further Malaysia's domestic interests. That

being the case, there should be a strategy on both the choice and order in which Malaysia enters such negotiations. Malaysian progress stems from its positioning as a small, open economy. The way forward is to remain true to that strategy.

In light of the increasing domestication of the economy since the AFC, this chapter has argued that the changing nature of the Malaysian economy needs to be better understood by policymakers mapping the future contours of the country's growth and development strategies. At a more micro level, strategies and policies regarding industrial development must then provide inputs to—and colour the formulation and execution of—the country's trade policy, including the strategy on agenda-setting and PTA negotiations.

The national transformation imperative does not just cover the growth dimension of the NEM. It also requires that there be a transformation in terms of what are the sources of growth and the overall productivity of the economy as well as resulting distributional outcomes. Having started out as a commodity trading economy that evolved into an export-oriented manufacturing nation, largely driven by FDI, it is unlikely that the next phase of the economy will be a domestically-driven one. Thus, trade policy should not just be linked to attracting more investment but also to achieving industrial development aims and the transformation agenda of the economy.

If the external sector is to remain a key feature and driver of Malaysian economic growth, how should trade policy be formulated to achieve the transformational objectives of the NEM? Choosing the right partners and addressing the right substantive issues in trade agreements are crucial, as different scenarios would require different negotiating strategies; bilateral negotiations would take on different sets of strategies from those of regional or multilateral trade negotiations. Ultimately, the primary objective of Malaysia's trade policy should be clear: to increase the volume of trade and the contributions of net exports to GDP.

Endnotes

[1]Economies of Brazil, Russia, India and China.

[2]See Rafiq and Zeufack (2012) for an empirical estimation of fiscal multipliers.

[3]Wholesale, Retail and Motor Vehicle sales are grouped together under Wholesale & Retail Trade sector.

[4]Officially known as the Silk Road Economic Belt and the 21st Century Maritime Silk Road, otherwise also referred to as the One Belt, One Road initiative.

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3

Recent Trends in Trade and Trade Agreements: Global Value Chains and Mega-Regional Agreements

Aidonna Jan Ayub and Intan Nadia Jalil

INTRODUCTION

The signing of the World Trade Organization (WTO) agreements in 1994 was significant in establishing rules on a wide range of issues regarding trade in goods, trade in services and trade-related intellectual property rights (IPRs). Since then, however, many new issues and trends have emerged, not least far-reaching changes in the nature of international exchange, a phenomenon often depicted by the terms global value chains (GVCs) or international production networks. Since the creation of the WTO its Members have signed numerous preferential trade agreements (PTAs), both bilateral and regional in character. These agreements contain commitments that go beyond the WTO agreements, namely WTO-plus issues and WTO-extra issues (for definitions see Box 1).

The push to strengthen countries' commitments in these areas is exemplified by the proliferation of preferential, or free—or in WTO nomenclature—regional trade agreements (RTAs)[1]. As of May 2018, 459 RTA notifications had been received by the WTO, of which 287[2] are in force (WTO2018, xii). Of these RTAs, perhaps the most significant

are those deemed 'mega-regionals', which can be loosely understood as "deep integration partnerships between countries and regions with a major share of world trade and foreign direct investment (FDI), and in which two or more of the parties are in a paramount driver position, or serve as hubs, in global value chains" (Meléndez-Ortiz and Estevadeordal 2013). The key mega-regionals that have been completed or are currently under negotiation are the Regional Comprehensive Economic Partnership Agreement (RCEP), the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Trans-Atlantic Trade and Investment Partnership (TTIP; currently suspended) and the European Union–Canada Comprehensive Economic and Trade Agreement (CETA). In addition, there is also the Continental Free Trade Area (CFTA) in Africa and the Pacific Alliance linking four outward-oriented trading nations in Latin America (Chile, Colombia, Mexico and Peru).

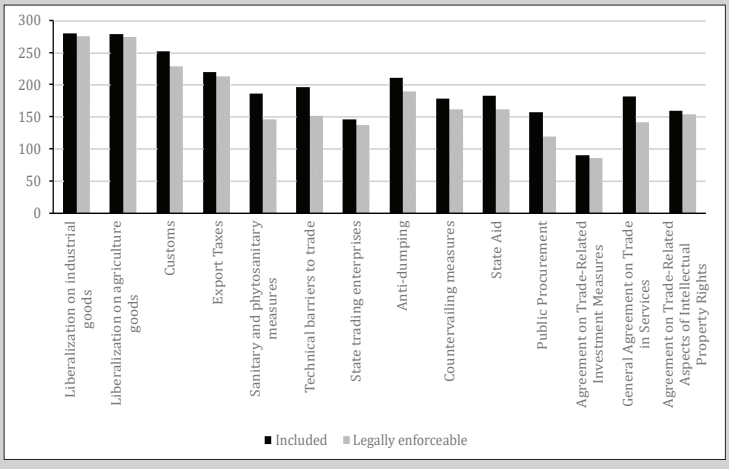
Box 1. WTO-plus and WTO-extra Issues

The issues discussed in international trade agreements can be loosely divided into three categories:

- **WTO issues**. Issues addressed under the World Trade Organization (WTO) agreements.
- **WTO-plus (WTO+) issues**. Issues subject to some form of obligation under the WTO agreements but which typically go beyond the WTO agreements in terms of breadth and depth. For example, a chapter on IPR under a PTA would go beyond the WTO IPR obligations in terms of both their breadth and depth.
- **WTO-extra (WTO-X) issues**. Issues that lie outside the WTO mandate (Horn, Mavroidis, and Sapir 2009). For example, issues such as competition policy, labour and environment are not the focus of any existing WTO agreements.

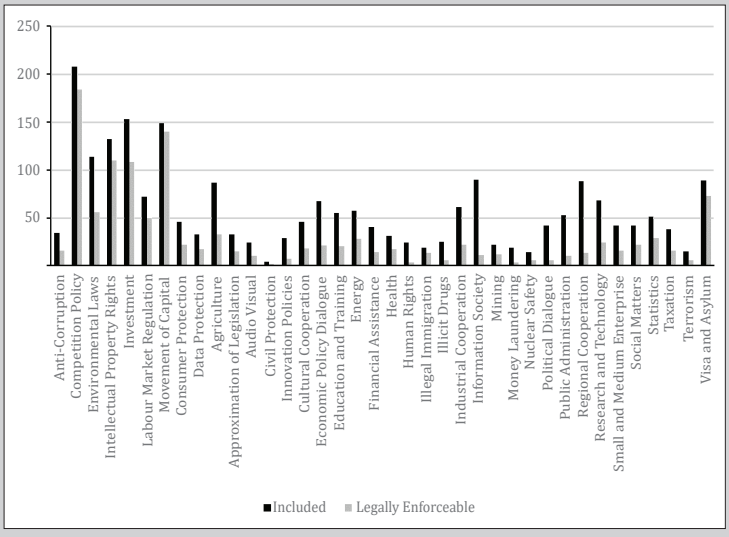
It is noteworthy that there is no standard definition of WTO-plus and WTO-extra issues. The categorisation is generally based on the scope and breadth of issues. Figures 1 and 2 illustrate the number of agreements that address WTO-plus and WTO-extra issues.

Figure 1. Number of Agreements Covering WTO-plus Policy Areas, 2015



Source: Hofmann, Osnago, and Ruta (2017).

Figure 2: Number of Agreements Covering WTO-extra Policy Areas, 2015



Source: Hofmann, Osnago, and Ruta (2017).

In general, the inclusion of WTO-extra issues in trade agreements does not necessarily mean that the issue directly relates to trade. Given that many policy areas would relate to trade, countries have argued for the inclusion of rules that reflect their specific trade (and non-trade) interests overseas. Rules on labour, environment, competition policy and state-owned enterprise (SOE) issues in trade agreements are not seen as being directly linked to trade but could be argued as affecting trade. In addition, quantifying the benefits of WTO-extra issues is not easy. Unlike tariffs and quotas, no widely accepted benchmark exists for domestic rules, regulations and standards in a trade agreement (Rodrik 2018, 79).

Table 1 lists WTO-plus issues whereas Table 2 lists WTO-extra issues covered in PTAs. The lists are loosely based on the work of Horn, Mavroidis, and Sapir 2009. Although they are not exhaustive these lists are useful for readers who want to understand the issues covered under the latest generation of trade agreements.

Table 1. Illustrative List of WTO-plus Issues

Issue	Content
Trade in goods: • Rules • Market access	Greater breadth and depth in rules and the liberalisation of markets
Sanitary and phytosanitary (SPS)	Greater breadth and depth in rules towards the harmonisation of SPS measures
Technical barriers to trade (TBT)	Greater breadth and depth in rules to ensure that technical regulations, standards, testing and certification procedures do not create unnecessary obstacles to international trade in goods
Anti-dumping (dumping of goods)	Additional anti-dumping obligations
Rules of origin	Rules of origin for the PTA
Customs valuation	Additional customs valuation obligations
Trade in services: • Rules • Market access	Greater breadth and depth in rules and the liberalisation of markets
Investment	Additional investment obligations
IPR	Additional IPR obligations

Government procurement (GP): • Rules • Market access	Greater breadth and depth in rules on GP and the liberalisation of GP markets

Source: Author.

Table 2: Illustrative List of WTO-extra Issues

Issue	Content
Labour	Rules on labour issues such as those related to the International Labour Organization (ILO) conventions on fundamental principles and rights at work
Environment	Rules on environmental issues that could include obligations to combat wildlife trafficking and illegal logging and to address fishing subsidies
Competition policy	Rules on competition-related issues such as the abuse of dominant position, monopolies, coordination and cooperation
State-owned enterprises (SOEs)	Rules on the treatment of SOEs
Data flows	Rules on the cross-border transfer of information by electronic means

Source: Author.

It is important to note that given the wide range of issues brought into trade agreements, WTO-extra issues are sometimes addressed in other international fora before they become commitments under trade agreements. International organisations such as the Asia-Pacific Economic Cooperation (APEC), the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF) and the World Intellectual Property Organization (WIPO) have all addressed issues that have subsequently been taken up in trade agreements in the form of legally binding rules and commitments. This book's Chapter 8 on SOEs provides an example of how issues first addressed in the OECD and the IMF could later 'migrate' into trade agreements. Therefore, non-binding commitments made in non-trade forums can later become legally binding and enforceable commitments under trade and investment agreements.

RECENT TRENDS IN MALAYSIA'S TRADE AGREEMENTS

Developments in Malaysia's trade policy have mirrored those of the international trading system. Like many other Members, Malaysia transitioned from membership of the General Agreement on Tariffs and Trade (GATT) to the WTO, a process which marked the liberalisation of the country's trade regime beyond that of goods. Then, beginning with the Malaysia-Japan Economic Partnership Agreement (MJEPA), Malaysia embarked on a second phase of post-Uruguay Round trade diplomacy—that of bilateral trade agreements. Although still based on the WTO template for trade in goods, services, IPR and trade-related investment measures, commitments made in bilateral trade agreements went beyond WTO commitments.

Malaysia is now transitioning towards what could be seen as a third phase in its international trade policy. This would include agreements that go beyond commitments made at the WTO and in its current PTAs. These include not only the CPTPP, but also the RCEP agreement, which covers the ten Association of Southeast Asian Nations (ASEAN) and the six states with which ASEAN has existing PTAs (Australia, China, India, Japan, New Zealand and South Korea). In addition, Malaysia's negotiations with the European Union (EU) towards a comprehensive bilateral PTA, which were put on hold in 2012, may be revived (European Commission 2018). Malaysia also has ongoing negotiations with the European Free Trade Association (EFTA), whose members are Iceland, Liechtenstein, Norway and Switzerland.

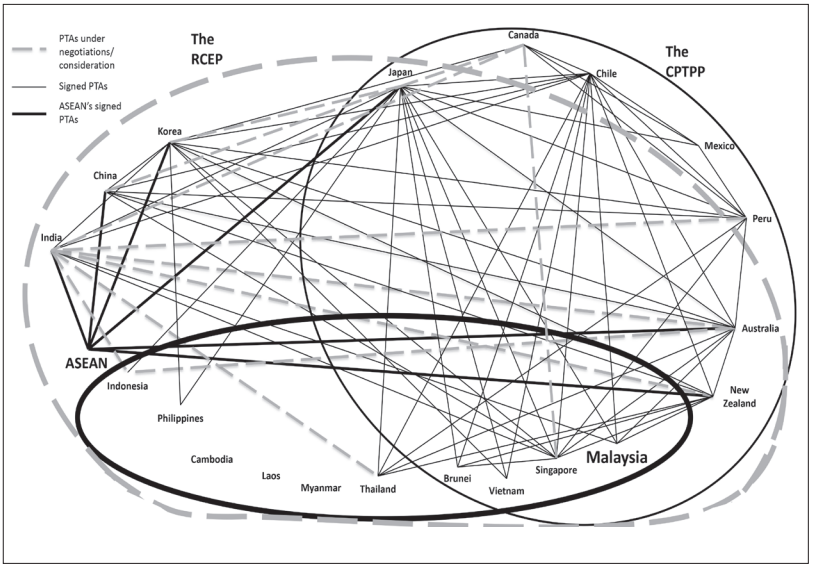
Of the mega-regionals noted above, it is the CPTPP that has attracted the most controversy, not only in Malaysia, but also in the other countries that negotiated the agreement: Australia, Brunei Darussalam, Canada, Chile, Japan, Mexico, New Zealand, Peru, Singapore and Vietnam. This agreement was previously known as the Trans-Pacific Partnership Agreement (TPPA), with the participation of the United States (US). However, in January 2017, newly elected US President Donald J. Trump announced the withdrawal of the US from the agreement, prompting the remaining eleven countries to renegotiate a rebranded CPTPP. The commitments and rules agreed under the CPTPP do not differ greatly from those of the TPPA, except for some specific commitments in selected chapters of the agreement, namely

those dealing with IPRs, investment and SOEs. Therefore, the general outcome of the CPTPP (and the TPPA) was strongly influenced by the US, as part of the initial TPPA negotiations[3].

Despite the potential that the TPPA could open up market access beyond WTO and other PTA commitments, several points of contention characterised the agreement. These related mainly to the demands for WTO-plus and WTO-extra commitments made by the developed countries taking part in the negotiations, namely the US, and to a certain extent, Australia, Canada, Japan and New Zealand. These demands tended to put the TPPA's developing country participants, including Malaysia, on the defensive.

The abovementioned developments are taking place against the backdrop of the ASEAN Economic Community (AEC), which was officially established at the end of 2015. Deemed to be a "major milestone in the regional economic integration agenda in ASEAN", the AEC provided access to a market of 634 million consumers in 2016 (CEIC Data 2016).

Figure 3. The Complexity of Key PTAs Signed or being Negotiated or Considered by the ASEAN, RCEP and CPTPP Countries



Source: Author, based on government websites. As of mid-June 2018.

Given these emerging trends and developments, Malaysia—like other participants of the global trading system—needs to be cognisant of its place in the evolving 'spaghetti or noodle bowl' of RTAs. It should not only consider the benefits of the preferential treatment it receives from its PTA partners, but also the relationships its PTA partners have with other countries, which may erode or augment the benefits of Malaysia's own PTAs (see Figure 3).

RECENT TRENDS IN TRADE AGREEMENTS: DRIVING FORCES AND IMPLICATIONS

From a broader perspective, what are the factors behind the recent strengthening of WTO-plus and WTO-extra commitments, as embodied in mega-regionals like the CPTPP? How can these trends impact the evolution of other developments in the global trading system, including the push towards regionalism, as exemplified by the AEC?

Firstly, the well-documented stagnation of the WTO's Doha Development Round (also known as the Doha Round) has played a role. Yong (2014) cites several reasons for the Doha Round stalemate. The first is the growing number of WTO Members, which complicates coordination and the quest for compromise, especially given the balance of concessions that need to be made among developed and emerging economies. Emerging economies themselves are not uniform, with large countries such as Brazil, China and India exerting more influence but simultaneously expressing heightened reluctance to grant market access concessions to meet some of the demands of the developed Members. This particularly challenging context is made more difficult under the current US administration with its focus on bilateral trade balances (chiefly in goods) and the imposition of tariffs on grounds of national security. Such policies have created tensions and raised concerns over the damaging risks of escalating trade measures.

The travails of the Doha Round occurred in parallel with another important development in global trade. If the modern era of globalisation can be encapsulated by a single phenomenon, it would be the prevalent fragmentation of production across geographical regions, or what Grossman and Rossi-Hansberg (2006), term 'trade in tasks' (which is separate from the more traditional 'trade in goods').

This shift in trade production (and cross-border investment) patterns, signified by a growing trade in intermediate goods and services, has been variously termed, as explained by Estevadeordal *et al*. (2013), as 'slicing the value-added chain' (Krugman 1995), 'disintegration of production' (Feenstra 1998), 'delocalisation' (Leamer 1996) and 'the great unbundling' (Baldwin 2006), but is perhaps most commonly known as offshoring, or GVCs.

The fragmentation of production allows developing countries in particular, to enter into cross-border production-sharing by specialising in one or a few stages of the production process, and hence being able to participate in a "finer international division of labour" (Estevadeordal *et al*. 2013). Participating in GVCs has become easier for countries to do because: (i) countries can take small steps in industrialisation, one offshore facility at a time; (ii) information and communications technology (ICT) has improved coordination possibilities, allowing developing countries to export parts; (iii) plugging into GVCs at a finer resolution magnifies national competitive advantages; (iv) countries need to absorb only the know-how to set up single stages rather than a whole sector; and (v) firms inside a GVC worry less about demand and market size issues (Baldwin 2016, 257).

The fact that links in the GVCs are located in countries with sometimes disparate levels of development has also fuelled demands for a new framework of trade rules beyond those provided by the WTO. As Stephenson (2016) mentions, the vertical silos in which WTO rules operate—with "parallel and dissimilar rules for goods, services and intellectual property"—is not aligned with the way in which GVCs operate. Therefore, a more integrated approach is needed that takes into account the application of disciplines in a variety of areas, such as competition, investment, procurement, standards, and transparency in both goods and services.

But is trade policy—in particular strengthening rules and commitments beyond those conceived at the multilateral level—the only way for countries to successfully leverage GVCs? Although PTAs can help to incentivise GVCs by reducing trade costs and regulatory burdens among their members, strict rules of origin (ROOs)—particularly in PTAs between developed country hubs and emerging economy spokes—can discourage the use of inputs from developing countries.

At the same time, the continued importance of distance and of trade costs as determinants of trade intensity explains why many production networks are regional and not global in character. This reality assigns a central role to PTAs in GVC governance.

UNDERSTANDING GLOBAL VALUE CHAINS

What are Global Value Chains?

A value chain can be described as "the full range of activities that firms and workers perform to bring a product from its conception to end use and beyond. This includes activities such as design, production, marketing, distribution and support to the final consumer" (Gereffi and Fernandez-Stark 2011).

The structure of GVCs is generally in the form of 'spokes', i.e. small and medium-sized enterprises (SMEs) in developing countries that supply 'hubs', i.e. multinational corporations headquartered in developed countries and established in developing countries. This non-linear hub and spoke pattern is sometimes referred to as a 'spider'. There is also the supply chain that moves through sequential steps or tasks (known as a 'snake'). In practice, supply chains are known to operate through a mix of snakes and spiders (Diakantoni *et al*. 2017). Hubs and spokes are not necessarily divided along developed or developing country lines. For example, a key global hub is China, while India and Thailand are hubs for specific value chains.

As explained by De Backer and Miroudot (2013, 7), GVCs capture the following characteristics of the world economy:

- **Increasing interconnectedness of economies**. Geographically dispersed economies are linked in a single industry through GVCs. In addition, GVCs help explain how export competitiveness depends on the efficient sourcing of intermediate inputs. For example, if a firm's product is an intermediate good that feeds into the final good or if it imports many intermediate goods to produce the final good, the trade impediments all along the value chain matter. Policy impediments in third countries become policy barriers affecting the total cost of the final good produced by the value chain, thus impacting the efficiency of the value chain itself.

- **Specialisation in tasks and business functions rather than specific products**. Goods are now manufactured 'in the world' (or in the region) rather than in one country to be exported to another. Thus, specialisation patterns focus chiefly on tasks and business functions rather than on specific products. In addition, competition focuses on economic roles within the value chain. Analysis of GVCs helps to address the need for a shift in perspective from the practice of crafting trade policies that focus on exporting a country's products to policies that reflect integrated value chains, whether global or regional in character.
- **Networks of global buyers and suppliers**. GVC analyses clarify the relationship between buyers and suppliers globally (or regionally)—the economic governance of lead firms and actors that control and coordinate activities in each value chain. An appreciation of these relationships is important for policymakers to understand the policies that impact the location and structure of activities and ensuing patterns of cross-border trade and investment.

Regional Nature of GVCs

As noted above, GVCs tend to be more regional than global in character (Stephenson 2013). GVCs are also generally focused on three hubs—North America and Europe as centres of demand and East Asia as a centre of supply (Stephenson 2013). Although there are GVCs outside these three hubs, other regions are generally seen to be far less integrated into cross-border production networks (Stephenson 2013). This pattern may change as production networks adapt to changing market conditions.

Comparative advantage, to a certain extent, has become more of a regional concept and less of a national one (Baldwin 2016, 266). Regions exhibiting higher levels of trade integration are seen to be attractive to lead GVC firms. This is because:

- The cumulative value of tariffs is lower within free trade areas.
- The administrative burden of addressing multiple ROOs is reduced as the movement of goods occurs within a free trade area.
- The harmonisation or mutual recognition of production standards within a free trade area means that broadly similar standards could be applied all along the production chain.

- The general administrative burden of passing through borders within a free trade area, involving as it does issues such as customs administration and trade facilitation, can be more easily addressed (Cattaneo *et al*. 2013).

Increasing fragmentation of the value chain has also created a 'trade-investment-services–know-how nexus' that relates to trade in intermediate goods, the movement of capital and ideas (such as investment in production facilities), and a demand for a host of services to coordinate fragmented value chains (production and distribution activities) (OECD, WTO, and World Bank Group 2014, 12). Technological advances have fostered the development of value chains enabling them to exist on a larger scale and be more dispersed across countries, notably through sustained reductions in transport and communication costs. This has allowed firms to react more dynamically in locating different parts of their value chains in the countries in which the business case for doing so is strongest. Therefore, although the advent of GVCs is not the only trend that is impacting international trade, it is a dynamic force prompting policymakers, businesses and academics to rethink their approach towards international trade policy.

Elements that have contributed to the reduction in trade costs include:

- **Trade in goods**. Reduction in land transport and port costs, freight and insurance costs, and lowered tariffs and duties. However, non-tariff barriers have become increasingly important.
- **Trade in services**. Transport costs have progressively been replaced by communication costs through increasing digitisation. Due to the diverse geographies involved in a value chain, coordination costs have become increasingly important. Thus, advances in ICT have greatly facilitated coordination and monitoring activities.
- **Other issues**. Liberalisation activities in trade and investment in general as well as pro-competitive reforms and regulatory convergence, particularly in the transport and infrastructure sectors have also contributed to the overall reduction in costs.

Note that many policy improvements freeing up trade in goods and services were enacted autonomously by governments rather than as a result of countries' obligations under trade agreements.

Beyond the reduction in trade costs, the emergence of Asian countries (particularly China) as key markets has impacted the structure of value chains. China, for example, has not only served as a 'factory to the world' but is also the largest single source of new consumers (De Backer and Miroudot 2013, 8–9).

Overview of GVC-related Policy Issues

As explained above, investment policies typically link with many other policies. This is also true of GVCs. It is noteworthy that although trade policy is an important component of an overarching GVC policy, it may not necessarily be the most central one. Determining the importance of one policy over another would depend on the structure of the economy and the policy objectives of each country seeking to facilitate the efficient functioning of GVCs.

Taglioni and Winkler (2016) identified three strategic directions to guide policy formulation, particularly for developing countries. These are:

- "Entering GVCs: attracting foreign investors and facilitating domestic firms' entry into GVCs.
- Expanding and strengthening GVC participation: promoting economic upgrading and densification; and strengthening domestic firms' absorptive capacity.
- Turning GVC participation into sustainable development: ensuring skill upgrading, social upgrading, and equitable distribution of opportunities and outcomes while promoting environmental sustainability."

Policies responding to the emergence of GVCs need to take into account governance issues and how a supply chain is controlled. This will typically facilitate firm entry and development within international industries (Gereffi and Fernandez-Stark 2011, 8). However, policies that promote the entrance of firms into GVCs also mean that questions relating to the specific stage of a value chain and the types of GVCs that a country integrates into, need to be addressed (Baldwin 2016). As mentioned above, GVCs can be fragmented along specific activities such as design, production, marketing, distribution and provision of support to the final consumer. For example, China has specialised in

assembly operations while India has specialised in business services (De Backer and Miroudot 2013, 1–2). In addition, the structure of a GVC may differ depending whether it is buyer-led or seller-led (Baldwin 2016, 273). There is a need to analyse the network of global buyers and suppliers that impact the value chains of domestic businesses (now and in the future) to enable countries to determine their different policy responses towards specific activities, industries, countries, regions and the international market in general.

Furthermore, given the interconnected nature of GVCs across multiple geographies, policies (particularly trade and investment policies) should focus not only on the relationship with direct trading partners but also on that with third countries participating in relevant value chains. Policies that impact trade and investment flows range from general policies (such as customs procedures that would impact the time taken for goods to cross the border) to industry-specific policies (such as investment policies to support specific industry participation in upgrading or integrating into specific types of value chains). In addition, the movement of people, capital and technology across borders could affect value chains.

Trade in Goods

Rules governing trade in goods and market access issues remain among the most salient issues to address in a GVC context. The impact of trade barriers will typically be compounded when parts and components cross the border many times during the life cycle of production (OECD 2013). Imports play an important role in export activities. The impact of imposing tariffs is magnified along all stages of the supply chain (Koopman *et al*. 2010), highlighting the importance of addressing tariff-related impediments (particularly tariff escalation) all along the value chain. This issue is of particular importance in sectors with long value chains and production stages (e.g. communications, electronics, motor vehicles and basic metals) (OECD, WTO, and World Bank Group 2014). In addition to tariffs, export restrictions affect the efficient functioning of GVCs (OECD 2013).

Standards and certification are now significant determinants of competitiveness—quality and safety standards are partly driven by concerns about information, coordination and traceability (OECD, WTO, and World Bank Group 2014). This phenomenon is arguably more acute within GVCs. These standards have become one of the main barriers hindering entities (particularly SMEs) wishing to plug into GVCs (OECD, WTO, and World Bank Group 2014).

Responding to heightened awareness of the need to reduce trade costs and enhance the quality of border management processes, trade facilitation has also become a central element in a GVC world. The removal of logistical barriers to the operations of value chains reduces costs (Draper *et al*. 2012). Moreover, ROOs should take into consideration the governance and structure of value chains. PTAs with ROOs that exclude key countries (such as China) in GVCs in which Malaysian entities operate may be of little value to Malaysian businesses as they exclude a likely source of efficient and cost-competitive supply.

Trade in Services

Services are increasingly recognised as essential enablers in GVCs. Requirements to coordinate GVCs (reduce inventories, shorten lead times and facilitate quicker customer response), and the need for efficient transport and logistics, are all being met by service sector firms (OECD, WTO, and World Bank Group 2014). In addition, services that promote the efficient functioning of the business environment include financial, ICT, professional and technical services, and utilities. High quality services enable businesses to create value in GVCs. They are also essential for attracting and retaining efficiency-seeking foreign direct investment (FDI) flows in GVC production.

Investment

Policies on investment and on promoting local suppliers impact the process of decision-making on the location of value chains. Focusing more closely on the activities of GVCs rather than on specific industries could foster more targeted and granular investment policies. In addition, capital is a key component of any business activity—GVCs depend both on inward and outward investment for their success

(OECD 2013). The OECD has highlighted that while discussions on GVC policies have largely focused on ways for countries to attract multinational corporations, inadequate attention has been paid to how best to foster the growth of local companies (OECD, WTO, and World Bank Group 2014, 25) and on the best way to strengthen durable and competitiveness-boosting linkages between domestic suppliers and lead firms.

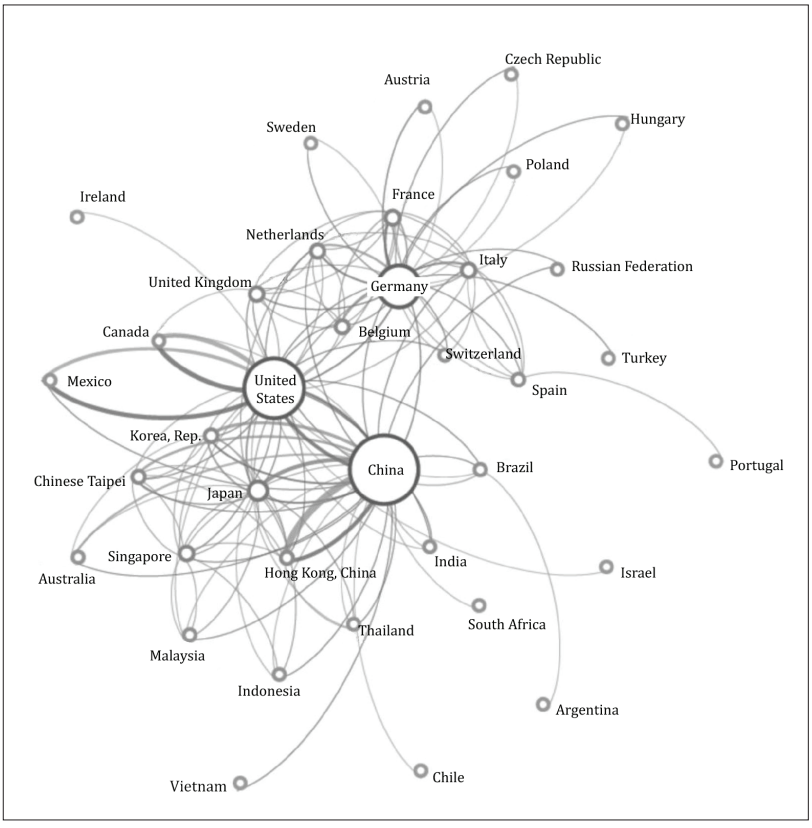
As well as general investment policies, there is a need to analyse the role of international investment agreements (IIAs) in operating GVCs. A representative of Huawei Technologies, a leading global ICT solutions provider, observed that "IIAs are becoming less applicable to some corporate investment strategies" (Lockett 2014). One possible explanation for the mismatch between IIAs and GVC investments is that value chains cover a multiplicity of connected countries while IIAs remain predominantly bilateral in nature (except when they are embedded in larger plurilateral PTAs). This observation supports the argument that mega-regional compacts represent a possible trade and investment policy response to the rise of GVCs.

GVCs and Malaysia

Worldwide, key hubs that have been identified are China, Germany, Japan and the US. Malaysia is linked to these economies through an intricate web of trade and investment relationships (Figure 4). Key hubs have undergone changes, with China gaining significance as a hub over time. As shown in Table 3, Malaysia is integrated into GVCs with a total GVC participation rate that is higher than the general participation rate of both developed and developing economies. However, it should be noted that growth in GVC participation across all regions has decreased, having peaked in 2010 – 2012 after two decades of continuous increases (UNCTAD 2018).

The GVC participation index is a rough indicator of the participation of countries in GVCs. This index could be seen as the GVC equivalent of trade openness indicators. Participation in GVCs is considered to be higher if the foreign value-added embodied in gross exports and the value of inputs exported to third countries that is used in that country's exports is high (Cattaneo *et al*. 2013). Elements that are perceived to impact the GVC participation index include:

Figure 4. Trade in Components through Three Interrelated Production Hubs



Note: Information is based on the UN Comtrade database. It includes the 61 economies in the OECD-WTO Trade in Value-Added database and their most important bilateral gross trade flows.

Source: Reproduced from Diakantoni *et al.* (2017) as cited in Dollar (2017).

Table 3. GVC Participation Index, 2011

	Malaysia	Developing economies	Developed economies
Total GVC participation	**60.4**	**48.6**	**48.0**
Forward participation	19.8	23.1	24.2
Backward participation	40.6	25.5	23.8

Note: The GVC participation index refers to percentage share in total gross exports.

Source: WTO 2016.

- **The size of a country**. Small countries tend to participate more in GVCs than do larger ones as companies are able to create production networks in different parts of a large country and seek to satisfy domestic needs. Malaysia's size means that its market is relatively small and its ability to fully satisfy the needs of production networks is limited.
- **The amount of natural resources available**. Countries that export natural resources and raw materials tend to have high value-added that becomes part of other countries' exports. This is due to the nature of the product being a raw material that is processed in other countries to produce final goods. Malaysia's exports include crude palm oil that is processed in other countries to produce a range of chemical and non-chemical products.

As shown in Table 3, Malaysia has stronger upstream links (or backward participation) in the chain, as compared to downstream links (or forward participation). Malaysia's backward participation rate is significantly higher than that of developed countries. This means that Malaysia imports foreign inputs to produce the goods and services that it exports. This is predominantly in the computer and electronic industry (also known as the electrical and electronic (E&E) industry), which accounted for a 40.5% share in total foreign content of exports in 2011. This was followed by the food and beverage (7.2%) and chemical products (5.9%) sectors (WTO 2016). The top three foreign input providers in 2011 were Japan, China and the US (WTO 2016).

In terms of Malaysia's forward participation, the country's top exports of domestically produced inputs to trading partners in charge of downstream production stages were in the mining (21.7%), wholesale and retail trade (17.9%), and computer and electronic (10.6%) industries[4] (WTO 2016). The top exporters of Malaysian inputs through GVCs in 2011 were China, South Korea and Singapore (WTO 2016).

In conclusion, due to the increasingly regional nature of GVCs, the trend towards mega-regional trade agreements could affect how future GVCs are structured.

MEGA-REGIONALS: A 'NEW BREED' OF TRADE AGREEMENTS

Continued stalemate in the WTO's Doha Round has led to a 'new breed' of RTAs—the so-called mega-regional trade agreements. A few of these—in particular the CPTPP, CETA, RCEP and (the currently suspended) TTIP—have the potential to form pillars of (plurilateral) trade governance in parallel with the WTO. This is so for a number of reasons: first, in terms of membership, should all negotiating countries ratify and implement these agreements, they could potentially affect a substantial share of global trade and investment in goods and services, including all major GVC hubs; and second, because of the breadth and depth of their substantive (i.e. normative) coverage.

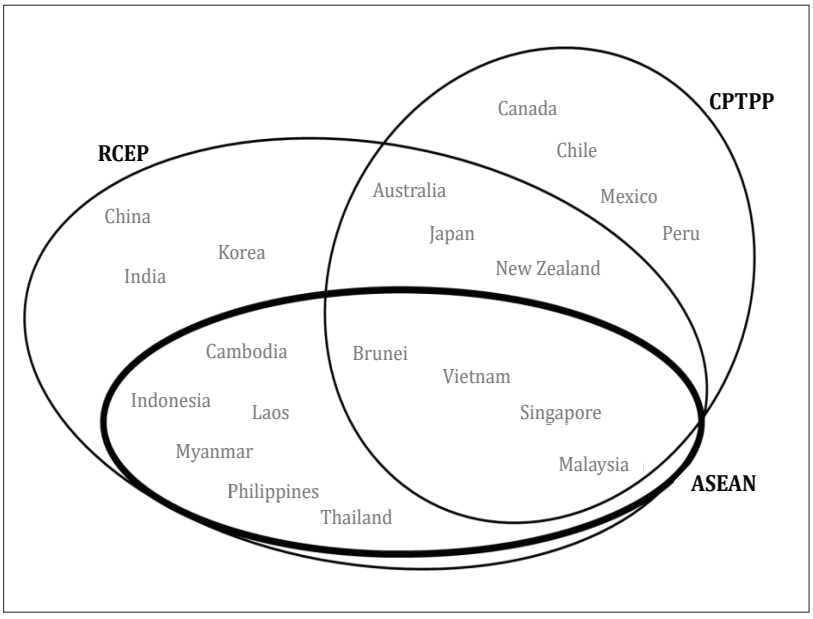
The recent years have also witnessed the launch of negotiations towards a RCEP agreement, which many in Asia and beyond see as the next step in the evolution of the so-called ASEAN+1 agreements. The TPPA/CPTPP too, evolved from earlier efforts to widen trade and investment under the APEC process through the creation of a Free Trade Area of the Asia-Pacific (FTAAP).

Mega-regionals and Malaysia

The two mega-regional agreements of particular relevance to Malaysia are the RCEP and the CPTPP (as shown in Figure 5 and Tables 4 and 5). The CPTPP covers 11 countries while the RCEP covers 16 countries. The US was initially part of the predecessor to the CPTPP, known as the TPPA. Key countries that were not part of the TPPA/CPTPP negotiations were China and India. This is significant given that China's total exports were equivalent to 61% of the total exports of CPTPP countries combined, while India's share stood at 13% in 2016 (WITS n.d.).

The RCEP promises to be large in terms of number of countries it encompasses as well as in population terms (more than 3.5 billion people), with potential membership comprising existing ASEAN Member States together with the countries with which ASEAN has signed PTAs—Australia, China, India, Japan, New Zealand and South Korea.

Figure 5. Member Countries of ASEAN, CPTPP and RCEP



Source: Author.

Table 4. Mega–Regionals—Stylized Facts

		TPPA	CPTPP	RCEP	Source database and year
Number of member countries		12	11	16	
GDP*	USD trillion	28.9	10.3	23.6	CEIC Data (2016)
	% of world	38.1	13.6	31.1	
Goods exports	USD trillion	4.0	2.1	3.5	WITS (2016)
	% of world	27.5	14.2	24.1	
Population	Person million	819.4	494.8	3,506.6	CEIC Data (2016)
	% of world	11.0	6.7	47.1	

Note: *GDP data does not include Myanmar.

Table 5. Key Features of the RCEP and the TPPA

	RCEP	TPPA/CPTPP
First mooted	November 2011	December 2009
Official negotiations began	May 2013	March 2010
Primary goal	Address 'noodle bowl' problem by streamlining ASEAN PTAs	**TPPA**: Address new and traditional issues through a comprehensive '21st century' PTA **CPTPP**: Realise expeditiously the benefits of the TPPA; and contribute to maintaining open markets, increasing world trade, and creating new economic opportunities for people of all incomes and economic backgrounds
Membership model	ASEAN+1 model Accession yet to occur	**TPPA**: All Asia-Pacific countries, accession encouraged **CPTPP**: Any state or separate customs territory Accession yet to occur
Relation to regional architecture	Affirms ASEAN Centrality Principle	Independent of any existing organisation
Scope and coverage	WTO-consistent and ASEAN+1 PTAs—mostly focused on WTO-plus issues	WTO-plus and WTO-extra issues
Major sponsor	In principle, ASEAN-led	**TPPA**: US **CPTPP**: Australia, Canada, New Zealand and Japan
Significant 'absent members'	US	**TPPA**: China, India, Indonesia, South Korea **CPTPP**: US, China, India, Indonesia, South Korea
Common members	Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, Vietnam	
Commitment level	Lower level of trade liberalisation	High level of trade liberalisation

	RCEP	TPPA/CPTPP
Special treatment of developing economies	Provided; consistent with the existing ASEAN+1 PTAs	Minimal (there are some exceptions in terms of different schedules for less developed economies for implementation)
Mode of agreement	All issues negotiated in parallel, although there is a possibility that agreement will not be reached as part of a 'single undertaking'	All issues negotiated under a 'single undertaking'

Source: Author, loosely adapted from Xiao (2015).

Compared to the CPTPP, the RCEP can be viewed more as an attempt to consolidate an existing network of ASEAN-centric RTAs, although there is interest among some participating countries in deepening economic integration beyond existing rules and commitments.

There are notable membership overlaps between the countries that are negotiating the RCEP and those that have signed the CPTPP, with Australia, Brunei Darussalam, Japan, Malaysia, New Zealand, Singapore and Vietnam taking part in both negotiating processes. This naturally raises the question of the hierarchy of trade and investment rules and overlapping preferences among such countries. For instance, should Malaysia accede to and ratify both the CPTPP and the RCEP, its existing PTAs with Australia, Chile, Japan and New Zealand could be ratcheted up in order to be harmonised with the stronger rules and commitments embedded in the CPTPP (as shown in Figure 3).

Seen through a geopolitical lens, RCEP has at times been depicted as an attempt by China to balance the influence that the US and Japan aimed to exert through the TPPA (a role played mainly by Japan under the CPTPP). Now that the CPTPP has been signed, the ongoing RCEP negotiations face an interesting dynamic—with the seven CPTPP signatories taking part in RCEP talks having an interest in pressuring other RCEP participants for higher standards. For Malaysia and other ASEAN Member States (AMS) that are members of the CPTPP, there is a third set of rules and commitments to consider—those of the AEC, a topic we turn to below.

Table 6. Malaysia's Trade with Selected Trade Partners, 2017

Partner country	CPTPP	RCEP	Ranking of total trade with Malaysia
Australia	√	√	13
Brunei	√	√	35
Canada	√		28
Cambodia		√	53
Chile	√		55
China		√	1
India		√	11
Indonesia		√	7
Japan	√	√	4
Laos		√	107
Mexico	√		24
Myanmar		√	34
New Zealand	√	√	26
Peru	√		59
Philippines		√	16
Singapore	√	√	2
South Korea		√	8
Thailand		√	5
US			3
Vietnam	√	√	14

Source: DOSM (2017).

To explain Malaysia's trade relationship with its partners, Table 6 illustrates the nature and extent of Malaysia's ties with each RCEP and CPTPP partner. The membership of RCEP and CPTPP includes many of Malaysia's top 10 trading partners except for the US (ranked 3rd), Taiwan (6th) and Hong Kong (9th). Both RCEP and CPTPP partners rank among Malaysia's top 35 trading partners, except for Cambodia (52nd) and Laos (106th) for RCEP, and Chile (55th) and Peru (59th) for

CPTPP. Some CPTPP and RCEP partners are thus clearly of greater importance to Malaysia than others. However, as shown in Figure 3, the importance of these ties should take into consideration the existing PTAs signed by Malaysia with these countries—whether through an ASEAN+1 agreement or a bilateral PTA. Care will be needed to ensure that the benefits of signing trade agreements with the same trading partners will not be watered down under RCEP.

In terms of Malaysia's investment relationship with its mega-regional partners, RCEP countries account for the larger share of Malaysia's FDI inflows and outflows, mainly due to Malaysia's relationship with China. CPTPP countries made up 8.9% of Malaysia's total FDI inflow in 2017, and 9.8% of total FDI outflows. RCEP countries, on the other hand, made up 12.5% of total FDI inflows and 11.7% of outflows (BNM 2017). As Chinese investments have become more significant for Malaysia in recent years, the investment provisions contained in RCEP would be likely to be used as a policy tool to manage the Malaysia-China investment relationship.

Coverage and Key Issues

One reason why countries on Malaysia's development trajectory would want to accede to a deeper WTO-plus and WTO-extra agreement such as the CPTPP would be to 'lock-in' or strengthen current domestic reforms, particularly those that are difficult to implement due to internal political economy impediments. For instance, Malaysia may want to accelerate the pace of its ongoing unilateral service sector liberalisation by committing to a host of new disciplines governing behind-the-border measures contained in the CPTPP. Similar outcomes could also be achieved through an ambitious bilateral PTA with the EU. Such binding commitments and the ratchet mechanisms typically found in them have the additional effect of constraining the scope for future policy reversals, particularly when combined with the investor–state dispute settlement provisions found in the CPTPP's Investment Chapter. Similar considerations apply to CPTPP provisions dealing with transparency, SOEs and regulatory coherence, as well as with GP disciplines and commitments.

However, experience shows that for governments to successfully use trade and investment agreements to lock-in domestic policy reforms, the sequencing of strategies matters. In general, there is evidence showing that an adequate domestic regulatory framework generally needs to be in place before acceding to international agreements that consolidate domestic reforms. Furthermore, countries may sometimes over-estimate the degree of scope available to liberalise sensitive sectors. Ignoring the above sequencing may result in domestic political resistance that may affect the terms of the agreement or the prospects for its implementation (VanGrasstek 2011). Such 'regulatory overshooting', has arguably occurred in the financial sectors of a number of developing and transition economies such as Vietnam, where "allowing new entry in banking without creating a mechanism to sift the sound institutions from the dubious ones led to disruptions that have had a durable effect on the development of the financial sector" (Hoekman and Mattoo 2013). Further, a paper by Ferrantino (2006), indicated no systematic pattern of improved governance in the trading partners of the US in the wake of trade negotiations with the latter.

While RCEP will, as noted above, mainly consolidate existing ASEAN+1 PTAs, the CPTPP seeks to extend commitments relating to WTO-plus and WTO-extra issues. Table 7 provides an overview of the key issues covered under the two mega-regional agreements. There are three key differences between the scope and coverage of the RCEP and that of the CPTPP. Firstly, the CPTPP covers a much wider range of areas than does RCEP, including many not found in more 'traditional' PTAs, such as labour and environment issues. Second, even in the more traditional areas covering market access, the CPTPP generally features stricter or more ambitious requirements, such as the negative-list approach for services and investment commitments.

Finally, the RCEP is widely perceived to be significantly less ambitious than the CPTPP, not only in terms of coverage but also in terms of the depth of liberalisation it aims for. This owes in part to the fact that the ASEAN+1 PTAs signed with countries like China, India and Japan have included extensive exclusions for sensitive domestic sectors. Further, China and India do not have a bilateral PTA (MOFCOM 2018), making a lot of the provisions new to a bilateral relationship that has experienced friction and geopolitical rivalry. The level of ambition is also affected by the diverse countries involved in RCEP,

Table 7. Comparison of Issue Coverage between the RCEP and the CPTPP

Topics	CPTPP	RCEP
Market access for goods	√	√
Rules of origin	√	√
Textile and apparel	√	O
Customs	√	√
Trade facilitation	√	√
Trade remedies	√	√
Sanitary and phytosanitary measures	√	√
Technical barriers to trade	√	√
Investment	√	√
Trade in services	√	√
Financial services	√	√
Temporary entry	√	√
Telecommunications	√	√
E-commerce	√	√
Government procurement	√	√
Competition	√	√
State-owned enterprises and designated monopolies	√	
Intellectual property	√	√
Labour	√	
Environment	√	
Economic and technical cooperation	√*	√*
Competitiveness and business facilitation	√*	
Development	√*	
Small and medium-sized enterprises	√*	√*
Regulatory coherence	√	
Transparency and anti-corruption	√	
Dispute settlement	√	√
Legal and institutional issues	√	O
Crosscutting horizontal issues	√	

Note: * Cooperation and capacity building. O – Issue is likely to be covered in RCEP.
Source: Author, based on government websites and Xiao (2015).

which range from highly developed (Australia, Japan, New Zealand, Singapore and South Korea) to least-developed countries (Cambodia, Laos and Myanmar). Countries seeking very ambitious outcomes would face resistance, given that the AMS would seek to maintain ASEAN Centrality in its negotiating positions, which would take into account the capabilities of the least-developed ASEAN countries.

Therefore, in practice, it may not prove possible to push for RCEP outcomes that are overly ambitious given the large differences in the level of economic development and thus the economic objectives assigned to the negotiations by individual participants. For example, Table 8 shows the average index score of each country grouping for 'best' services commitment in a PTA. This provides an indication, on average, of the best commitment provided by countries in each grouping. The table shows how CPTPP countries have, on average, committed to higher levels of liberalisation as compared to their RCEP brethren.

Table 8. Country Groupings—Stylised Facts

		TPPA	CPTPP	RCEP	ASEAN	Source database and year
Number of member countries		12	11	16	10	
Goods exports	USD trillion	4.0	2.1	3.5	1.0	WITS (2016)
	% of world	27.5	14.2	24.1	6.9	
Intermediate goods export	USD billion	704.0	392.0	815.5	252.3	
	% of world	23.0	12.8	26.6	8.2	
Average of index scores for 'best' services commitment in a PTA*		63.2	62.7	53.8	46.2	Roy (2011)

Note: *Data for RCEP and ASEAN do not cover Cambodia, Laos and Myanmar.

In addition to differences between the scope and coverage of these two mega-regional agreements, it is worth noting that the CPTPP broke new ground by featuring a specific chapter dedicated to GVCs (Competitiveness and Business Facilitation). This clearly marks a rule-making response to the emerging GVC trends described earlier in this chapter. However, the decision of the US to withdraw from the agreement makes a significant difference to the ultimate value-added of the chapter to the actual operation of GVCs. As shown in Table 8, the percentages of intermediate and final goods exports drop significantly from the TPPA to the CPTPP. The scope for consolidating existing ASEAN+1 PTAs under RCEP therefore gains in value given that RCEP countries account for more than a quarter of world trade in intermediate goods.

ASEAN Integration and Mega-regionals

As a participant in both the RCEP and TPPA/CPTPP negotiations, and as an AMS, Malaysia confronts two competing policy challenges. On the one hand is the development of stronger regional ties with its ASEAN neighbours as well as its largest trading partner through the RCEP, which in turn is linked to the establishment of the AEC. On the other hand, policymakers in Malaysia have stressed the importance of the CPTPP in terms of not being seen to be left out of such a major agreement and in light of shifting domestic reform priorities.

On balance, one may posit that Malaysia could actually derive greater longer-term benefits from RCEP than from the CPTPP (KRI 2014). For one, the RCEP market is geographically more relevant for Malaysia given its centrality to ASEAN and is therefore key to managing transaction costs for businesses and investors with priority partners. The RCEP would provide enhanced access for Malaysian products in the key markets of China and South Korea, where tariff protection remains substantial compared to the markets of the US and other advanced CPTPP nations. The RCEP is further expected to complement ASEAN's initiatives aimed at establishing itself as a single production base within the mosaic of regional value chains, which Malaysia can leverage to enhance the value-added of its own manufacturing and services sectors. RCEP further affords the enticing prospect of stronger two-way trade and investment ties with India, with which Malaysian trade and FDI ties have so far been suboptimal.

It is noteworthy that RCEP is seen to be an ASEAN-led initiative, as the ASEAN+1 PTAs are the basis for the choice of countries participating in RCEP negotiations. One of the four key characteristics of the AEC is to make it a region fully integrated into the global economy (ASEAN 2008). RCEP can thus be viewed as a strategic measure taken by ASEAN Member States to fulfil this core AEC aim. Indeed, one of the principles guiding the RCEP negotiations is to "facilitate the participating countries' engagement in global and regional supply chains" (ASEAN 2012). Therefore, ASEAN countries may be willing to grant greater market access and agree to stronger rules if this would result in stronger GVC ties throughout the region. In addition, because RCEP includes all AMS, it could be argued that preferential treatment gained because of RCEP negotiations could facilitate the GVCs of ASEAN as a region.

It is commitments made in agreements outside the ASEAN framework that require deeper analysis. For example, as the CPTPP is likely to be more ambitious than is RCEP, there may be a gap in terms of AMS' commitments favouring non-ASEAN countries. Thus, the ASEAN Centrality principle may not be upheld in its strictest form.

ASEAN agreements have included some mechanisms to address this concern, such as through a liberal most-favoured nation (MFN) principle written into the ASEAN agreements. However, there are gaps where an AMS could provide better treatment to a non-AMS in its PTAs. For example, in the case of commitments made under IIAs, the ASEAN Comprehensive Investment Agreement (ACIA) MFN provision (Article 6) allows AMS to enjoy the benefits Malaysia provides to CPTPP countries with regard to investment protection and selected investment liberalisation commitments. This means that ASEAN countries still benefit from stronger CPTPP obligations, albeit in a limited way, for investment liberalisation for the services sector[5]. As the ASEAN Framework Agreement on Services (AFAS) does not have a similar MFN provision, any gaps between AFAS and CPTPP liberalisation levels would need to be negotiated into the final AFAS package of commitments, targeted to be signed in 2018 (ASEAN 2017).

CONCLUDING THOUGHTS

This chapter provides a brief overview of a number of salient trends in contemporary trade and investment governance, assessing their relevance to Malaysia. The rise of the GVC phenomenon in particular is forcing a global rethink of the optimal architecture and substance of modern trade and investment agreements and the scope that may exist to address the multiplicity of silos in the multilateral trading system. The development of GVC-friendly policies needs to address three strategic issues—entering GVCs, expanding and strengthening GVC participation, and turning GVC participation into sustainable development. Trade and investment agreements are useful tools to address these questions insofar as they facilitate trade in goods, services and investment in a seamless manner.

The persistent Doha Round deadlock has prompted many WTO Members, particularly from developed countries, to turn to PTAs as a means of 'exporting' developed-world standards to their trading partners in the GVCs of which they are hubs. Most notably, this is occurring through the creation of mega-regionals, most of which feature provisions not found in current global trade rules. Such WTO-plus and WTO-extra rules and commitments cover a wide range of issues that do not necessarily originate from trade agreements. Provisions (including of a soft law nature) agreed under organisations such as APEC, OECD, IMF and WIPO can migrate into trade agreements to become legally binding and enforceable commitments. In turn, given the economic weight of mega-regional agreements in global trade, commitments made in these agreements could become building blocks for future WTO negotiations. As countries engage in negotiating new rules that cover a broad range of new issues of significance to key partner countries, plurilateral norms, particularly those relating to behind-the-border issues, show an increasing tendency to be implemented on a non-discriminatory basis, resulting in their incipient, *de facto*, multilateralisation.

One reason why countries such as Malaysia may wish to take on deeper WTO-plus and WTO-extra commitments under an agreement such as the CPTPP is to lock-in or lend greater external visibility to current domestic reforms, particularly those that are difficult to implement due to internal political impediments. The signalling properties of

participating in mega-regional compacts may be particularly strong for a country like Malaysia that competes fiercely with regional neighbours to attract and retain efficiency-seeking FDI for which an accommodating trade policy and complementary domestic regulatory framework would be useful. However, experience shows that the sequencing of strategies matter, for governments to successfully utilise trade agreements to lock-in domestic policy reforms. An adequate domestic regulatory framework sometimes needs to be in place before international agreements that consolidate such reforms can be useful.

Of the mega-regionals that concern Malaysia, the CPTPP has attracted the most controversy, partly due to the breadth and depth of WTO-plus and WTO-extra issues incorporated into the agreement and the importance of the US as a trading partner (in the initial TPPA negotiations). Despite the withdrawal of the US, the CPTPP raises the question of how trade agreements signed by AMS with non-ASEAN countries impact the ASEAN Centrality principle and ASEAN integration in general. Apart from the CPTPP, Malaysia is also involved in the RCEP negotiations, an ASEAN-led effort to support and promote GVCs in the region, among other objectives. RCEP seeks to consolidate existing ASEAN+1 PTAs with a view to facilitating the operation of regional GVCs among signatories with close (and growing) trade and investment ties. Given the mostly regional character of GVCs, the emergence of mega-regional trade agreements will impact how GVCs are structured in the future. Although RCEP could simplify regional trade and investment governance by reducing the prevailing spaghetti-bowl of rules between RCEP countries, the spaghetti-bowl of rules worldwide are still best addressed under the auspices of the WTO so long as meaningful progress can be made—and much needed governance reforms agreed—at the global level.

A looming threat on the horizon that could cause significant disruption to existing patterns of trade and investment and sources of comparative advantage is the dazzling speed at which disruptive technologies, such as advanced robotics, three-dimensional (3D) printing and artificial intelligence, are advancing and being increasingly deployed (Baldwin 2016). By making mass customisation and far-reaching 're-shoring' possible, supply chain unbundling and the international division of labour brought about by the GVC revolution could be seriously undermined. Disruptive technologies allow firms to increasingly

customise products according to customer preferences, in multiple locations and closer to consumers. These trends may result in a substantial shortening of supply chain trade, and a reduction in the volume of both trade in intermediate products and of FDI flows. Such developments are unlikely to be kind to technological laggards and highlight the importance of domestic policies that reinforce the innovation capacities of firms and workers. Governments, including that of Malaysia, will need to be highly flexible and creative in navigating the new trade environment, one that will rely more heavily on the movement of information (data) and possibly services than that of goods.

Endnotes

[1]In this chapter, we use the terms RTA and PTA interchangeably.

[2]Refers to 'physical' RTAs, which include goods, services and accession agreements together, rather than separately.

[3]For the purposes of this chapter the terms CPTPP and TPPA will be used interchangeably, particularly in reference to the agreement's negotiations.

[4]Percentage numbers refer to percentage share in total exports of domestic inputs sent to third countries.

[5]As mentioned above, ACIA covers investment liberalisation for five sectors and services incidental to these sectors. Therefore, ACIA's MFN clause would cover these sectors.

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4

Services Sector Reforms in Malaysia

Rokiah Alavi[1]

INTRODUCTION

The importance of the services sector in an economy increases simultaneously with the level of economic development. Services play a key role in determining the competitiveness of firms in all sectors of the economy, namely agriculture, manufacturing, mining and the service sector itself. The availability of efficient and cost-effective services is crucial in influencing a country's investment climate, and therefore has a significant impact on overall business performance, level of investment, productivity and economy-wide performance, including in export markets (Cali, Ellis and Velde 2008). The competitiveness of manufacturing firms is critically influenced by access to low-cost and high-quality services such as telecommunications, transport, distribution services and financial intermediation, among others (Francois and Hoekman 2010). This is even more important for businesses that participate in global production networks.

Being an upper middle-income country that aspires to becoming a high-income nation by 2020, Malaysia has seen successive governments devise strategies to make the country an internationally competitive producer of high-technology manufactured goods as

well as a regional hub for selected knowledge-intensive services. The Malaysian New Economic Model[2] of 2010 emphasised the importance of knowledge, particularly research and development in the science and technology sector, in propelling Malaysia's economic growth and competitiveness forward. Various policy initiatives were drawn up under the Industrial Master Plan 3, the Economic Transformation Programme and the Malaysia Plans to shift the economy towards more technology- and knowledge-driven activities. For the manufacturing sector, the government has placed particular emphasis on promoting investment in new production technology and high value-added sectors with the objective of moving up the value chain. This is reflected in a significant increase in foreign direct investment (FDI) and concomitant policy liberalisation in new growth areas such as renewable energy, aerospace, pharmaceuticals and medical equipment (BNM 2011). A large share of the new investments is also being channelled into the less capital-intensive but high-skilled services sector, such as financial services and shared services operations[3] (BNM 2011).

This chapter takes stock of the status and development level of the services sector in Malaysia. The remainder of the chapter is organised as follows. The first section briefly covers the background and contribution of the services sector to the economy. This is followed by an analysis of patterns of services value-added and trade. The third section examines various ongoing services liberalisation initiatives and the extent to which levels of protection in the sector have been reduced as a result of recent policy initiatives. The final section discusses the challenges faced by the industry and concludes with policy recommendations.

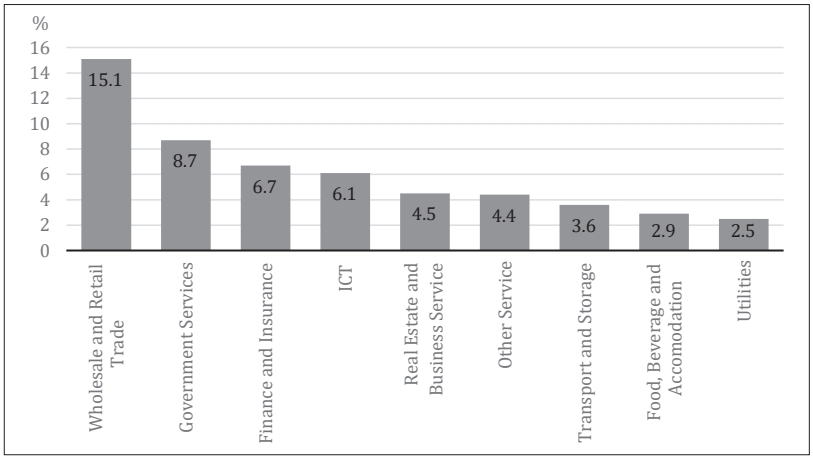
SERVICES IN THE MALAYSIAN ECONOMY: SALIENT TRENDS

The service sector has steadily gained importance in the Malaysian economy in recent years, its overall contribution to the country's gross domestic product (GDP) expanded from 38.3% in 1970, to 46.8% in 1990, and to 54.8% in 2017. The sector is also the country's largest employer, supplying 3 in 5 (62.0%) jobs in the first half of 2017 (Treasury Malaysia 2017). Within the service economy, as in many other economies, the wholesale and retail trade sector contributes the largest share of GDP at 15.1%, followed by government services

at 8.7% and finance and insurance services at 6.7% (see Figure 1). In 2017, the fastest-growing service sectors in Malaysia were information and communication services (8.5%), food, beverage and accommodation services (7.6%), real estate and business services (7.2%) and wholesale and retail trade (6.5%). According to the Treasury Report 2015, strong growth witnessed in the retail sector was brought about by various initiatives undertaken by the government, particularly the 1Malaysia Mega Sales Carnival and the expansion of retail outlets, both of which attracted foreign tourists and locals to shop in Malaysia.

In 2017, total investment in the service sector was RM121.1 billion (USD29.8 billion), with domestic investment accounting for 76.2% of the total[4]. Even though foreign investment in the services sector accounted for only 23.8% of total investment, total FDI inflows destined to the sector have increased markedly in recent years, rising from RM4.1 billion (USD1.3 billion) in 2010 to RM17.7 billion (USD5.1 billion) in 2014 and RM28.3 billion (USD6.3 billion) in 2016. The real estate subsector has recently been the major recipient of inward investment, with RM98.6 (USD28.2) billion worth of FDI in 2014, accounting for two-thirds of total FDI in the sector. In 2016, the subsector accounted for 45% of the total FDI in services. It is important to note that the developmental impact of FDI in real estate is not as transformative as inflows in key producer services would be.

Figure 1. Malaysia: Sectoral Breakdown of Services in GDP, 2017



Source: Treasury Malaysia (2017). Data is estimated figures for 2017.

While Malaysia is therefore attracting more services FDI, this may not necessarily be the most desirable type of foreign inflow from an economy-wide perspective.

The shift in policy emphasis towards knowledge and technology intensive (KTI) industries in Malaysia has had a significant impact on the growth of output and trade in knowledge-intensive (KI) services. The value-added of KI service industries in Malaysia doubled from USD11.8 billion (RM44.8 billion) in 2000 to USD38.2 billion (RM133.4 billion). The industry grew steadily during this period, with an annual average growth of 8.0% per year.

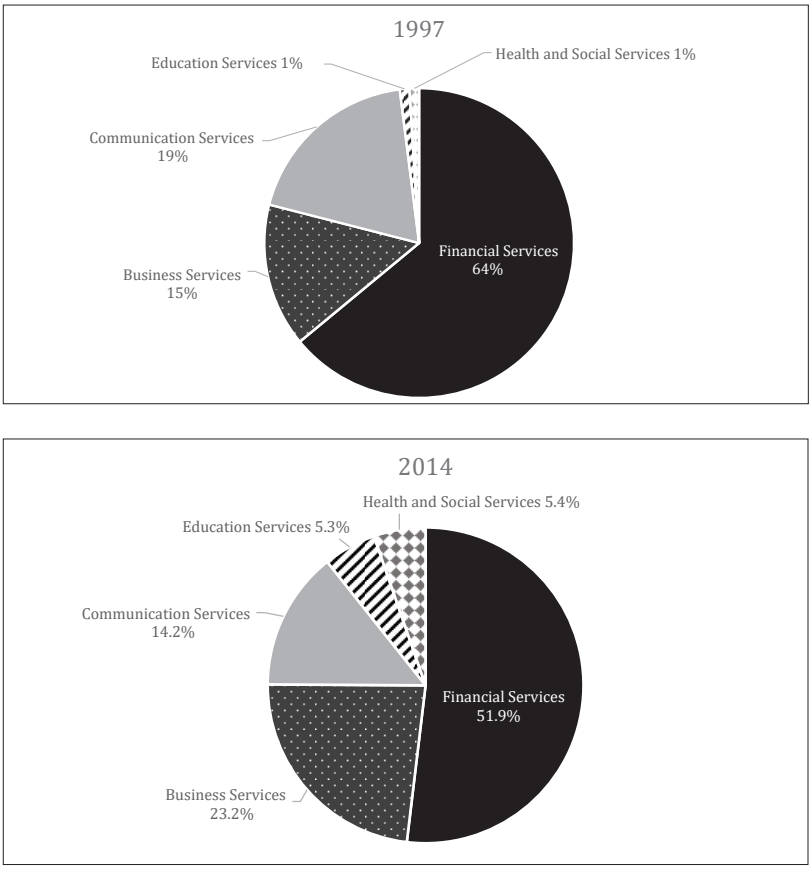
Financial services is the largest sector in the commercial KI services industry and was the top contributor to the expansion of the industry. Growth in this sector was mainly driven by bank lending activities (BNM 2012). However, financial services' share in total commercial KI services value-added declined significantly from 64% in 1997 to 51% in 2014, due to expansion of other sectors under the KI category, such as business services, education services and social and health services. Such signs of KI diversification are both welcome and encouraging in an economy many consider at risk of falling into the middle-income trap.

Bank Negara Malaysia (2012) noted that the financial sector has been the primary driver of service-led economic development in Malaysia. Since the late 1990s, the Malaysian financial sector has placed a greater emphasis on Islamic financing, with the aim of becoming a leading player in Islamic finance globally. Initially, the sector concentrated only on Islamic banking products and services. But today, the service offering has expanded to cover *Shari'ah*-compliant insurance and capital markets (*sukuk*[6]) activities. The Malaysian Government foresees the share of Islamic finance increasing to 40% of total domestic financing by 2020, up from 24% at the end of May 2014[7].

Education and health services, including health-related tourism services, are two other service sectors that have received a determined policy push and benefited from various support measures over the past two decades. The value-added of these two sectors was relatively small and grew at a much slower pace than that of other KI service sectors[8], as befits sectors in which productivity

measurements are always challenging. Still, value-added in education services grew from USD201.0 million (RM782.3.0 million) in 1997 to USD2.4 billion (RM8.4 billion) in 2014, with the sector's share in total KI services value-added increasing from 1% to 5% over the period (see Figure 2). During the same period, the health and social services sector's value-added also grew steadily, from USD191 million (RM743.4 million) in 1997 to USD2.4 billion (RM8.4 billion) in 2014[9].

Figure 2. The Share of Knowledge-intensive Service Subsectors Value-added in 1997 and 2014



Source: Based on data extracted from US Science and Engineering Indicators, 2014 and 2016.

Private healthcare services experienced remarkable growth in response to the government's active promotion of health-related tourism. In 2011, there were 221 private hospitals in Malaysia, a number that is expected to reach 239 in 2018. Other private healthcare service facilities, namely maternity units, nursing homes, ambulatory care centres, blood banks, haemodialysis centres and combined facilities have also experienced significant growth. As with the educational sector, the share of Malaysia's health sector in the KI services industry increased from 1% in 1997 to 5% in 2012 (see Figure 2). Given the strong role that women play in both the education and healthcare sectors, evidence of such sustained growth suggests important gains in inclusiveness[10].

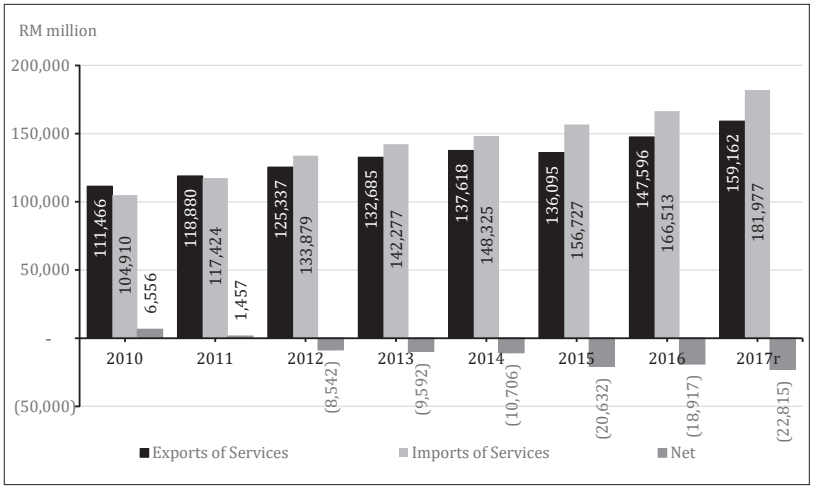
MALAYSIA'S SERVICES TRADE PROFILE

The share of Malaysia's services exports in global services trade remains marginal, accounting for only about 0.7% of aggregate services trade in 2017[11]. In comparison, the share of the services exports of the United States was 14.7%, that of the United Kingdom was 6.6%, with Singapore at 3.1%, China at 4.3%, India at 3.5%, Thailand at 1.4%, the Philippines at 0.7% and Indonesia at 0.5%.

Still, total services exports increased steadily between 2010 and 2017, from RM111.5 billion (USD36.2 billion) to RM159.2 billion (USD39.2 billion) (see Figure 3). Malaysian services exports mainly comprise travel-related services, which accounted for 50.0% of total services exports in 2017, reflecting the key importance of tourism to the overall economy (see Figure 4). Other key services exports include other business services (16.0%), transport services (12.0%) and telecommunications and information and communications technology (ICT) services (7.0%).

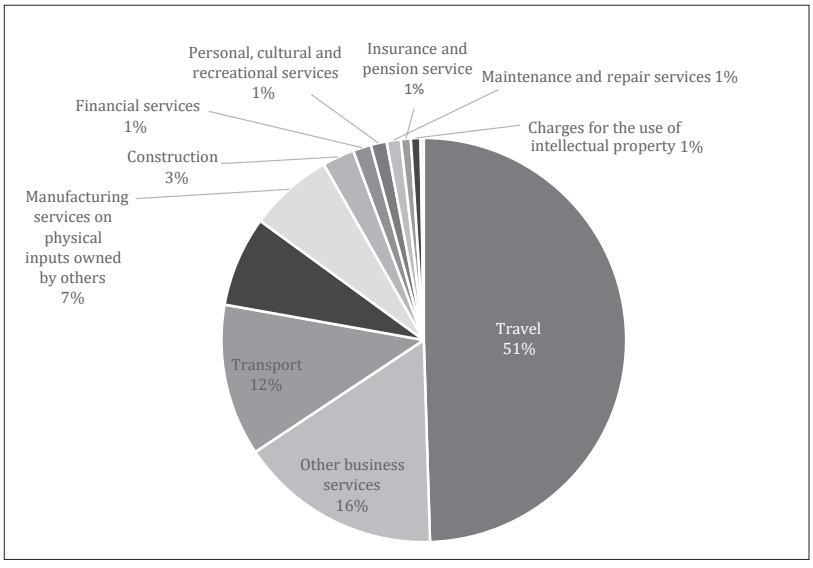
Figure 5 shows that travel-related services experienced the fastest export growth in recent years. The value of exports in this sector rose from RM58.4 billion (USD18.9 billion) in 2010 to RM78.8 billion (USD19.4 billion) in 2017, representing growth of 35.0%. The second fastest growing service sector was other business services, which grew steadily at an average of 8.1% per annum, contributing RM25.7 billion (USD6.4 billion) worth of exports in 2017. Other sectors showed very modest growth.

Figure 3. Malaysia's Trade in Services, 2010 – 2017



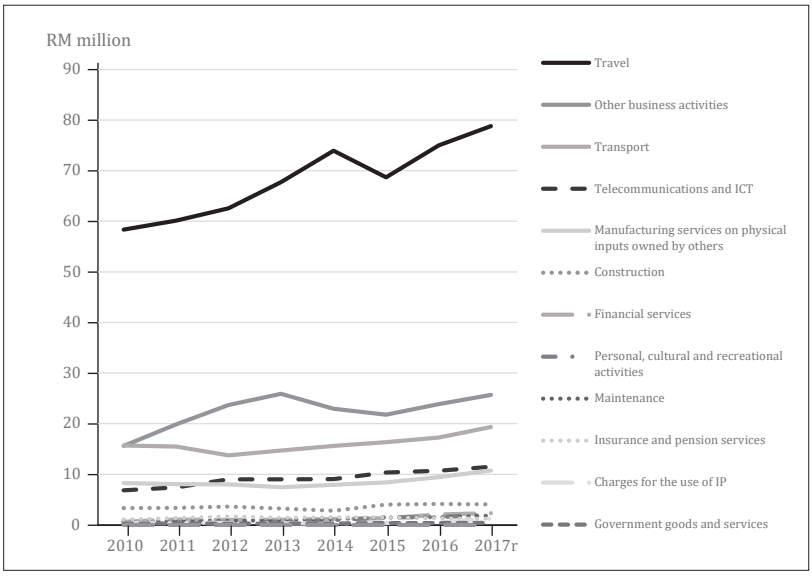
Note: r, revised.
Source: Department of Statistics Malaysia.

Figure 4. Composition of Malaysian Service Exports, 2017



Note: n.i.e. – not included elsewhere.
Source: Department of Statistics Malaysia.

Figure 5. Malaysia's Exports in 11 Specific Services Categories, 2010 – 2017



Note: r, revised.
Source: Department of Statistics Malaysia.

The concern lingers that the key sources of Malaysian services exports remain traditional sectors[12], especially travel and transport services. The trade performance of the country's KI services industries has yet to live up to expectations. Flaaen, Ghani and Mishra (2013) reported that modern[13] services exports in Malaysia grew at a much slower pace than those of other countries, namely Brazil, China, India, Singapore, the Republic of Korea, the Philippines and the US. A recent joint study by the ASEAN Secretariat and the World Bank found that, with the exception of the Philippines and Singapore, most ASEAN member states had failed to tap into the new services opportunities such as IT and business-related services (ASEAN and World Bank 2015). The study reported that exports of modern services in Singapore grew notably since the mid-1990s and became a key locational determinant for more KI industries in global value chains, particularly in pharmaceutical research and development. The Philippines, on the other hand, registered an outstanding performance in recent years in BPO[14] and IT-enabled services exports, emerging as a region-wide (and global)

success story. By 2014, the Philippines had overtaken India as the largest hub for call centres in the world (Maddineni 2015). In that year, ICT-related services accounted for 71.5% of the Philippines' services exports[15]. In contrast, Malaysia's ICT services exports accounted for only 29.1% of the country's total[16]. Malaysia's performance in other KI service sectors has not been impressive either. For instance, Malaysia's share in global health services exports was only 0.04% in 2010 as compared to India (1.65%), Indonesia (0.45%), Singapore (0.25%) and Thailand (0.18%)[17]. Similarly disappointing results relative to ASEAN neighbours were also recorded in computer-related services, communication and education services (see Table 1).

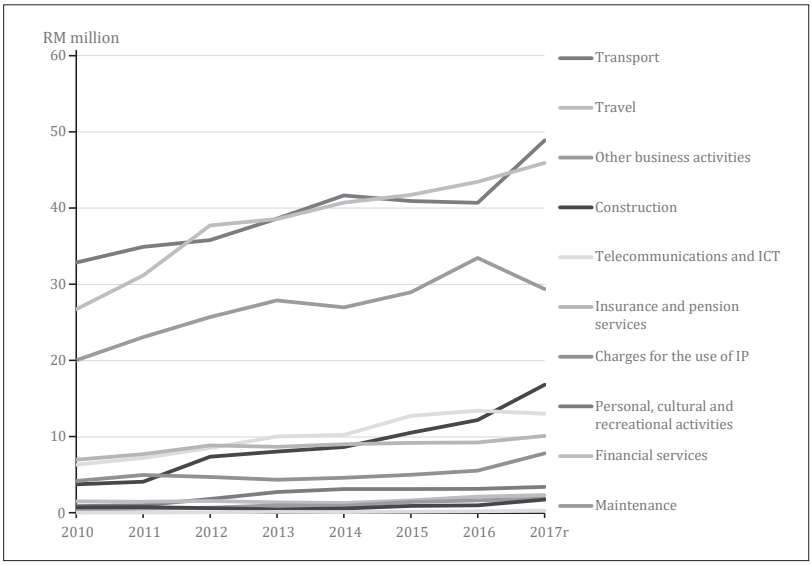
Figure 6 depicts trends in Malaysian services imports. It shows that transport, travel and other business services accounted for 68.2% of total service imports in 2017. This implies that a large proportion of the country's imported services are used as inputs in the production of manufactured goods, a trend that evidences Malaysia's strong insertion in regional and global production networks in manufacturing.

Table 1. Share in Global Exports for Selected Knowledge-intensive Services Sectors (%), 2010

Country	Computer-related services	Communication services	Education services	Health and social services
European Union	35.2	19.2	29.9	33.9
United States	30.3	25.7	31.6	33.3
Japan	13.4	7.4	6.9	10.3
China	2.0	12.5	6.7	2.8
India	1.7	2.0	1.6	1.7
South Korea	1.4	1.0	2.3	1.3
Taiwan	0.5	0.8	0.8	0.4
Indonesia	0.3	1.6	0.5	0.5
Singapore	0.2	0.5	0.2	0.3
Philippines	0.1	0.4	0.3	0.1
Malaysia	0.1	0.5	0.1	0.04
Thailand	0.1	0.3	–	0.2

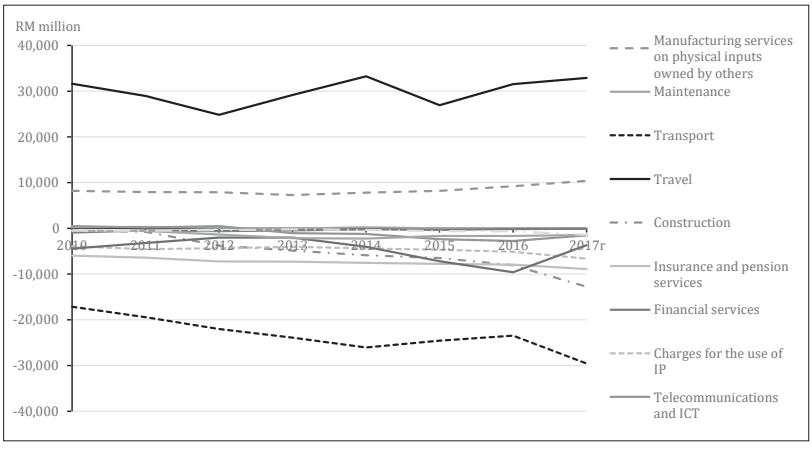
Source: Based on data extracted from US Science and Engineering Indicators, 2013.

Figure 6. Malaysia: Trends in Service Imports, 2010 – 2017



Note: r, revised.
Source: Department of Statistics Malaysia.

Figure 7. Malaysia: Service Trade Balance, 2010 – 2017



Note: r, revised.
Source: Department of Statistics Malaysia.

Services imports have experienced faster growth than exports over the last decade, resulting in a widening of the country's services trade deficit, particularly after 2011. The deficit rose from RM8.5 billion (USD2.8 billion) in 2012 to RM10.7 billion (USD3.1 billion) in 2014 and worsened further to RM22.8 billion (USD5.6 billion) in 2017. Travel and manufacturing services on physical inputs owned by others are the only two sectors that recorded a trade surplus over the period (see Figure 7). Transport services recorded the largest total trade deficit between 2010 and 2017, followed by construction services, charges for the use of intellectual property and telecommunications and ICT services.

TRENDS IN SERVICE SECTOR LIBERALISATION

Malaysia has a long history as a trading nation. Its trade openness ratio stood at 131.1% of GDP in 2017[18], implying an above-average dependency on international trade. As noted earlier, the country aspires to becoming a regional hub for exports of KI services, particularly in education and health-related services. KI service sectors are seen as holding the key for moving the economy up the services value chain, in line with Malaysia's Vision 2020, with a view to achieving high-income nation status. Various types of policies, such as unilateral liberalisation initiatives and pro-competitive regulatory reforms of the services sector, improvement of infrastructure and logistics, upgrading the quantity and quality of human capital, enhancement of productivity, and tax incentives for private companies have been implemented in recent years to create a business-friendly and FDI-attracting environment that helps service providers to strive to achieve international competitiveness. In 2010, 11 service sectors were identified as New Key Economic Areas in the New Economic Model[19] on the basis of their potential to contribute to gross national income and export competitiveness. These are: (i) oil, gas and energy-related services; (ii) palm oil-related services; (iii) financial services; (iv) tourism; (v) business services; (vi) electronics and electrical machinery-related services; (vii) wholesale and retail trade; (viii) education; (ix) healthcare; (x) communication content and infrastructure; and (xi) services related to agriculture.

Extensive trade and investment liberalisation was undertaken in response to the country's immediate and longer-term needs, particularly in facing the challenges of globalisation and growing competition from regional giants China and India. Many service sectors were liberalised autonomously in addition to market opening commitments under a wide array of preferential trade agreements (PTAs). These include ASEAN's Framework Agreement on Trade in Services (AFAS), several bilateral PTAs, the World Trade Organization's General Agreement on Trade in Services (GATS) and the recently signed Comprehensive and Progressive Trans-Pacific Partnership (CPTPP).

The first phase of autonomous service sector liberalisation was announced in April 2009, when 27 services subsectors were liberalised by allowing 100% foreign ownership by 2012. A second round of liberalisation took place in 2012, involving a further 18 service subsectors. Malaysia has concluded bilateral PTAs with seven countries so far, namely Australia, Chile, India, Japan, Pakistan, New Zealand, (where no commitments were initially made in services) and Peru. Malaysia also participated in the so-called ASEAN+1 PTAs concluded between ASEAN and six countries namely Australia, China, India, Japan, New Zealand and South Korea. As an ASEAN member state, Malaysia is also taking part in ongoing negotiations towards a Regional Comprehensive Economic Partnership (RCEP) linking ASEAN member states to the six regional partners with whom it already has entered into ASEAN+1 agreements.

AFAS has recently completed its tenth package of liberalisation as part of the ASEAN Economic Community (AEC) initiative (see Table 2)[20]. Under the AEC, ASEAN members committed to eliminating all restrictions in Priority Integration Sectors (PIS), namely air transport, e-ASEAN, healthcare and tourism by 2010. The logistics services sector was given a longer liberalisation timetable up to 2013. The AEC aimed to see all restrictions on services sectors 'substantially' removed by the end of 2015. Dee (2015) argued that there was a significant lag between AFAS commitments and reforms in domestic policies. One of the initiatives taken to enhance the implementation of AFAS and ongoing efforts towards deepening services integration is to replace AFAS with a new legal instrument called the ASEAN Trade in Services Agreement (ATISA) whose negotiation is expected to be completed in 2018.

Table 2. Summary of AFAS Targets

	5th Package	7th Package	8th Package	9th Package	10th Package[20]
Completion Target	AEM 2006	AEM 2009	AEM 2011	AEM 2013	AEM 2015
Scheduled Subsectors		65	80	104	128
Mode 1 (including horizontal)	None	None	None (for all 80 subsectors)	None (for all 104 subsectors)	None (for all 128 subsectors)
Mode 2 (including horizontal)	None	None	None (for all 80 subsectors)	None (for all 104 subsectors)	None (for all 128 subsectors)
Foreign Equity Limitation (including horizontal)	PIS: 49% Construc-tion: 51% Other: 30%	29 PIS: 51% 9 LOG: 49% 42 Other: 49%	29 PIS: 70% 9 LOG: 51% 42 Other: 51%	29 PIS: 70% 9 LOG: 51–70% 66 Other: 51%	29 PIS: 70% 9 LOG: 70% 90 Other: 51–70%
Mode 3 MA Limitations (including horizontal)		29 PIS: max 2 limitations 9 LOG: max 3 limitations 27 Other: max 3 limitations	29 PIS: No limitation 9 LOG: max 2 limitations 16 Other: max 3 limitations 16 Other: max 2 limitations	29 PIS: No limitation 9 LOG: No limitation 26 Other: max 2 limitations 26 Other: max 1 limitation	29 PIS: No limitation 9 LOG: No limitation 90 Other: No limitation
Mode 3 NT (including horizontal)		N.A.	Max 4 limitations /subsector	Max 3 limitations /subsector	Max 1 limitation /subsector
Mode 4		N.A.	To be agreed	To be agreed	To be agreed
15% Flexibility		N.A.	To be agreed	To be agreed	To be agreed

Notes : PIS – Priority Integration Sectors
LOG – Logistics services
Other – Other Services
AEM – ASEAN Economic Ministers Meeting

Source: Narjoko (2015).

In November 2012, ASEAN further launched the RCEP with its dialogue partners and has concluded 22 rounds of negotiations to date. RCEP would be the world's largest trading bloc if the partnership materialises and will be the main setting for ASEAN to deepen economic integration with East Asian nations, especially China. In October 2015, Malaysia concluded the Trans-Pacific Partnership Agreement (TPPA) with 11 nations, including the United States (which has subsequently withdrawn from the Agreement). The CPTPP, which comprises the remaining 11 nations, was signed on 8 March 2018. The CPTPP covers 21 issue areas under 29 chapters that go beyond traditional market issues by dealing with novel and, at times, contentious, issues such as investor-state dispute settlement, trade-related intellectual property rights, competition policy, state-owned enterprise reform, government procurement and labour/human rights as well as digital trade.

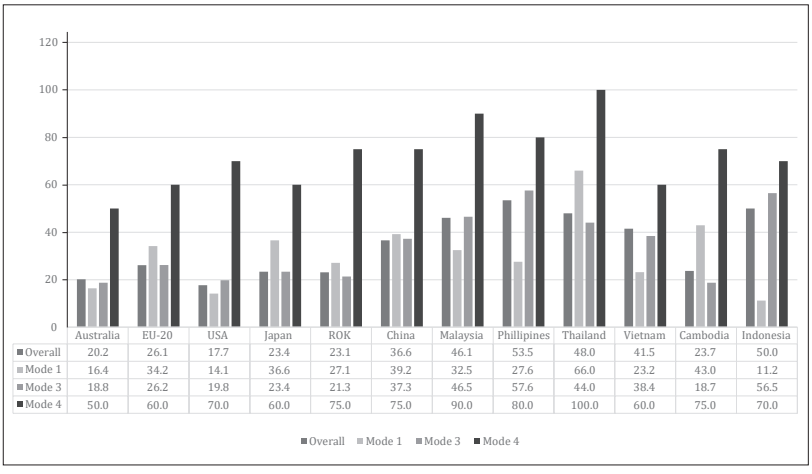
Despite the numerous market opening initiatives depicted above, Malaysia's service sector remains subject to strong doses of protection in selected areas and progress in eliminating trade and investment restrictions remains inadequate. Menon and Melendez (2015) noted that ASEAN service liberalisation has been slow and that the existing commitments made by ASEAN Member States were insufficient in both the 7th and 8th Packages of AFAS. The extent to which the latest liberalisation packages and the new legal instrument under ATISA will be able to tackle the issue of lagging domestic reforms and further deepen regional services sector integration remains to be seen. It is notable that Malaysia, like all its ASEAN brethren, stood on the side-lines of Geneva-based talks towards a (currently stalled) WTO+ plurilateral Trade in Services Agreement (TiSA) whose aim was to define the new frontiers of services trade governance in an age of production networks and increasing servicification of economies at all levels of development (Sauvé, 2013).

MITI[21] reported that Malaysia had not met the market opening thresholds foreseen under AFAS and that the country had one of the most protected services sectors in the region. Indeed, several types of barriers still exist in the Malaysian service sector despite various liberalisation initiatives (Mahani 2011). These include measures such as statutory or constitutional limitations on foreign equity participation, restrictions on land ownership, and domestic impediments to professional or labour mobility (Severino and Menon

2013). Furthermore, professional associations representing lawyers, nurses, architects and doctors, still tend to oppose the freer mobility of professionals from abroad, despite the conclusion of mutual recognition agreements in some of these very professions under AFAS.

Figure 8 shows a comparison of the services trade restrictive index for Malaysia, selected countries in the region, the United States and the EU-20. The overall index tracks the liberalising level of actual service sector regulation, irrespective of countries' binding commitments under trade agreements. The data shows that service sector regimes in the US, EU-20, Australia, Cambodia, China, Republic of Korea, New Zealand, EU-20 and Japan are all significantly open to foreign competition, with relatively minor restrictions Malaysia appears to have major restrictions in Modes 1 and 3, while Mode 4 appears virtually closed with limited opportunities to enter and operate, as is the case of most of the country's trading partners.

Figure 8. Service Trade Restrictions Index of Malaysia and Selected Partners[22]



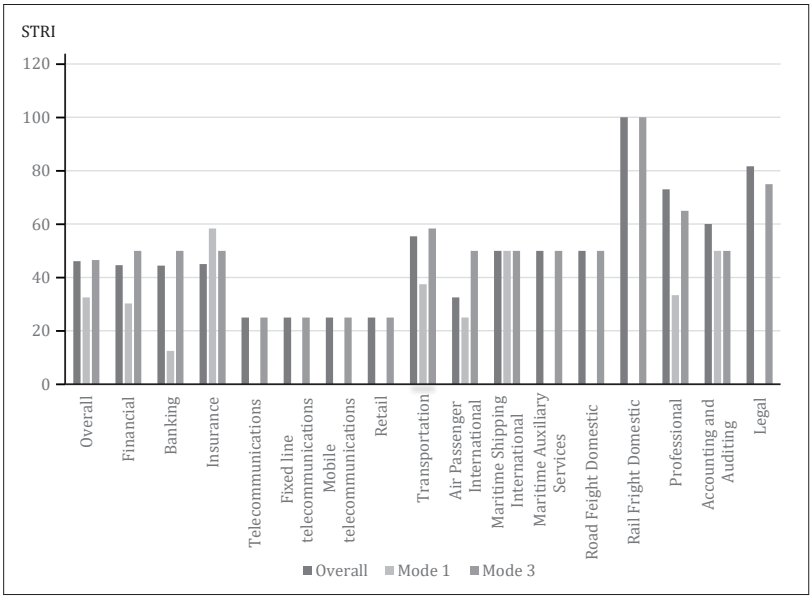
	Australia	EU-20	USA	Japan	ROK	China	Malaysia	Phillipines	Thailand	Vietnam	Cambodia	Indonesia
Overall	20.2	26.1	17.7	23.4	23.1	36.6	46.1	53.5	48.0	41.5	23.7	50.0
Mode 1	16.4	34.2	14.1	36.6	27.1	39.2	32.5	27.6	66.0	23.2	43.0	11.2
Mode 3	18.8	26.2	19.8	23.4	21.3	37.3	46.5	57.6	44.0	38.4	18.7	56.5
Mode 4	50.0	60.0	70.0	60.0	75.0	75.0	90.0	80.0	100.0	60.0	75.0	70.0

Source: Services Trade Restrictions Database, World Bank http://iresearch.worldbank.org/servicetrade/#. Accessed 20 April 2015.

At the sectoral level, the level of openness for Malaysia differs quite markedly. Figure 9 reveals that the retail, mobile telecommunications and fixed-line telecommunications sectors are open to foreign competition, whereas the rail freight sector is completely closed. Professional services, financial services and domestic transport sectors are also highly protected.

Most of Malaysia's highly protected service sectors are considered to be strategically or economically sensitive and therefore reforms tend to be sticky and resisted by domestic interests. Hence, in such cases, participating in trade agreements could be a solution and potentially assist the government to undertake reforms and overcome domestic resistance to change. Such engagement can help supply a useful political economy means for governments to break domestic deadlocks

Figure 9. Malaysia: Services Trade Restrictiveness Index by Sector



Note: STRI for Mode 1 for Accounting and Auditing, Transportation, Maritime Shipping, Maritime Auxiliary Services, Banking and Telecommunications are not available (appears as 0 in the graph). The value of STRI for Mode 1 of Retail Services is 0. There is no data for Mode 2 while data for Mode 4 is only available for 4 sectors.

Source: World Bank http://iresearch.worldbank.org/servicestrade/home.htm. Accessed 12 April 2015

by mobilising lobby groups in support of contentious reforms (Francois and Hoekman 2010). Malaysia's decision to participate in the TPPA and CPTPP negotiations despite the likely controversial contents and strong domestic resistance suggested the government's desire to leverage external pressure to drive the domestic reform process. In fact, external pressure that has driven domestic regulatory reforms and liberalisation has been much in evidence since the GATS and deepened further with subsequent PTAs and other regional integration initiatives that Malaysia has taken part in. This has been reported by many studies. For example, in ASEAN countries, service sector liberalisation commitments under AFAS and bilateral PTAs have deepened significantly beyond the GATS (Dee 2015, Intal *et al*. 2014, Hamanaka 2013). As noted above, the only exception to Malaysia's participation in externally-inducing service sector liberalisation initiatives concerned Geneva-based talks towards a plurilateral TiSA, in which no ASEAN Member State is currently participating, but whose negotiation has also been suspended since the current US administration was elected.

ASEAN's further liberalisation obligations in the impending AFAS packages (i.e. AFAS 10 to AFAS 12) are set to further reduce services trade barriers, particularly in Modes 3 and 4. Intal *et al*. (2014), however, cautioned that the investment liberalisation process under AFAS would be tougher after the launch of the EAC[23]. They noted that although Malaysia has a very liberal investment regime for foreign investors in the manufacturing sector, the country's investment regime in services remains significantly more restrictive. Their study showed that the overall level of liberalisation achieved across all service sectors in Malaysia under the AFAS-8 package was quite disappointing and that compliance was even lower in the priority sectors. Data shown in Figures 8 and 9 confirm their view that services provided under Mode 3 and Mode 4 are still highly protected.

Umezaki (2012) and Menon and Menendez (2015) argued that the slow pace of liberalisation partly owes to the built-in flexibilities introduced under the ASEAN-X formula, where countries that are ready to liberalise can proceed first while other Member States can join later as and when they are ready to do so. More flexibility was for instance granted to the financial services sector. In addition, Member States are

granted policy space by being allowed to carve out subsectors that they are not ready to liberalise, taking their national policy objectives and level of economic and financial sector development into consideration (Nikomborirak and Jitdumrong 2013, Umezaki 2012). This is further compounded by the fact that foreign equity liberalisation under the AEC is capped at 70% rather than 100%. In addition, Malaysia also maintains measures requiring foreign enterprises to allocate *Bumiputera* capital ownership of 30% or more in selected service sectors, thus making complete investment liberalisation almost impossible in certain sectors.

Studies[24] have shown that a negative-list approach to scheduling services commitments often leads to deeper liberalisation than do agreements predicated on a positive-list approach to market opening. Malaysia confronted a negative-list approach to market opening for the first time during the TPPA negotiations. Most parties to the TPPA negotiations had used the negative-list approach in previous PTAs, with the exception of Malaysia and Vietnam (see Table 3).

The negative-list approach assumes that all sectors (possibly including future services not in existence at the time of an agreement's entry into force), are covered and fully liberalised under an agreement unless they are specifically reserved under various exception lists (Annexes) for existing or future non-conforming measures. This can prove administratively challenging and potentially risky because a negative-list approach requires full knowledge of the measures in place in all sectors. Aidonna Jan (2011) suggested that adoption of the negative-list approach in the TPP required Malaysia to identify and present specific laws and regulations for about 80% of its services subsectors that were not covered in previous agreements. Nevertheless, a number of good governance promoting properties can be secured from negative listing. Under this approach, all existing discriminatory and other non-conforming measures imposed on foreign service providers are clearly listed. It therefore offers greater regulatory clarity and transparency for the private sector, services exporters and trade negotiators. In addition, the whole course of scheduling the commitments under the negative-list approach may offer meaningful learning-by-doing advantages for the officials involved and promote needed dialogue between trade and sectoral regulatory authorities. During the TPPA negotiating process, valuable knowledge was gained from compiling, auditing

Table 3. TPP Partners: PTAs with the United States and Use of the Negative-list Approach in Past PTAs

TPP negotiating partner	Has signed a trade agreement covering trade in services with the US	Has signed an agreement that uses the negative-list approach for trade in services
Malaysia	No	No
The US	–	Yes
Australia	Yes	Yes
Brunei	No	Yes
Chile	Yes	Yes
New Zealand	No	Yes
Peru	Yes	Yes
Singapore	Yes	Yes
Vietnam	No	No

Source: Aidonna Jan (2011).

and reviewing domestic regulatory regimes governing the Malaysian service economy, which indirectly enhanced inter-ministry cooperation and deepened knowledge not only on the regulations but also on the service sectors themselves. Such an approach could ultimately turn out to be a 'game changer' by encouraging the development of a comprehensive services trade strategy (Dee 2015).

Table 4 shows that Malaysia committed to full liberalisation in 10 subsectors under the CPTPP. These subsectors were either not offered or offered with limitations under both the GATS and AFAS.

The CPTPP's liberalisation commitments go significantly beyond those under the GATS. This should hardly come as a surprise given that the former commitments are some two decades old while the latter were made in the wake of significant post-Uruguay Round liberalisation, both autonomously decreed and arising from engagement in numerous PTAs. In the case of education services, for example, Malaysia offered only private higher education institutions under the GATS. However, under the CPTPP, all types of education services are offered except for preschool, primary and secondary school education services covering Malaysian national curriculum

Table 4. Malaysia: Services Sectors that are Fully Liberalised under the CPTPP

Sectors	GATS	AFAS 9th Package	CPTPP
Accounting, Auditing and bookkeeping services	Offered with limitations	Offered with limitations	Fully liberalised
Taxation Services	Offered with limitations	Offered with limitations	Fully liberalised
Landscape Architectural Services (CPC 86742)	Not offered	Offered with limitations	Fully liberalised
Medical Specialty Services	Offered with limitations	Not offered	Fully liberalised
Computer and Related Services	Offered with limitations	Fully liberalised	Fully liberalised
Research and Development Services	Offered with limitations	Offered with limitations	Fully liberalised
Rental and Leasing Services	Offered with limitations	Offered with limitations	Fully liberalised
Other business services	Offered with limitations	Offered with limitations	Fully liberalised
Environmental Services	Not offered	Offered with limitations	Fully liberalised
Recreational, Cultural and Sporting Services	Not offered	Offered with limitations	Fully liberalised

Source: The CPTPP Texts, GATS and AFAS Package 9 Specific Commitment Schedules.

and religious schools. Only one limitation was reserved under the CPTPP—a requirement for foreign education service suppliers to be registered and established in Malaysia (a so-called local presence requirement). This is far greater liberalisation than Malaysia has offered under the GATS, AFAS and other PTAs. For instance, Malaysia unbound Mode 1 for both market access and national treatment in all previous trade agreements and prescribed two limitations for market access, namely the requirement for franchise and twinning arrangements between foreign-based institutions and Malaysian based educational institutions and the requirement of commercial presence. No such restrictions can be found in the CPTPP. Regarding Mode 3, all previous trade agreements imposed foreign equity constraints and

applied economic needs tests. Foreign equity is restricted to 49% in all of Malaysia's past trade agreements, except in AFAS and in PTAs entered into with New Zealand and Pakistan, where the foreign equity cap was set at 70%. Under the CPTPP, foreign education institutions are allowed to be fully foreign-owned. Commitments under Mode 4 were mainly unbound in all of Malaysia's previous trade agreements, except in the ASEAN-Republic of Korea and ASEAN-New Zealand PTAs, where a cap on the number of foreign lecturers and experts can be found. This requirement has been removed under the CPTPP and Malaysia has committed to improving the processing of visas not only for education professionals seeking contracts to work in Malaysia's education institutions but also their spouses. Longer periods of stay are also granted and independent education marketing professionals are allowed to work temporarily in Malaysia.

The CPTPP has a separate chapter on Electronic Commerce that aims to facilitate the free flow of data across borders and eliminate barriers to the electronic transmission of goods and services across borders. The most contentious issue relating to this chapter was the called-for prohibition on local data storage (so-called 'localisation' requirements). Article 14.17 of the Electronic Commerce chapter also prevents CPTPP member countries from requiring access to source code as a precondition for conducting business (Klein 2015). Malaysia imposes restrictions on local content for data storage and maintains a high level of data privacy protection (see Table 5). This would mean that Malaysia may have to undertake significant policy revisions to comply with the CPTPP provisions on Electronic Commerce.

CHALLENGES AND WAY FORWARD

Malaysia has a long way to go if it is to achieve its stated objective of becoming a regional hub for services and a world-class service provider. The sector as a whole continues to face several challenges and obstacles that need to be resolved through policy intervention aimed at creating a more conducive and business-friendly environment that would facilitate structural shifts towards an efficient, technologically-driven, and KI economy able to become an endogenous source of growth while also sustaining competitiveness gains in manufacturing, agriculture and extractive industries where services assume increasingly important intermediation functions.

Table 5. Privacy Protection among TPPA Negotiating Countries, 2013

High Level of Protection of Privacy	Low Privacy Protection	No Domestic Law
Canada New Zealand Mexico Peru Chile Malaysia Japan Australia	Republic of Korea United States Singapore	Vietnam Brunei

Source: Cerda and Rossini (2013).

The preceding analysis has shown that Malaysia's service sector is still strongly protected. In most cases, barriers result from restrictive domestic regulations, the prevalence of state-owned enterprises whose reform is often challenging as well as closed or discriminatory *Bumiputera* procurement practices that hinder reform efforts and hold back the competitiveness of the domestic service industry. Ishido and Fukunaga (2012) asserted that to maximise the gains from trade liberalisation, domestic regulatory reforms are vital and must be supported by complementary policies. The regulatory, governance and innovation-related indicators that are of particular relevance to services markets imply that Malaysia is facing challenges that could prevent or delay the country's progress towards a high-income, service-driven economy. Slow reforms on the services front will further impede the country's quest for moving up manufacturing value chains and contribute to the perpetuation of the middle-income trap challenges it confronts. Yet the progress registered in exports of education and health-related tourism services through dedicated public policy support (both trade and investment promotion and targeted sectoral policies) shows that forward movement is possible where a strong political will prevails. Similar observations can be made with regard to the country's ascendency in Islamic finance.

Still, important reform bottlenecks persist. Table 6 reveals that the regulatory quality index in Malaysia is far below that of the region's most efficient and successful services exporters, namely Singapore

and Hong Kong. Although many positive developments have occurred in innovation and education policies in recent years, and while Malaysia generally scores well on institutional indicators, such as ease of doing business and protecting investors, its performance in governance, education quality and innovation-related indicators, such as patent ownership, online creativity and royalty fees is still far from satisfactory. Such deficiencies have arguably been compounded by recent political uncertainty and its negative reputational impact on the investment front. In 2017, Malaysia ranked 62nd under Transparency International's Corruption Perception Index (CPI)[25] and ranked near the bottom globally—145th out of 180 countries—in the 2018 World Press Freedom Index[26].

Malaysia has little choice but to undertake comprehensive domestic regulatory reforms and enhance complementary socio-economic conditions—particularly as regards education, freedom of speech, gender equality and quality of life indicators—that would support the development and competitiveness of its service industry and help it achieve its 2020 aims. Regulatory reforms can only be effective if the country's policy-makers and stakeholders gain an in-depth understanding of the industry at the sectoral and disaggregated levels, clearer knowledge of the industry's competitive strengths and weaknesses, and a better sense of the market failures calling for informed policy interventions. Cali, Ellis and Velde (2008) recalled how appropriate complementary policies need to vary from sector to sector. Care is thus needed in drawing up and executing required policies. The challenge for domestic policy-makers will be to identify sector-specific reform road maps and address the knowledge gaps that weigh most centrally on their implementation. Malaysia's service economy remains very much under-researched, mainly because existing data is still deficient in terms of quality and quantity (Baker 2008). In addition, reform efforts often trigger resistance both from powerful market players and from small and medium-sized enterprises that are apprehensive about the resulting competition and greater transparency in the domestic market. Comprehensive and effective regulatory reforms will require strong doses of political will, more effective inter-agency coordination and decisive leadership in political and business circles. All have arguably been in short supply in Malaysia in recent years.

Table 6. Selected Regulatory, Governance and Innovation-related Indicators, 2016

	Score (0 – 100)	Rank (Out of 143)	Top three countries and their respective scores
Ease of getting credit	70	27	New Zealand (100), Colombia (95), Rwanda (95)
Market capitalisation, percentage GDP (2012)	135.8*	6	Hong Kong (100), Singapore (100), South Africa (100)
Ease of starting a business	95.3	14	New Zealand (99.96), Macedonia (99.86), Canada (98.23)
Ease of protecting minority investors	78.3	4	Hong Kong (83.3), New Zealand (83.3), Singapore (83.3)
High-tech net imports, %, 2014	23.1*	3	Costa Rica (23.74), Hong Kong (43.78)
High-tech net export, % of total trade, 2014	28.2	–	China (28.02), Singapore (26.85)
Graduates in S&E, % of total tertiary education	33.3	6	Thailand (100), Iran (95.35), Tunisia (89.99)
Logistics performance	72.6	24	Germany (100), Netherlands (96.17), Belgium (96.01)
Intensity of local competition†	73.4†	36	Japan (88.86), Hong Kong (86.02), United Kingdom (83.69)
Regulatory quality	60.9	78	Singapore (100), Hong Kong (99.62), New Zealand (92.92)
Knowledge-intensive employment, % of workforce (2014)	25.2*	51	Luxembourg (62.3), Singapore (53.07), Switzerland (52.09)
Tertiary enrolment, % gross (2013)	38.53	68	Greece (110.16), Korea (95.36), Finland (91.07)
PISA scales in reading, maths and science	30.52	51	China (100), Singapore (87.38), Hong Kong (86.53)
ICT use, 2015	47.6	54	Denmark (88.32), Norway (84.3), United Kingdom (84.19)
ICT access, 2015	66.1	55	Luxembourg (94.94), Iceland (93.7), Hong Kong (93.22)

	Score (0 – 100)	Rank (Out of 143)	Top three countries and their respective scores
Patent by Origin, billion PPPD GDP, 2014	181.76*	52	China (44.29), Germany (19.7), Japan (55.79)
Royalty and licence fees receipts, % total trade, 2012§	0.05*	65	USA (5.08); Switzerland (4.99); Netherlands (4.69)

Note: * value
† a survey question
[a] index
§ data sourced from the 2013 report

Source: Dutta, Lanvin, and Wunsch-Vincent 2014. https://www.globalinnovationindex.org/userfiles/file/reportpdf/GII-2014-v5.pdf. Accessed 16 April 2015.

Not surprisingly, Malaysia finds itself ensnared in a middle-income trap, finding it difficult to compete, including regionally, against advanced economies that have higher levels of innovation and value-adding activities. The country is, at the same time, increasingly squeezed by lesser developed economies that offer cheaper alternative products and services and more cost-competitive working conditions. Rising from low- to middle-income status is much easier than moving up from a middle-income to a high-income one (Fleming and Soborg 2012). To maintain competitiveness in largely labour-intensive, lower-skilled, manufacturing and services industries, Malaysian businesses resorted to employing imported low-cost, low-skill labour from neighbouring countries. The number of immigrant workers in the country has soared in recent years, facilitated by flexible immigration policies and a lack of effective enforcement. A shortage of skilled human resources is yet another obstacle that has hindered graduation towards high-income status. The paradox is that Malaysia is far from short of university graduates. As a result of heavy public investments in secondary and tertiary education, the number of students with tertiary education almost doubled in recent years, rising from 574,421 in 2000[27] to 1.3 million in 2015[28]. The share of science and engineering students in total tertiary education in 2016 was relatively high by international standards at 33.3%, with Malaysia ranking 6th in the world (see Table 6). Yet a recurring industry complaint concerns the lack of skilled workers. Abdul Rahim *et al.* (2013) reported that there

was a critical shortage of experienced and skilled workers in the construction sector that had repercussions for the quality of housing and buildings as well as being partly responsible for skyrocketing of real estate prices in Malaysia. A similar situation was found in the Islamic banking and finance industry, where, Asian Institute of Finance (AIF) CEO, Dr Raymond Madden, recently mentioned the need for an additional 56,000 finance professionals, 40% of which are needed in the Islamic finance sector alone[29]. He cautioned that the shortage of qualified Islamic finance professionals would hold back the sustainable growth and competitiveness of the industry. A serious shortage of trained professionals in this industry has resulted in staff poaching, where the 'poacher' is willing to pay much higher wages to fill skill gaps, causing overall operating costs to rise and undermining the sector's overall competitiveness and attractiveness to foreign investors.

The above problems arise because of the mismatch between the supply and demand for graduates. The Tenth Malaysia Plan noted that employers and industry associations had raised the concern that many graduates lacked 'soft' skills such as work ethics, communication skills, teamwork, ability to make decisions and leadership qualities (Tenth Malaysia Plan 2010). Nazery (2008) found that jobs requiring highly technical know-how and 'soft skills' such as maritime engineering, training in sophisticated areas, such as ship-handling simulations, naval architecture, cartography, hydrographical survey, maritime law and ship financing, were not taken up by Malaysian graduates, thus requiring the industries concerned to hire foreign expertise. He also reported that owing to a lack of capacity and technical ability of local shipyards to undertake big and sophisticated jobs at competitive prices, Malaysian ship-owners were increasingly commissioning new building orders and shipyard services for their vessels from service providers abroad.

At the same time, Malaysia's service industry also confronts a serious brain drain, exacerbating an already acute shortage of talent. Further complicating the matter, as is the case everywhere, the country's most talented and productive workers are also its most mobile. While, on paper, appropriate policies and strategies have already been designed to address this challenge, what is needed is effective and systematic policy execution, strong administrative capability and political will.

Malaysia is still grappling to better understand the supply capacity, competitiveness and ultimate interests of its service economy. Historically, the primary concern of the country's trade and regulatory officials has been the extent to which Malaysia would be able to retain needed regulatory policy space when engaging in international negotiations. But policy space for what ends? Heightened external pressures brought about by engagement in deep trade and investment agreements can prove useful for the government to break the prevailing reform deadlock and address a number of restrictive and unnecessary regulations that otherwise would not be possible under purely domestic dynamics. Malaysia's participation in the CPTPP and RCEP can and should be viewed in such a manner, as the reform pressures resulting from participation in mega-regional constructs that define new frontiers in trade and investment governance promise important benefits for businesses and consumers alike. It may also contribute to putting an end to the oligopolistic rents enjoyed by some interest groups and state-owned enterprises in the country.

Endnotes

[1]The author would like to thank Nurul Aina Hayati Mohd Sharir and Siti Aiysyah Tumin for their assistance in updating data and editing this chapter.

[2]National Economic Advisory Council (2010), *New Economic Model for Malaysia*, NEAC: Putrajaya. Available at http://www.epu.gov.my/epu-theme/pdf/nem.pdf.

[3]Shared services refer to an operational strategy that centralises administrative functions of a company that were once performed in separate divisions or locations. Services that can be shared among the various business units of a company include finance, purchasing, inventory, payroll, hiring and information technology. It can also apply to partnerships formed between separate businesses. In this case, the tenants of an office building might share telecommunications or maintenance service. Shared services are also available on the Internet. An example of this form of shared services is Application Service Providers (ASPs) who offer numerous business clients access to online applications so they can avoid having to purchase special systems and software (http://www.inc.com/encyclopedia/shared-services.html).

[4]Calculated from data obtained from MIDA's website, http://www.mida.gov.my/home/facts-and-figures/posts/

[5]The latest data available in US Science and Engineering Indicators 2016 is for 2014.

[6]*Sukuk* is Islamic bonds designed to generate returns to investment in compliance with Islamic guidelines or *Shari'ah*. In contrast to conventional bonds, *Sukuk* provides investors ownership of an investment asset. The objective is for the investor to share risks in the investment, since earning returns from interest is prohibited in Islam.

[7]Moody's Investors Service. 2014. "Malaysian banks' record *sukuk* issuance in 1H 2014 driven by rapid asset growth and Basel III Capital Needs." https://www.moodys.com/research/Moodys-Malaysian-banks-record-sukuk-issuance-in-1H-2014-driven--PR_303015. Accessed 12 August 2015.

[8]Note that this could well be due to measurement difficulties.

[9]The latest data available in US Science and Engineering Indicators 2016 is for 2014.

[10]See The Star, Private health and social sector growing by leaps and bounds, October 19, 2017. Accessed September 7, 2018. https://www.thestar.com.my/news/nation/2017/10/19/private-health-and-social-sector-growing-by-leaps-and-bounds/#ep5t24PJ5yqA1UpS.99

[11]Based on calculations using data from the Trademap Database. Data available at http://www.trademap.org/tradestat/Service

[12]Traditional services include travel, transportation, construction, and personal, cultural and recreational services.

[13]Modern services include telecommunications, computer and information services, other business services, financial services, insurance, royalties and licence fees. These sectors are knowledge-intensive.

[14]Business process outsourcing (BPO) is an outsourcing activities where parts of the business operation and services are contracted out to a third-party service provider.

[15]Data from http://data.worldbank.org/indicator/BX.GSR.CCIS.ZS. Accessed January 2016. However, it is important to note that 80% of the Philippines' BPO export revenue came from voice call centres as opposed to more technical IT outsourcing (Maddineni 2015).

[16]Data obtained from http://data.worldbank.org/indicator/BX.GSR.CCIS.ZS. Latest data available for Malaysia is for 2013. Accessed January 2016.

[17]This is based on data extracted from the US Science and Engineering Indicators Report (2013). The latest data available is for 2010.

[18]Calculated using data from Department of Statistics Malaysia. Accessed from https://www.dosm.gov.my

[19]National Economic Advisory Council. 2010. *New Economic Model for Malaysia*. Putrajaya: NEAC. Available at http://www.epu.gov.my/epu-theme/pdf/nem.pdf

[20]Information on the 10th package of liberalisation commitments under AFAS and on ATISA was not publicly available at the time of writing. Writing in April 2018 about these latest developments, the Chairman of the 32nd ASEAN Summit held in Singapore remarked: "On services, we look forward to the signing of the Protocol to Implement the 10th Package of Commitments under the ASEAN Framework Agreement on Services (AFAS) this year. We noted with appreciation the significant progress made in the negotiations for the ASEAN Trade in Services Agreement (ATISA), and look forward to the signing of the Agreement this year." Source: https://www.asean2018.sg/MFA/Newsroom/Press-Releases/Press-Release-Details/20180428_Chairmans_Statement

[21]Sourced from MITI's website.

[22]The Services Trade Restriction database developed by the World Bank covers 103 countries that represent all regions and income groups of the world. For each country, five major services sectors are covered. These encompass a total of 19 subsectors that include financial services, telecommunication services, retail distribution services, transportation services and professional services. The index is categorized into five broad categories, i.e. completely open (0); virtually open but with minor restrictions (25); major restrictions (50); virtually closed with limited opportunities to enter and operate (75); and completely closed (100). For further details on the index, please visit http://iresearch.worldbank.org/servicetrade/aboutData.htm

[23]East Asian Community is a proposed trade bloc between Southeast and East Asian nations (ASEAN+3).

[24]See Snape and Bosworth (1996), Mattoo and Wünsch (2004), Martin, Juan and Hoe (2006), Mattoo and Sauvé (2010) and Sauvé (2013).

[25]http://www.transparency.org/country/MYS

[26]https://rsf.org/en/malaysia

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5

International Investment Agreements: Challenges and Opportunities for Malaysia

Aidonna Jan Ayub[1]

INTRODUCTION

In 2017, foreign direct investment (FDI) flow to developing economies was USD671 billion or 47% of global FDI inflows. Malaysia received 0.7% of the total inflow in 2017. In the same year, developed countries received USD712 billion or 50% of global inflows. An important recent trend is the rise of developing countries as sources of FDI. In 2017, FDI outflows from developing and transition economies accounted for 29% of global FDI outflows (USD432 billion), as compared to 12% at the beginning of the 2000s. Malaysia was the source of approximately 1.3% of global outflows from developing and transition economies in 2017 (UNCTAD 2014a, 2018a).

Among the policy tools available to promote predictability, stability and transparency in the investment environment, many countries have in recent decades resorted to international investment agreements (IIAs). An IIA is an international agreement that governs the relationship between a foreign investor and the host government. It is an agreement signed by the governments of two (or more) countries that sets the minimum standard of treatment of the foreign investor of one country

when investing in the other (host) country. Malaysia has signed more than 70 IIAs to date, most of which are stand-alone agreements that mainly cover investment protection issues, known as bilateral investment treaties (BITs).

A key feature of many IIAs—and increasingly a source of policy controversies in recent years—is the inclusion of an investor-State dispute settlement (ISDS) mechanism that allows foreign investors to challenge host government laws and policies through international arbitral means in instances of alleged treaty breaches. Under such provisions, a foreign investor could bring the host government to international arbitration without necessarily utilising the domestic judicial system.

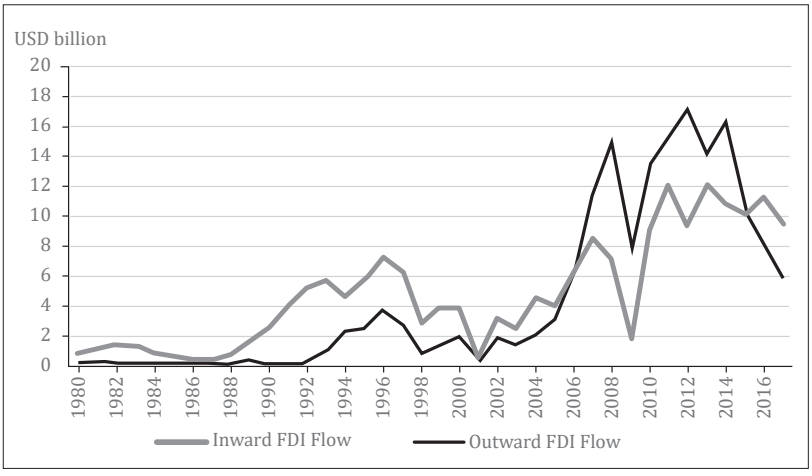
Against this backdrop, this chapter discusses what IIAs are and what they could mean to policymakers, businesses, academics and the Malaysian public in general. This chapter is organised as follows. The first section describes Malaysia's investment trends. The next section explains Malaysia's investment policy landscape. This is followed by a section that maps the universe of Malaysia's IIAs and highlights the country's experience with investor-State arbitration to date. The next section assesses IIAs as a policy tool and Malaysia's approach towards IIAs. The final section looks to the future of investment policy.

Attracting greater volumes of FDI is often touted as one of the reasons to promote the signing of IIAs. Conversely, the potential exposure of host country governments to ISDS claims may involve important costs in ensuring a stable and predictable investment environment. In the case of Malaysia, like many other emerging countries, to this already complex equation must now be added considerations relating to the costs and benefits of IIAs looked at from an offensive, capital-exporting, vantage point.

MALAYSIA'S INVESTMENT TRENDS

In recent years, the value of Malaysia's inward and outward FDI has generally been higher than it was in the 1980s, 1990s and early 2000s (Figure 1). This is an indication of the increasing importance of both inward and outward FDI to Malaysia. Outward FDI flows were more prominent than inward FDI flows between 2007 and 2014. Therefore, in general, not only do foreign investors have an interest in the Malaysian market, so too do Malaysian firms investing abroad.

Figure 1. Malaysia's Inward and Outward FDI by Flows and Stocks, 1980 – 2017



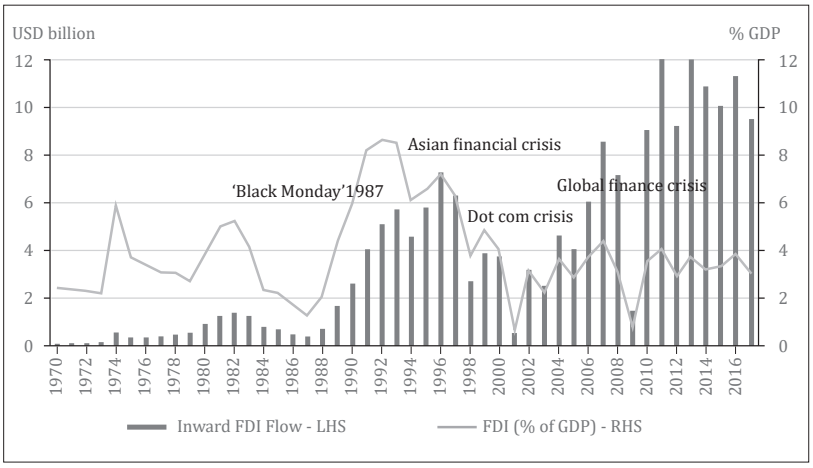
Source: UNCTAD Stat (2018).

Among the Association of Southeast Asian Nations (ASEAN), Singapore's inward FDI flow has generally surpassed that of other ASEAN countries since the 1990s. However, Malaysia did better than the remaining ASEAN countries in the 1990s until the Asian financial crisis of the late 1990s, whereby Thailand, Indonesia and Vietnam have performed better than Malaysia at different points in time.

As shown in Figure 2, the trend of inward FDI flows into Malaysia reflects the pattern of recent international economic upturns and downturns. This is partly due to the export propensity of many foreign investors in Malaysia (OECD 2013).

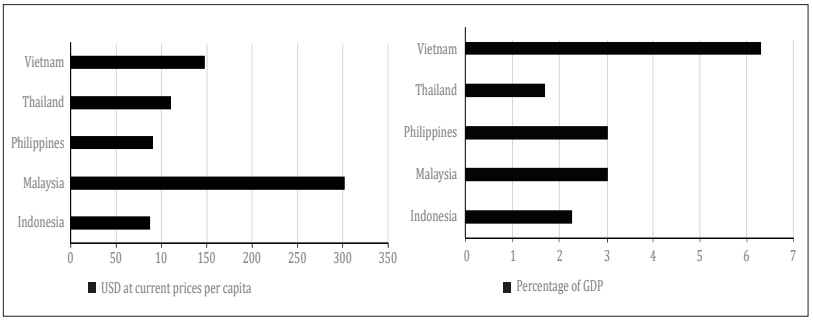
When FDI flows are expressed on a per capita basis and as a share of gross domestic product (GDP) (Figure 3), Malaysia fares well in comparison to other ASEAN countries. Recognising that Singapore still outperforms other ASEAN countries on a per capita basis (USD10,861) and in terms of percentage share of GDP (20%), Malaysia's FDI inflow per capita was significantly higher than that of Thailand and of other ASEAN countries in 2017. Given that Vietnam is a smaller economy than Malaysia, its inflow of FDI contributed to a higher percentage of GDP than that of Malaysia.

Figure 2. Trends in Inward FDI in Malaysia, 1970 – 2017



Source: UNCTAD Stat (2018).

Figure 3. FDI Inflows in 2017: USD per Capita and Percentage of GDP

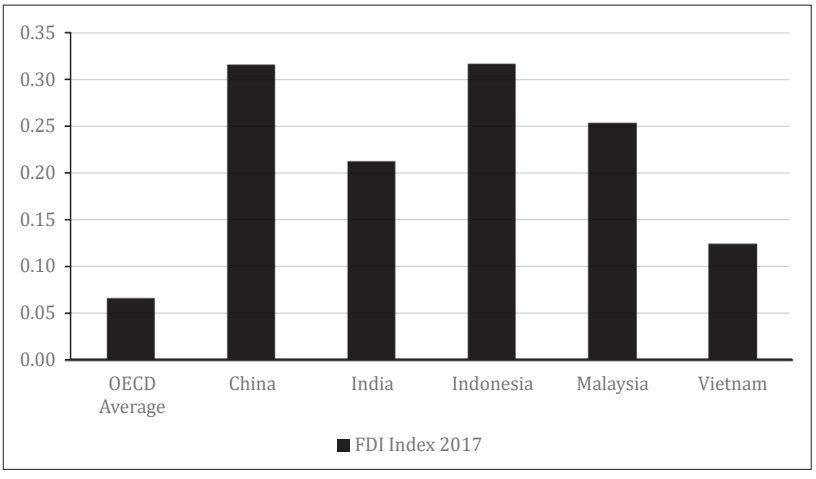


Source: UNCTAD Stat (2018).

In terms of its investments overseas, Malaysia ranked among the top 30 investors worldwide in 2017, holding the 29th spot with approximately USD5.8 billion worth of overseas investments. The top-ranking countries were the United States (US), Japan, China and the United Kingdom (UK). Other countries that invested more abroad than Malaysia included Singapore, South Korea and Thailand. However, Malaysia was reported to invest more than countries like Indonesia, the Philippines and Vietnam in 2017 (UNCTAD 2018a).

Malaysia is generally seen to be relatively open in investment matters, as compared to other developing Asian countries. For example, Figure 4 shows that although Malaysia's level of regulatory restrictiveness on FDI is higher than the Organisation for Economic Co-operation and Development (OECD) average, it is still lower than that of countries such as China and Indonesia. The OECD found that Malaysia had no regulatory impediments to FDI in sectors such as electrical and electronics, architecture and engineering. Foreign investment was reported to face the most restrictions in the forestry sector (OECD 2018).

Figure 4. FDI Restrictiveness Index, 2017

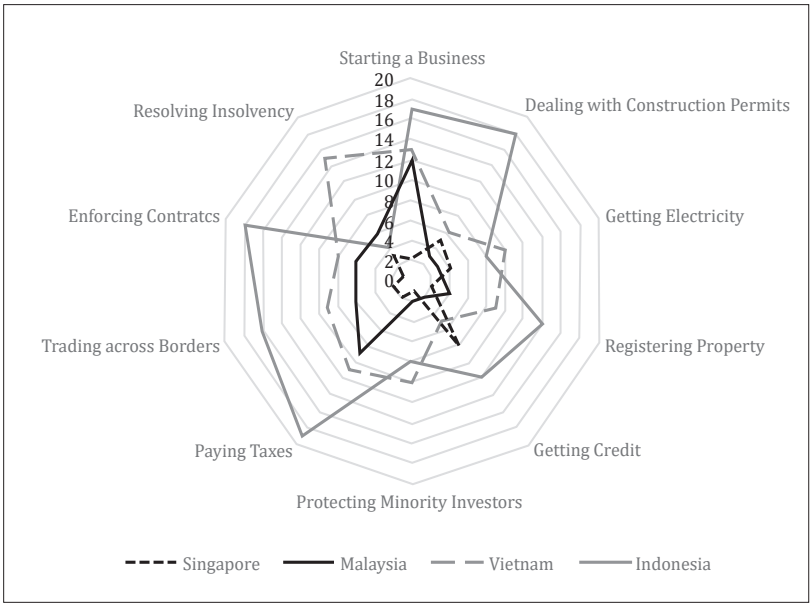


Source: OECD (2018).

In addition, Malaysia was ranked 24th out of 190 economies under the World Bank's Doing Business rankings in 2017. This indicator measures business regulation and the protection of property rights in relation to the effect of these criteria on businesses, particularly domestic small and medium-sized enterprises (SMEs) (World Bank 2018).

Figure 5 illustrates that Malaysia is second only to Singapore in terms of its overall Doing Business ranking among the larger ASEAN countries. The World Bank ranked Malaysia highly in terms of protection given to minority investors and getting credit, while Malaysia's ranking is least strong for procedures regarding starting a business (World Bank 2018).

Figure 5: Ease of Doing Business in 2017

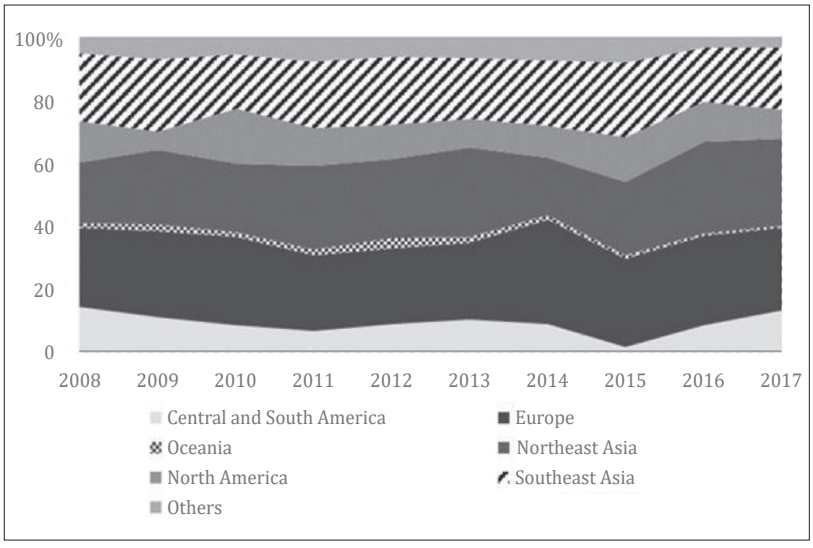


Source: World Bank (2018).

Malaysia's sources of FDI inflows are relatively diversified and stable, as shown in Figure 6. The main contributors to FDI are Singapore, the Netherlands, Japan, the US and Hong Kong. Thus, the US, for example, accounts for most of the FDI from North America; Japan, Hong Kong and China account for the majority of FDI from Northeast Asia and Singapore for FDI from Southeast Asia. The Netherlands, the United Kingdom, Germany and France together have accounted for more than half of FDI inflows from Europe since 2008. The role of Chinese FDI inflow into Malaysia has strengthened through the years. In 2008, China was the 15th largest contributor of FDI inflows (RM1.1 billion or USD0.3 billion) and had become the 6th largest contributor in 2017 (RM10.1 billion or USD2.4 billion).

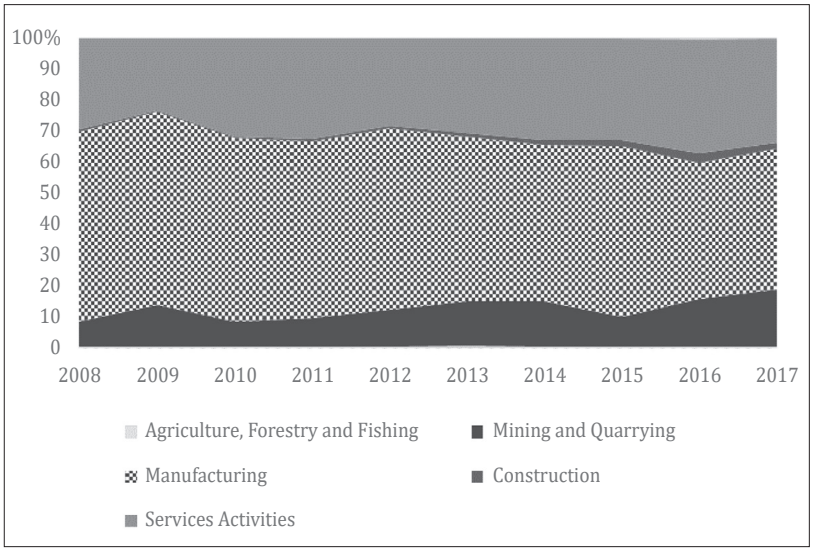
The sector that enjoys the highest level of FDI inflows in Malaysia is manufacturing. As shown in Figure 7, this sector attracted close to half (46%) of total FDI inflows in 2017. The second most attractive sector is services, which attracted 33% of FDI inflows in the same year. The major service sectors attracting FDI inflows were wholesale and

Figure 6. FDI Inflow into Malaysia by Region, 2008 – 2017



Source: BNM (2018).

Figure 7. FDI Inflows into Malaysia by Sector, 2008 – 2017



Source: BNM (2018).

retail trade, financial and insurance activities, and information and communication services. Meanwhile, the mining and quarrying sector attracted approximately 19% of FDI inflows in 2017.

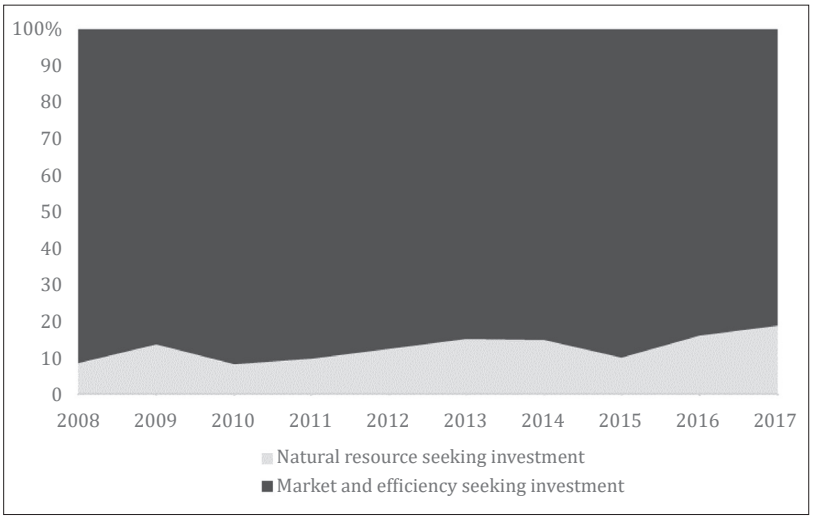
These trends illustrate the importance of FDI to Malaysia and its general openness towards foreign investment. The next section takes a broad approach in explaining the types of FDI inflows into Malaysia and Malaysia's investment policy landscape.

MALAYSIA'S INVESTMENT POLICY LANDSCAPE

Types of Investment Flows into Malaysia

Research on the linkage between the impact of IIAs on FDI sometimes makes a distinction between the types of investment that a country aims to attract. In the case of Malaysia, its foreign investment policy is very much attuned to the types of investment that the country has traditionally attracted. As shown in Figure 8, Malaysia's FDI inflows chiefly consist of market-seeking and efficiency-seeking investments, which have been broadly categorised as covering investments in manufacturing, construction and services activities. Natural-resource-

Figure 8. FDI Inflows by Type of Investment, 2008 – 2017[2]



Source: BNM (2018).

seeking investments, on the other hand, covers a grouping of agriculture, forestry and fishing, as well as mining, oil and gas, and quarrying activities. These latter types of investments are likely to include elements of strategic asset or capability-seeking investment. Box 1 explains the different types of FDI in greater detail.

The section below discusses Malaysia's investment policy stance towards FDI. It is not surprising that the country's policies that impact foreign investment broadly focus on market-seeking and efficiency-seeking investments, given that natural-resource-seeking foreign investment forms a significant but relatively small element of Malaysia's FDI inflows.

Box 1. Types of FDI Activities

Following Dunning (1993), the cross-border investment activities of foreign investors can be divided into four categories. Note that FDI may not only focus on one activity but also on a combination of activities. These are:

- **Natural resource seekers**. This refers to investors aiming to gain access to immobile natural resources such as minerals and agricultural products.
- **Market seekers**. Investors in this category are seeking to supply goods or services to specific domestic or regional markets. This form of FDI seeks to either protect existing markets or exploit new ones. Market-seeking investment is undertaken for various reasons, such as to take advantage of regulatory measures, to adapt products to local tastes, to be closer to the target markets or to be seen to have a physical presence in key markets.
- **Efficiency seekers**. This form of investment seeks to use investments as a means of inserting firms in the common governance of geographically dispersed activities. It is typically export-oriented and involves significant trade in intermediate products (goods and services). Benefits include addressing economies of scale and scope as well as risk diversification and value-chain optimisation.
- **Strategic asset or capability seekers**. This category of FDI activity focuses on acquiring foreign assets to meet long-term strategic objectives. This may include acquiring some form of competitive strength in an unfamiliar market, or purchasing a local brand or distribution network (Dunning and Lundan 2008).

Malaysia's Investment Policies

Malaysia's approach towards FDI can be characterised as being designed to afford maximum policy space to serve the changing needs and direction of the country's industrial policy (IISD 2004). Domestic investments generally make up a larger share of total investments (72.2% in 2017) than do foreign investments (27.8%) (MIDA 2018). Malaysia does not have a dedicated law that governs FDI, although FDI is regulated through sector-specific regulations (OECD 2013, 57). Laws, regulations and policies on foreign investment are dealt with on two levels:

- **Federal level**. This is where most laws, regulations and policies on foreign investment issues are addressed. The relevant ministries and agencies regulate the investment landscape in their areas of coverage. For instance, the liberalisation of foreign equity limitations in the health services sector is generally the responsibility of the Ministry of Health.
- **State level**. Foreign investment also requires approval at the state level of government, particularly for land-related issues.

The closest Malaysia has come to a foreign investment screening mechanism is the Foreign Investment Committee (FIC) under the Economic Planning Unit of the Prime Minister's Department. In 1974, the government established the FIC, giving it the responsibility for "approving the acquisition of substantial assets by foreign interests and takeovers of Malaysian companies and businesses that will result in ownership or control being passed to foreign interests" (Mahani 2011). FIC approval was required for the acquisition by foreign investors of:

- local companies or businesses valued at more than RM5 million;
- 15% or more of voting power of a company; or
- 30% or more of cumulative voting rights by associated or non-associated groups of foreign interests (Mahani 2011).

In addition, the FIC was also charged with maintaining a 30% foreign equity requirement, particularly as a result of the sale of businesses or properties (Mahani 2011). These FIC rules were relaxed over time and finally repealed in the late 2000s for acquisitions of interest, mergers and takeovers. Thereafter, the FIC played a significantly smaller role, mainly in the property sector (FMM 2011). It is noteworthy that sectoral policymakers and regulators can currently impose foreign equity restrictions. For example, in the case of transportation services, foreigners are not allowed to own more than 49% of equity shareholding in any entity supplying specific freight transportation services[3]. Malaysian measures that explicitly govern investment include the Promotion of Investment Act (PIA) 1986. The PIA provides for corporate income tax relief for the establishment and development in Malaysia of specific economic activities, and for the promotion of exports (PIA 1986). In addition, policy documents, particularly at the federal level, do recognise the importance of FDI to Malaysia. For example, one policy document that touches on Malaysia's investment policy is the Malaysia Plan. The Malaysia Plans are five-year development plans which began with the First Malaysia Plan from 1966 to 1970.

The Eleventh Malaysia Plan states the following:

- Policies that target foreign investment. Efforts to increase FDI focus on attracting investments in higher value-added and knowledge-intensive employment activities.
- Policies that target investment in general:
    - Strategies to strengthen private investment include reducing the cost of doing business through increased provision of basic infrastructure and facilities, and reviewing bureaucratic regulations; providing performance-based incentives for high-income and knowledge-intensive economic activities by reviewing the current investment incentive programme; and addressing the talent gap and mismatch by establishing a labour market data warehouse and improving the labour market clearance mechanism as well as addressing re-skilling and multi-skilling programmes.

- Efforts to spearhead economic growth include the promotion of private investment in agriculture, manufacturing and services. The services sector in particular focuses on high-value, knowledge-intensive services.
- Efforts to accelerate investment in regional economic corridors include enhancing facilitation for investors, improving connectivity and mobility as well as intensifying research, development and commercialisation. Competitive cities and regional economic corridors are aimed to be the catalysts for growth, creating vibrant hubs for investment as well as developing talent and knowledge.

- Incentives to invest in areas where the majority of households are in the bottom 40% of income levels (known as B40). Multinational corporations (MNCs) and large local companies are encouraged to locate their business operations in urban and rural areas with a majority of B40 households so as to provide better job opportunities for workers in local communities, especially high-paying jobs. Existing incentives such as double deduction and tax relief are provided to encourage MNCs and large local companies to employ and train the local workforce. Basic infrastructure and facilities can also be provided to support these businesses and reduce their cost of doing business. In the rural areas, integrated facilities will be provided through rural development centres (EPU 2015).

Implementing some of these policy objectives involves a key federal-level agency under the Ministry of International Trade and Investment (MITI). The Malaysian Investment Development Authority (MIDA) is the principal agency for the promotion of the manufacturing and services sectors in Malaysia. For example, some of the promoted activities and products under the PIA are eligible to apply for Pioneer Status and Investment Tax Allowance benefits.

An illustration of the interlinkages between other policies and the country's trade and investment policies is Malaysia's industrial policy. Over the years, Malaysia has experimented with both import-substitution (IS) and export-orientation (EO) strategies. Foreign firms have played a key role in the growth and diversification of the

Malaysian economy, particularly in Malaysia's EO strategies (OECD 2013). Liberal ownership rules and pro-MNC policies have contributed towards strong waves of FDI inflows in the 1970s and since the mid-1980s (Rasiah 2011). Box 2 summarises this experience.

Box 2. Malaysia's Experience with Import-substitution and Export-oriented Strategies

Table 1. Malaysia's Industrial Strategies and Trade Orientation, 1958 – 2010

Phases	Trade orientation	Period of dominance	Policy instruments
Phase 1	Import-substitution	1958 – 1968	Pioneer Industries Ordinance, 1958
Phase 2	Export-orientation and import-substitution	1968 – 1980	Investment Incentives Act, 1968 Free Trade Zone Act, 1971
Phase 3	Import-substitution	1980 – 1985	Heavy Industries Corporation of Malaysia (HICOM), 1980
Phase 4	Import-substitution and export-orientation	1985 – 2010	Industrial Master Plan, 1986 Promotion of Investment Act, 1986 Action Plan for Industrial Technology Development (APITD), 1990 Industrial Master Plan 2, 1996 Industrial Master Plan 3, 2006

Source: Reproduced from Rasiah (2011,93).

As shown in Table 1, the first phase of Malaysia's industrial strategy (1958 – 1968) was characterised by attempts at attracting investors in targeted sectors to generate employment and reduce import leakages. This approach involved minimal governmental intervention, as public investment focused on infrastructure development. The second phase (1968 – 1980) saw a shift in government policy towards the active promotion of export-orientation through the introduction of the Investment Incentive Act of 1968 and the opening of free trade zones in 1972 (Rasiah 2011).

Towards the end of the 1970s, the government recognised the need to ensure better integration between the IS and EO sectors. Thus, the third phase (1980 – 1985) saw a greater focus on the development of heavy industries to bridge this gap. This included government-sponsored heavy industries. In 1985, Malaysia entered into phase four of its industrial strategy, with a greater focus on EO, although IS strategies did run in parallel (Rasiah 2011). Foreign firms have thus played a prominent role in the growth and diversification of the Malaysian economy, particularly in Malaysia's export-orientation strategies (OECD 2013).

In terms of Malaysia's more recent efforts to liberalise the economy, in 2012, 18 services subsectors were liberalised, where up to 100% foreign equity participation is allowed for areas such as environmental services, and wholesale and retail trade. Malaysia has not undertaken major services liberalisation since then, although foreign equity restrictions were removed in unit trust management companies and credit rating agencies in 2014 and 2017, respectively (WTO 2017).

INTERNATIONAL INVESTMENT AGREEMENTS (IIAS)

The role of IIAs is to contribute to predictability, stability and transparency in the investment environment. An IIA allows for the treatment of foreign investors to be based on international standards rather than solely on domestic standards of treatment. This provides a level of certainty for investors when investing abroad and may also reduce the probability of abuse of foreign investors by host governments. In situations where they feel that they are being treated unfairly, foreign investors seek recourse to an IIA to address their concerns. Furthermore, in some IIAs, foreign investors enjoy access to the ISDS mechanism, affording them the right to challenge host country governments for alleged breaches of IIA obligations. Box 3 describes various types of IIAs.

It is noteworthy that the scope and depth of IIAs can differ greatly. Foreign investors looking to utilise an IIA and governments signing such treaty instruments need to understand IIA provisions in detail. In addition, although IIAs are policy tools to provide a level of certainty to foreign investors, this does not necessarily lead to IIAs becoming

Box 3. A Typology of IIAs

The term IIA is a general term that includes:

- **Bilateral investment treaties (BITs)**. BITs are typically stand-alone agreements, signed between two countries. BITs are also known as investment guarantee agreements (IGAs). Historically, their prime focus has been investment protection.
- **Investment provisions under preferential trade agreements (PTAs)**. PTAs go beyond investment issues and may sometimes involve multiple countries. They typically also address both investment protection and liberalisation matters.

Table 2 draws attention to some of the main differences between a BIT and a PTA.

Table 2. Comparison of the Characteristics of a BIT and a PTA

General characteristics	BIT	PTA
Stand-alone agreement	Yes	No Typically, the investment provisions (e.g. the investment chapter under a PTA) make up only one of a number of chapters. Other issues covered under a PTA include trade in goods, trade in services, intellectual property rights and government procurement.
Includes investment protection provisions	Yes	Yes
Includes investment promotion provisions	Sometimes	Sometimes
Includes investment liberalisation provisions	Sometimes	Yes
Includes the ISDS mechanism	Sometimes	Sometimes

Source: Author.

a tool that actually attracts FDI. Indeed, the empirical literature is somewhat ambiguous on the specific investment-inducing properties of BITs, even as such impacts are deemed greater when investment rules are embedded in a comprehensive set of trade disciplines.

Malaysia has a wide network of IIAs. This means that Malaysian investors have access to IIAs when investing in selected countries abroad. It also means that the Malaysian Government could potentially be brought before international arbitration under the ISDS mechanism by any investor covered by Malaysia's IIAs. This section that follows first explains the landscape of Malaysia's IIAs before describing Malaysia's experience with ISDS.

Mapping of Malaysia's IIAs

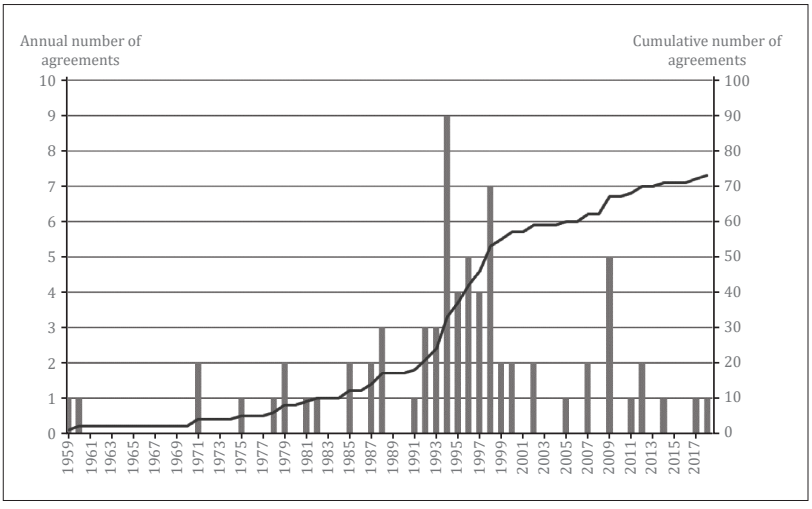
Malaysia's broad IIA network is depicted in Figure 9. The different shades represent the different years when Malaysia signed an IIA with a partner country. More than 30 of Malaysia's IIAs were signed in the 1990s, including agreements with Denmark, Vietnam, Cambodia and Namibia (Figure 10). Most of Malaysia's IIAs are BITs, stand-alone agreements that mainly cover investment protection issues. Out of a total of more than 70 IIAs, more than 60 are BITs, while the remainder are investment chapters that are part of various PTAs. Malaysia is a party to agreements signed at the ASEAN-level (such as the ASEAN-Australia-New Zealand FTA, AANZFTA) and the agreement among ASEAN Member States known as the ASEAN Comprehensive Investment Agreement (ACIA). Malaysia is also party to two mega-regional agreements—the recently signed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the ongoing negotiations towards a Regional Comprehensive Economic Partnership (RCEP) agreement.

It is noteworthy that Malaysia has multiple IIAs with some of its investment partner countries. For example, Malaysia signed a bilateral agreement with New Zealand in 2009 (known as the Malaysia-New Zealand FTA, MNZFTA). New Zealand is also part of the recently signed CPTPP. Overlaps in IIAs can create an opportunity for investors to choose which IIA is most beneficial to them, particularly when seeking to utilise the ISDS mechanism[4]. This also means that

Figure 9. Map of Malaysia's IIAs

Note: Publicly available list of IIAs as of March 2018.
Source: Author, based on MITI.

Figure 10. IIAs Signed by Malaysia, 1959 – 2018



Note: Publicly available list of IIAs as of March 2018.
Source: Author, based on MITI.

governments with overlapping IIAs need to be aware of gaps in protection and liberalisation elements and thus the possibility that foreign investors could exploit these gaps to their own gain. In addition, governments need to be cognisant of the value-added of signing any additional IIA with the same country.

Malaysia's Experience with Investor-State Dispute Settlement

Malaysia's experience in signing more than 70 IIAs is part of a global recent trend towards countries signing IIAs. Worldwide, an estimated 2,672 IIAs are currently in force (UNCTAD 2018b). All of Malaysia's BITs have been reported to contain an ISDS mechanism (WTO 2017). As explained above, ISDS allows foreign investors to bring host governments before international arbitral tribunals to address the host government's obligations under an IIA when these are deemed to have been breached. As parties involved in an ISDS case can choose not to make information on their case publicly available, information on the number, types and parties involved in ISDS cases is often incomplete. To date, 114 countries have been respondents in one or more known ISDS cases, from a total of 817 known ISDS cases since 1987 (UNCTAD 2017b).

ISDS cases have addressed a wide range of domestic policy issues such as the revocation of licences, the design of health policies and environmental policies. The increasing number of ISDS cases, and the sensitivities surrounding many of the contentious policies at play, have raised increasing concerns over the cost-benefit impact of IIAs, notably as regards the right to regulate for legitimate public policy purposes. This has prompted several governments to reassess their policies regarding such agreements, resulting in some recent instances in treaty termination or renegotiation. For example, India and Indonesia have terminated 7 and 11 treaties respectively (UNCTAD 2017a).

Malaysia has seen both sides of the ISDS mechanism as Malaysian investors have also initiated ISDS cases. Other countries in the region that have been respondents in ISDS cases include China, Indonesia, Vietnam and the Philippines.

Malaysia has been involved as an ISDS respondent in cases brought by Belgian, British and Thai investors:

- Philippe Gruslin v. Malaysia (ICSID Case No: ARB/94/1 and ARB/99/3): Two cases were brought by Philippe Gruslin. In the first, a settlement was agreed by the parties and proceedings were discontinued (Helgeson and Lauterpacht 2002). The second case involved portfolio investments in securities listed on the Kuala Lumpur Stock Exchange and alleged losses caused by Malaysia's imposition of exchange controls (ICSID, 2000). The award rendered dismissed the claim brought by Mr Gruslin, a Belgian national.
- Malaysian Historical Salvors, SDN, BHD (MHS) v. Malaysia (ICSID Case No: ARB/05/10): This case involved a salvage contract and payment to MHS for salvaged items from the cargo of a British vessel that sank off the coast of Malacca, Malaysia in 1817. The tribunal decided in favour of the State. However, this case went to annulment proceedings, whereby the award on jurisdiction in MHS v. Malaysia was annulled. The Malaysian Government had to bear the full costs and expenses incurred by ICSID, while each party bore its own costs of representation in connection with the annulment proceedings.
- Boonsom Boonyanit v. Malaysia: This case involves land owned by a Thai investor and has yet to be resolved. A notice of dispute has been issued on behalf of the Thai investor. The investor claimed that the land was wrongfully sold using a forged signature. This case was brought before Malaysian courts, all the way up to the Federal Court. The investor claimed that the Federal Court's decision had wrongly denied the Thai investor the rights to and enjoyment of its investment (italaw 2017).

Malaysian investors have also been ISDS claimants in cases that include:

- MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile (ICSID Case No: ARB/01/7): This case involved zoning regulations in Chile. Specifically, the Malaysian investor intended to build a mixed-use planned community in an area that was originally zoned for agricultural use. This case was decided in favour of the investor (UNCTAD 2016a).

- Telekom Malaysia Berhad v. The Republic of Ghana (Case No. HA/RK): This case involved expropriation of assets (Brown and Miles 2011). This case was settled (UNCTAD 2016a).
- Ekran Berhad v. People's Republic of China (ICSID Case No. ARB/11/15): This case involved the revocation of a 70-year lease of 900 hectares of land in China's Hainan province (Fei, Horrigan, and Furlong 2014). This case was settled (UNCTAD 2016a).
- Axiata Group v. India: This case involved the cancellation of telecommunications licences by the Supreme Court (Hepburn 2012). The Mauritius-India BIT was utilised as Axiata had investments in Mauritius. Based on publicly available information, it is unclear whether this case proceeded to international arbitration.
- Astro v. India: This case involved criminal investigations in India in relation to the suspected bribery of Indian government officials (UNCTAD 2016b). The United Kingdom (UK) and Mauritian affiliates of Astro (Astro All Asia Networks and South Asia Entertainment Holdings) invoked the UK-India BIT and Mauritius-India BIT respectively (Yong 2016). Based on publicly available information, a tribunal has been appointed for this case.

ASSESSING IIAS AS A POLICY TOOL: THE MALAYSIAN APPROACH

Determining how best to use IIAs as a policy tool requires striking a balance between the cost of negotiating and upholding IIA obligations and the possible benefits that IIAs bring to a country. Although IIAs have been signed between countries for decades, only in the 1990s was there a significant rise in investors' use of IIAs to bring claims against host governments under the ISDS mechanism. Experience with ISDS cases has opened the eyes of businesses to the full benefits and scope of IIAs. In turn, the rise in ISDS cases has prompted host governments to realise just how much of a 'bite' IIAs can have on domestic policymaking—the full extent of the strength of the obligations and the potential costs (and benefits) associated with litigation.

It has been reported that at least 40 countries have in recent years undergone some form of review of their policies on rule-making with regard to international investment (UNCTAD 2014b). These reviews range from analysing a country's overall investment policy (towards domestic and foreign investment) to reviewing specific elements of an IIA to ensure that the agreement is in line with current domestic policy objectives. In an effort to re-evaluate and recalibrate investment policies, some countries have gone as far as terminating existing treaties.

The United Nations Conference on Trade and Development (UNCTAD 2017a) has developed a Road Map for IIA Reform. This reform agenda covers five action areas which are: "safeguarding the right to regulate, while providing protection; reforming investment dispute settlement; promoting and facilitating investment; ensuring responsible investment; and enhancing systemic consistency" (UNCTAD 2017a).

Any re-evaluation or recalibration of policies regarding IIAs needs to be done with an understanding of the role of IIAs and with a realistic approach to undertaking domestic and international reforms, if deemed necessary. This section starts with an assessment of what is known regarding the possible costs and benefits of IIAs before discussing areas where Malaysia has made selective adjustments to its IIAs.

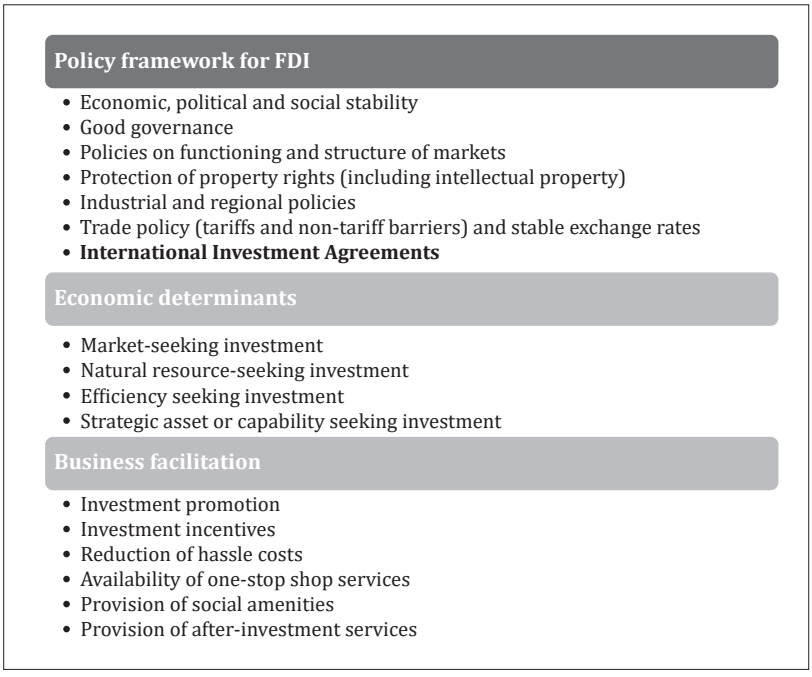
Assessing the Cost and Benefits of IIAs

An important aim of IIAs is to contribute to a predictable, stable and transparent investment climate. Attracting FDI is neither the main nor the only role of IIAs (UNCTAD 2014a). However, the role of IIAs in attracting FDI has been used as justification for countries to sign IIAs. Therefore, the relationship between IIAs and FDI is seen as important to policymakers, academics and the general public.

Determinants of FDI

IIAs are only one of many factors that influence investors' decisions on where to locate their investments. Other factors that influence the flows of FDI into a country include the country's policy framework (such as good governance and trade policy), economic determinants and business facilitation conditions. Figure 11 illustrates how IIAs are likely to play only a complementary role among the many factors that

Figure 11. Host Country Determinants of FDI



Source: Adapted from UNCTAD (1998) and UNCTAD (2010), cited in UNCTAD (2014a).

influence firms' decisions on where to locate their investments and thus cannot guarantee the inflow of foreign investment (UNCTAD 2014a). In addition, UNCTAD has highlighted that "IIAs cannot be a substitute for domestic policies and a sound national regulatory framework for investment…[and thus] IIAs alone cannot turn a weak domestic investment climate into a strong one" (UNCTAD 2014a). The necessary domestic institutions should be in place for FDI to interact with IIAs in making IIA commitments credible and valuable to investors (Tobin and Rose-Ackerman 2011).

Studying the Relationship between IIAs and FDI

A review of the literature on the relationship between IIAs and FDI shows sometimes contradictory and therefore inconclusive findings. Many studies show a positive relationship between IIAs and FDI whereas others have shown little or no effect on FDI flows (UNCTAD

2014a). In general, earlier studies tended to focus on the relationship between FDI and IIAs. The more recent studies take a more nuanced approach by determining the type of FDI that has a positive correlation with IIAs (Kerner and Lawrence 2014, Im 2016, Sirr, Garvey, and Gallagher 2017) and studying the impact of IIAs depending on the quality of the underlying treaty (e.g. the actual obligations of the IIA) (Dixon and Haslam 2016). The latter, more nuanced approach would be more useful for policymaking purposes, as the discussion focuses on the strength of obligations in IIAs and the elements that would promote the type of FDI that governments wish to attract and retain.

In addition, most empirical studies tend to focus on the impact of BITs rather than that of investment chapters contained in PTAs. This is an important distinction as BITs typically focus on protecting current investments rather than liberalising the investment environment. Studies that differentiate between the impact of investment chapters under a PTAs and BITs suggest that PTAs tend to have a greater impact on FDI as compared to BITs (Dixon and Haslam 2016, UNCTAD 2014a). This is likely because PTAs influence a wider range of policies that affect FDI than BITs do, as well as encourage a more dynamic interaction between trade and investment.

The studies that examined the causal relationship between IIAs and FDI have observed that:

- One study indicated that the existence of BITs seems to mainly influence the decision to invest in sectors that involve large sunk costs (initial capital) and are susceptible to expropriation. Natural-resource-seeking FDI is predominantly concerned by such considerations, as are a number of capital intensive market-seeking investments in services, such as in energy or water distribution. These sectors are also typically seen to be politically sensitive. BITs are seen to have a strong impact on FDI in the extractives sector. However, the impact of BITs on FDI in the utilities sector varies (Colen and Guariso 2014).
- Another study indicated that BITs do help to attract FDI to developing countries. However, in the case of the US, there is no clear link between BITs and FDI to developing countries that have entered into a bilateral treaty with the US (Busse, Königer, and Nunnenkamp 2008).

Moreover, distinguishing whether an additional IIA causes an increase in FDI as opposed to a simple correlation requires one to tease out that (i) there is no reverse causality where an increase in FDI could increase the probability of countries signing an IIA; and that (ii) there is no other exogenous variable that simultaneously impacts FDI and IIAs (UNCTAD 2014a).

Obligations in IIAs can differ in terms of the breadth and depth of the commitments they generate. Many studies assume that IIAs are generally similar to one another, as building an econometric model that tracks the impact of specific commitments in different IIAs is not easy.

A few studies (Berger *et al*. 2013, Dixon and Haslam 2016) tried to disentangle the impact of agreements based on the depth of commitments made by signatories. Specifically, Berger *et al*. (2013) focused on details such as (i) market access commitments (the national treatment (NT) and most-favoured nation (MFN) obligations) in the pre-establishment phase; and (ii) the ISDS obligation in the post-establishment phase. Their study found that:

- PTAs with investment chapters that contain NT obligations in the pre-establishment phase promote bilateral FDI. The authors suggest that the signalling effect to foreign investors is most effective if market access is predictable, namely through the use of the negative-list approach to scheduling investment liberalisation commitments covering all sectors. It is noteworthy that more general studies on the signalling effects of treaty-making indicate inconclusive results on the use of IIAs as a tool to signal that a government is committed to a pro-business environment. One study indicates that BITs do have a signalling effect (Kerner 2009) while another indicates otherwise (Dixon and Haslam 2016).
- Foreign investors react strikingly differently to PTA and BIT obligations. Investors tend to respond favourably to the mere existence of BITs but are not seen to react if a PTA does not contain any specific liberal market access commitments or an effective dispute settlement mechanism.
- The ISDS mechanism appears to play a minor role as compared to the inclusion of NT obligations. This could be because generally lower-income host countries have agreed to strong ISDS obligations (Berger *et al*. 2013).

Drawing generalisable policy conclusions from available studies remains problematic. However, the available evidence tends to support the conclusion that BITs and other IIAs do provide a measure of stability for foreign investors through factors such as risk reduction and the general ability to contribute to a better investment environment (UNCTAD 2014a). In addition, two studies with similar methodologies indicate that BITs are useful in promoting investments that would otherwise bear political risks (Kerner and Lawrence 2014). Specifically, BITs seem to have a positive effect on FDI related to global value chains, where there is higher "expropriation risk, poorer law and order and lower government stability" (Sirr, Garvey, and Gallagher 2017).

What is seen to be more important is strong investment protection that is coupled with deep economic integration (Dixon and Haslam 2016). Furthermore, studies show that the impact of IIAs is also conditional on, or mediated by, other key factors that influence FDI such as "the sector and industry in which the FDI takes place, the country of origin of investors, the governance and institutions of host countries, and the life-cycle of an IIA (e.g. the size of [the] impact is highest immediately after [an IIA's] entry into force and then tails off)" (UNCTAD 2014a). More nuanced studies on the type of FDI (including whether this impacts brownfield or greenfield investments), and the impact of key elements in IIAs on FDI, could contribute to a better understanding from a policymaking perspective.

Trends in International Investment Disputes

As noted earlier, the number of ISDS cases has risen markedly in recent years, with 114 countries worldwide having been brought to international arbitration by foreign investors, facing a total of 817 known ISDS cases (UNCTAD 2017b). It is noteworthy that ISDS cases have covered many sectors—ranging from oil and gas to the agriculture sectors. Government measures subject to ISDS challenge range from health sector reforms to privatisation-related measures, and also include economic measures taken in response to a financial crisis. In turn, Malaysian investors abroad could use IIAs to supplement their understanding of the host country's investment environment.

Furthermore, the rise in investment-related judicial activism means that Malaysian policymakers from different ministries need to be aware of their potential exposure to the ISDS mechanism based on past case law when enacting or implementing domestic laws and regulations. Examples of possible areas of exposure include:

- The Ministry of Health in relation to health sector reforms.
- The Ministry of Finance in relation to public tenders, taxation measures, privatisation-related matters, economic measures taken to mitigate a financial crisis, the treatment of state-owned enterprises (SOEs) and the restructuring of sovereign debt obligations.
- The Ministry of Natural Resources and Environment in relation to environmental legislation.
- All ministries in relation to direct and indirect expropriation, and the confiscation or seizure of assets. In general, obligations on expropriation are relatively clear for direct expropriation but less clear for so-called regulatory takings (i.e. indirect expropriation).

Data on the actual dollars and cents spent on ISDS cases reveals the real cost of these disputes to governments and foreign investors utilising the ISDS mechanism. Information[5] on claims and damages in ISDS cases indicates that:

- **Claim size**. In cases decided in favour of the investor, the average amount claimed by the investor was **USD1.4 billion**, with a median amount of USD113 million (UNCTAD 2017b). However, the range of damages claimed is large, from less than USD1 million to **USD91.2 billion** (Hulley Enterprises v. Russia, PCA Case No. AA 226) (UNCTAD 2018b).
- **Damages awarded**. The average arbitral award was **USD522 million**, which is approximately **39% of damages claimed**. The damages awarded vary widely— from USD0.03 million (Bogdanov v. Moldova (III), SCC Case No. 114/2009) to **USD40 billion** (Hulley Enterprises v. Russia, PCA Case No. AA 226) (UNCTAD 2018b). A study conducted by Hart (2014)[6] indicates that in general, the bigger the amount claimed, the smaller the percentage

of damages awarded. Other observations based on this trend are: (i) a higher recovery percentage is generally observed for smaller sized claims, and (ii) only about 9% of cases result in awards of 100% of the claimed amount (Hart 2014).

- **Cost of arbitration**. According to Hart (2014), the size of the claim tends to impact the cost of the arbitration, with a loose upward trend showing that the higher the claim size, the higher the total cost of the arbitration to both parties in the arbitration.

It is important for Malaysia to take note of the latest trends on the mounting cost of ISDS cases, as the average ISDS claim size and the highest known damages awarded would make up approximately 2.6% and 77.7%[7] of Malaysia's central government revenue in 2017 respectively.

Malaysia's Selective Adjustments in IIAs

As countries reassess their position on the usefulness of IIAs as a policy tool and the elements that should go into an IIA, Malaysia has taken the opportunity to make selective adjustments to its latest generation IIAs. Malaysia does not feature among those countries that are currently seeking to withdraw from their existing IIAs. Rather, Malaysia's approach has been to continue engaging in IIA negotiations while at the same time tweaking the contents of its IIAs to secure the desired balance between investor rights and policy space for the government.

The CPTPP is the most recent example of a PTA signed by Malaysia. It is also arguably the most ambitious PTA signed by Malaysia thus far. Comparing[8] Malaysia's IIA commitments under the CPTPP to its previous IIAs, Malaysia has chosen to widen the scope of its IIA commitments in some instances while limiting the scope of obligations in other areas. The subsection that follows highlights these important differences.

A Wider Scope of IIA Commitments

Malaysia's commitments under the CPTPP are more extensive than those under its previous IIAs mainly due to Malaysia's investment liberalisation commitments.

Negative-list approach to liberalisation. The structure of the CPTPP is such that all sectors are fully liberalised unless specific limitations are clearly laid out in annexes to the agreement. This is known as the negative-list approach. It is noteworthy that the negative-list approach also implies that new sectors are automatically liberalised unless otherwise specified in the agreement. This differs from Malaysia's general approach in previous trade and investment agreements, which consisted in solely listing areas that are to be liberalised (known as the positive-list approach). The significance of this is that Malaysia, like all other CPTPP Parties, has had to carefully choose the sectors it does not want to liberalise in the future or preserve the right to maintain or introduce new non-conforming measures. Although Malaysia had used the negative-list approach in previous IIAs, the CPTPP marks a significant shift in the country's approach as the CPTPP's investment provisions also cover all service sectors. For example, the ACIA covers services incidental to manufacturing, agriculture, fishery, forestry, mining and quarrying whereas the CPTPP generally covers all service sectors.

Rules on market access. In addition to the negative-list approach, the CPTPP also features a wider range of commitments. For example, the Malaysia-Australia FTA (MAFTA) covers NT and MFN. The CPTPP goes beyond MAFTA with Malaysia committing to more rules regarding the prohibition of performance requirements and restrictions linked to senior management and boards of directors. Specifically, the CPTPP provision on the prohibition of performance requirements covers the pre- and post-establishment phases of an investment. There are also specific rules on what type of requirements cannot be linked to an advantage (such as an incentive) provided by the government to foreign investors. Therefore, under the CPTPP, Malaysia for example cannot link investment approval or subsidies to a requirement to achieve a given level or percentage of domestic content.

Government procurement. The CPTPP is the first trade agreement in which Malaysia has made specific commitments on government procurement rules and market access (see Chapter 7). However, Malaysia has retained specific flexibility in as much as the ISDS mechanism does not apply to contract values below a specific threshold[9].

Limiting the Scope of the Investment Chapter

The CPTPP also limits the scope of its investment chapter in response to emerging case law on the impact of specific provisions in the IIA. For example, this could be due to a better understanding of the impact of specific IIA provisions or of the need to clarify the intention of Parties to the IIA.

Limiting the scope of application of the ISDS mechanism. It is noteworthy that under the CPTPP, the ISDS mechanism applies to most of the CPTPP countries. However, at New Zealand's request, the CPTPP's ISDS mechanism only applies between Malaysia and New Zealand if the Host State explicitly consents to it[10]. This effectively means that the ISDS mechanism does not apply to the Malaysia-New Zealand relationship. New Zealand also signed similar separate legally binding letters with Brunei and Vietnam. Further, New Zealand signed separate side letters with Australia and Peru stating that ISDS provisions do not apply between the signatory countries.

New Zealand had actively sought to exclude ISDS from the CPTPP (MFAT 2018). This was due, in part, to concerns over the risks that New Zealand might face if a future ISDS claim that could potentially prevent "future governments from taking regulatory action in areas of importance to New Zealand" (MFAT 2018). This means that the the ISDS mechanism does not apply to all CPTPP signatories equally, an indication that even developed countries such as New Zealand are not fully convinced of the need for an ISDS mechanism in some, if not all, of its agreements in the future.

Tobacco control measures. Malaysia may also deny ISDS claims challenging a tobacco control measure under the CPTPP. This exception is important as the CPTPP countries have chosen to allow for a broad exception specifically for this sector, with most other exceptions being country-specific in nature. The reason behind CPTPP countries agreeing to ensure there is policy space for tobacco control measures is rooted in an ISDS case that was ongoing during the Agreement's negotiations. In essence, a foreign investor had sued the Australian government for its law that specified how cigarette packaging should look— known as the plain packaging law. This law was imposed to achieve public health objectives such as "discouraging people from taking up smoking, or using tobacco products" (Tobacco

Plain Packaging Act 2011). Tobacco control measures are in addition to explicit reference made in the Investment Chapter's NT article allowing for treatment that distinguishes between investors or investments on the basis of legitimate public welfare objectives.

Indirect expropriation. The CPTPP has a specific annex to clarify the standard of treatment for expropriation. Direct expropriation is where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure. Indirect expropriation is an area where jurisprudence suggests a need for greater clarity on the intention of the countries signing the IIA. Indirect expropriation is where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure. Determining indirect expropriation requires a case-by-case, fact-based, inquiry that considers specific criteria. In line with explicit clarification on the ability to apply non-discriminatory legitimate public welfare objectives; specific reference is made to public health, safety and the environment.

CONSIDERATIONS FOR FUTURE INVESTMENT POLICY

Assessing IIAs Moving Forward

As developing countries become capital exporters, their interest in using IIAs as a policy tool to protect overseas investments naturally increases. In the case of Malaysia, while inward FDI remains crucially important to the country's diversification aims, outward FDI has gained increasing prominence since the 2000s. Therefore, Malaysia needs to strike a balance in using IIAs as a policy tool for both domestic and foreign investments. Thus, not only is the signing of IIAs seen as a signal of a host state's willingness to provide a predictable investment environment for foreign investors, there is also an increasing interest in locking in investment protection in overseas markets. The growing web of Malaysia's IIAs is evidence of its use of such agreements as a tool to protect foreign investments in Malaysia and to offer protection to Malaysian investors abroad.

However, with the increase in the number of ISDS cases, governments and businesses are now more aware of how much 'bite' IIAs have in disciplining host states given the breadth of policies addressed in ISDS cases. The potential exposure of host countries to ISDS claims is an important (and sometimes controversial) cost of ensuring a stable and predictable investment environment. Malaysia is no exception, having been brought to international arbitration in several ISDS cases.

Determining the cost of signing IIAs should include an assessment of the average claim size and the average arbitral award, both of which have been on an upward trend in recent years in an environment characterised by considerably greater doses of judicial activism. Such costs, however, need to be balanced against the reciprocal benefits accruing to home country investors overseas. The risk of being exposed to ISDS cases also increases the importance of ensuring that a country's laws and regulations are properly aligned with IIA commitments and implemented accordingly. In addition, the potential 'cost' of upholding IIA obligations could potentially have a significant impact on Malaysia.

In view of increasing awareness on the breadth and depth of IIAs, many countries are reassessing their position on the usefulness of IIAs as a policy tool and/or the need to tweak IIAs to suit domestic policy goals. Therefore, a finer understanding of IIAs is required to better appreciate how they can impact domestic policies. This is where economic literature on the potential benefits of IIAs plays a role in informing governments on the usefulness of IIAs as a policy tool. Perhaps the central challenge confronting policymakers in approaching IIAs is the need to strike an appropriate balance between the decision to voluntarily constrain domestic regulatory sovereignty with a view to affording foreigners a business facilitating investment climate and the retention of adequate policy space to pursue legitimate public policy objectives, including in the realm of economic and sustainable development.

Unfortunately, a review of the literature on the relationship between IIAs and FDI shows sometimes contradictory and therefore inconclusive findings. Many studies show a positive relationship between IIAs and FDI whereas others have shown little or no effect (UNCTAD 2014a). Therefore, a positive relationship mainly answers the question of whether IIAs should be a policy tool used by countries. It does not, however, provide enough answers to the questions of what obligations

are important in an IIA to attract the kinds of investment that are important to the government, and to Malaysian investors going overseas. As the breadth and depth of IIAs can vary, more nuanced studies on the type of FDI and the impact of key elements in IIAs on FDI, would contribute to better understanding from a policymaking perspective.

Drawing generalisable policy conclusions from available studies remains problematic. However, these studies do tend to show that BITs and other IIAs provide a measure of stability for foreign investors through factors such as risk reduction and the general ability to contribute to a better investment environment (UNCTAD 2014a).

Malaysia's Experience with the CPTPP

The CPTPP is Malaysia's most recent and most ambitious PTA featuring an Investment Chapter. The CPTPP marks the first time that Malaysia agreed to a negative-list approach for the liberalisation of both investment and services, covering all sectors instead of selected ones.

Although both the positive-list and negative-list approach can in theory achieve the same level of liberalisation, studies indicate that negative-list agreements "offer incentives for wider but not deeper commitments" (Fink and Molinuevo 2007). In addition, an earlier study looking into the gap between Malaysia's positive-list approach and a possible negative-list approach in the services sector suggested that the adoption of the negative-list approach would require the identification of specific laws and regulations limiting investment in approximately 80%[11] of Malaysia's subsectors (Aidonna Jan 2011). The negative-list approach required the Malaysian government to undertake an in-depth stocktaking of the country's regulatory regime to identify areas that needed to be explicitly carved out of the agreement through the maintenance of transparently listed non-conforming measures. Details on the Malaysian government's policy sensitivities in investment and services are listed in Table 3.

The level of liberalisation agreed to in the CPTPP goes beyond what Malaysia has committed to under the ASEAN framework of agreements. ACIA, for example, limits investment liberalisation to manufacturing, agriculture, fishery, forestry, mining and quarrying, and the services incidental to these sectors. The ASEAN Framework Agreement on Services (AFAS) on the other hand is still undergoing stages of

Table 3. Malaysia's Non–conforming Measures under the CPTPP

	NT		MFN		PPR	SMBD	MA	LP
	Investment and Cross-Border Trade in Services Chapters				Investment Chapter		Cross-Border Trade in Services Chapter	
	I (Article 9.4)	S (Article 10.3)	I (Article 9.5)	S (Article 10.4)	(Article 9.10)	(Article 9.11)	(Article 10.5)	(Article 10.6)
Annex I								
All Sectors (sole proprietorship, partnership, cooperative societies)	✓							
Manufacturing (motor vehicles, batik)	✓							
Manufacturing (multiple areas)					✓			
Marine Capture Fisheries (foreign fishing vessel)	✓	✓						✓
Patent Agent Services Trademark Agent Services								✓
Professional Services covering: Engineering Services Quantity Surveying Services Land Surveying Services Architectural Services	✓	✓						✓
Legal Services (other than arbitration)	✓	✓					✓	✓
Real Estate Services (on a fee or contract basis)	✓	✓						

	NT		MFN		PPR	SMBD	MA	LP
	Investment and Cross-Border Trade in Services Chapters				Investment Chapter		Cross-Border Trade in Services Chapter	
	I (Article 9.4)	S (Article 10.3)	I (Article 9.5)	S (Article 10.4)	(Article 9.10)	(Article 9.11)	(Article 10.5)	(Article 10.6)
Communication Services (telecommunications services, satellite broadcasting, subscription broadcasting, terrestrial free to air TV, terrestrial radio broadcasting)	✓	✓						✓
Education Services (preschool, primary school, secondary school, religious school)	✓	✓						✓
Private Healthcare Facilities and Services Allied Health Services	✓	✓						✓
Customs Agents and Brokers		✓						
Tourist Guide Services		✓						
Utilities (gas, water, electricity, disposal of waste)	✓	✓				✓	✓	✓
Transport Services (international maritime transport services (including maritime cabotage and government cargo))	✓	✓				✓	✓	✓
Distribution Services	✓	✓			✓	✓	✓	✓

	NT		MFN		PPR	SMBD	MA	LP
	Investment and Cross-Border Trade in Services Chapters				Investment Chapter		Cross-Border Trade in Services Chapter	
	I (Article 9.4)	S (Article 10.3)	I (Article 9.5)	S (Article 10.4)	(Article 9.10)	(Article 9.11)	(Article 10.5)	(Article 10.6)
Construction and Related Engineering Services	✓	✓				✓	✓	
Freight Road Transportation Services	✓	✓					✓	✓
Wholesale and Distribution Services (batik, motor vehicles)	✓	✓						
Oil and Gas	✓	✓			✓	✓	✓	✓
Annex II								
Land and Real Estate	✓							
Oil and Gas	✓	✓			✓	✓	✓	✓
All Sectors (privatisation)	✓	✓	✓	✓	✓	✓	✓	✓
All Sectors (Bumiputera)	✓	✓			✓		✓	
All Sectors (National and State unit trusts)	✓							
All Sectors (regional integration and sector-specific international agreements)			✓	✓				

	NT		MFN		PPR	SMBD	MA	LP
	Investment and Cross-Border Trade in Services Chapters				Investment Chapter		Cross-Border Trade in Services Chapter	
	I (Article 9.4)	S (Article 10.3)	I (Article 9.5)	S (Article 10.4)	(Article 9.10)	(Article 9.11)	(Article 10.5)	(Article 10.6)
Manufacture, Assembly, Marketing and Distribution of Explosives, Weapons, Ammunitions, as well as Military-related Equipment/ Devices, and Similar Products	✓				✓	✓		
Gaming, Betting and Gambling (including supply and suppliers of betting and gambling equipment, wholesale and retail of gambling equipment)	✓	✓			✓	✓	✓	✓
Non-medical Utilisation/ Application of Atomic Energy	✓	✓	✓	✓	✓	✓	✓	✓
Cultural Services	✓	✓	✓	✓	✓	✓	✓	
Wholesale and Distribution Services	✓	✓						✓
Sewage and Refuse Disposal, Sanitation and other Environmental Protection Services	✓							

	NT		MFN		PPR	SMBD	MA	LP
	Investment and Cross-Border Trade in Services Chapters				Investment Chapter		Cross-Border Trade in Services Chapter	
	I (Article 9.4)	S (Article 10.3)	I (Article 9.5)	S (Article 10.4)	(Article 9.10)	(Article 9.11)	(Article 10.5)	(Article 10.6)
Air Transport Services	✓	✓				✓	✓	✓
Passenger Road Transportation Services (covering taxi services and scheduled passenger road transportation) Legal Services	✓	✓			✓			✓
covering Mediation and Shari'a Law	✓	✓	✓	✓	✓	✓		✓
All Sectors (non-internationalisation of Ringgit)	✓	✓						
Social Services	✓	✓	✓	✓	✓	✓		✓

Note: NT = National Treatment; MFN = Most-Favoured Nation; PPR = Performance Requirements; SMBD = Senior Management and Boards of Directors; MA = Market Access; LP = Local Presence.

Source: Author, summarised from CPTPP Annexes I and II (Malaysia).

progressive liberalisation through a positive-list approach, as explained in this book's chapter on services. In addition, the ASEAN Economic Community Blueprint targets liberalisation of up to 70% foreign equity as part of the goals in establishing the ASEAN Economic Community (ASEAN 2008). Judging by the level of ambition of previous AFAS packages, it is likely that Malaysia has committed to a higher level of liberalisation under CPTPP, affording non-ASEAN partners a higher degree of investment access than it does to its ASEAN brethren.

ASEAN Member States (AMS) may yet have access to the ASEAN agreements to enjoy some of the IIA benefits under the CPTPP. In general, ACIA's MFN article (Article 6) allows AMS to enjoy the benefits Malaysia provides to CPTPP countries on investment protection and selected investment liberalisation commitments. This means that ASEAN still benefits from stronger CPTPP obligations, albeit in a limited way for investment liberalisation for the services sector[12]. As AFAS does not have a similar MFN provision, any gaps between AFAS and CPTPP liberalisation would need to be negotiated into the final AFAS package of commitments, targeted to be signed in 2018 (ASEAN 2017).

Malaysia's IIAs and Future Challenges

The CPTPP has become the new benchmark of the level of investment protection and liberalisation Malaysia is willing to bind itself to. This new standard can be expected to impact all of Malaysia's ongoing and future BIT and PTA negotiations, as trade and investment partners seek Malaysia's commitment to similar high standards in any new agreements. It will therefore become harder for Malaysia to protect sectors that were opened under the CPTPP.

A key development in the TPPA was the US government's decision to withdraw from this agreement, prompting the remaining eleven countries to renegotiate the agreement, which was rebranded as the CPTPP. The possibility remains that the US may ultimately decide to join the CPTPP. This would likely result in extensive renegotiations on issues that are sensitive to the CPTPP-11 countries. In addition, elements that were suspended under the CPTPP would likely be reintroduced. These would include allowing for the ISDS mechanism to apply to investment agreements[13] and investment authorisation[14]—elements that would broaden the scope of the Investment Chapter significantly.

Key PTA negotiations include those on the RCEP agreement and the Malaysia-European Union Free Trade Agreement. In the case of the RCEP negotiations, China is a big economy that is not part of the CPTPP. As China's investments in Malaysia have become more significant in recent years, the investment provisions contained in RCEP would likely be used as a policy tool to manage the Malaysia-China investment relationship. In addition, one of the principles guiding

the RCEP negotiations is to "facilitate the participating countries' engagement in global and regional supply chains" (ASEAN 2012). Therefore, engagement on this agreement should be mindful of the study that suggests that an IIA could have a positive effect on FDI related to global value chains, where there is higher "expropriation risk, poorer law and order and lover government stability" (Sirr, Garvey, and Gallagher 2017).

It is unlikely that RCEP will outdo CPTPP in terms of its level of ambition, given the diverse range of countries participating in the negotiations—from least developed countries (LDCs) to developed ones. However, the level of ambition of RCEP's Investment Chapter remains unclear given that Indonesia and India (both RCEP countries), are actively reassessing their IIAs. In addition, New Zealand had actively sought to exclude ISDS for New Zealand from the CPTPP (MFAT 2018). Therefore, it is possible that New Zealand may seek to do the same under the RCEP negotiations. New Zealand's reservations regarding ISDS may resonate with other RCEP countries, particularly the LDCs (Myanmar, Lao People's Democratic Republic and Cambodia), as well as India and Indonesia. There is thus a genuine possibility that the RCEP Investment Chapter may not contain an ISDS mechanism or that such a chapter would apply only to some signatories. This issue is likely to be hotly negotiated all the way up to the highest political levels. New Zealand's approach is an indication that Malaysia's trade and investment partners are questioning the basic makeup of IIAs and re-evaluating the benefits of strong investment provisions.

Malaysia may face a different rule-making challenge under the ongoing Malaysia-EU bilateral negotiations. A recent opinion by the European Court of Justice (ECJ) (Opinion 2/15) highlighted the need for additional ratification processes in areas that cover certain types of investment (such as portfolio investment) and the ISDS mechanism. Both areas were deemed by the ECJ to fall within the joint competence of the European Commission and its Member States (CJEU 2017). The EU will thus likely propose the adoption of two agreements[15] if portfolio investment and ISDS are covered by the bilateral pact with Malaysia. The first agreement would be a PTA covering all areas falling under the EU's exclusive competence, and the second an Investment Protection Agreement covering investment-related issues. The former agreement would require approval from the European Council and the consent of

the European Parliament while the latter would require the additional approval of each Member State (European Commission 2018a). As not all of Malaysia's IIAs cover portfolio investment, it is possible that Malaysia could choose to stick to areas that fall under the exclusive competence of the European Commission to avoid the need for individual EU Member States to ratify any part of the agreement.

If Malaysia decides to embark on IIA negotiations that include ISDS, the EU's current approach is furthermore to promote a bilateral investment court system that the EU hopes will eventually lead to the creation of a multilateral investment court. This is seen as a means to correct various weaknesses in the design and operation of the ISDS mechanism (European Commission 2015). Specifically, a "lack of or limited legitimacy, consistency [in arbitral decisions] and transparency as well as the absence of a possibility of review have been identified as problems stemming from ad hoc ISDS which is based on the principles of arbitration" (European Commission 2017).

The EU's recently concluded agreements with Canada and Vietnam both established permanent appeal tribunals to hear appeals regarding the awards issued. The EU's trade agreement with Singapore explicitly tasks the agreement's committee on investment to examine the need for an appellate mechanism to review, on points of law, awards rendered by a tribunal under the ISDS mechanism. The EU's agreements with Canada and Vietnam also foresee the creation of a multilateral investment tribunal and appellate mechanism that would replace the current bilateral investment court systems. The EU's approach in its IIAs is to include provisions that support the future creation of a multilateral investment court (European Commission 2018b).

The effectiveness of an appeals tribunal and a multilateral investment court remains to be seen as such an approach has yet to be tested. Further, the cost of supporting the operations of a multilateral investment court system could be significant, for developing countries in particular. In the case of the EU and its Member States, a multilateral investment court is expected to cost them EUR5.4 million (RM26.2 million) per year. Nevertheless, this approach could prove useful to countries that still believe in the virtues of ISDS but also agree that major changes are needed to enhance the system's legitimacy. Malaysia will need to decide whether it agrees with the EU approach in the context of the Malaysia-EU FTA negotiations.

Endnotes

[1]The author would like to thank Nadia Mazlan, Ahmad Nazmi Bahruddin, Nabihah Norizam, Shukri Al-Hilmi and Mohamad Afiq Husaini for their research assistance in data collection and background research.

[2]Strategic asset- or capability-seeking investment is not included in this analysis owing to difficulty in assigning sectors to this category. This graph provides a simple analysis of natural-resource-seeking investment (sum of agriculture, forestry, fishing, mining and quarrying sectors) and market- and efficiency-seeking investment (sum of manufacturing, construction and services sectors).

[3]For more information, see CPTPP Annex I-Malaysia-27.

[4]The Side Letter between New Zealand and Malaysia under the CPTPP (previously known as the TPPA) confirms that "Nothing in TPP will derogate from the rights and obligations of New Zealand or Malaysia under AANZFTA or MNZFTA. To the greatest extent possible, the Agreements will be interpreted consistently. Where AANZFTA, MNZFTA or TPP provides different treatment for an exporter, service supplier or investor of New Zealand or Malaysia, that exporter, service supplier or investor is entitled to claim the more favourable of the treatment accorded to that exporter, service supplier or investor under that Agreement." Source: TPPA 2016.

[5]Publicly available information as of December 2017.

[6]This study is based on publicly available information as of 30 June 2013.

[7]Based on the calculation of damages for the case Hulley Enterprises v. Russia, PCA Case No. AA 226.

[8]Analysis is based on a general comparison of selected IIAs. A more accurate, in depth study comparing the scope and depth of Malaysia's IIA commitments with those under the CPTPP would require in depth analysis of the exact wording of each agreement.

[9]Without prejudice to a claimant's right to submit other claims to arbitration pursuant to Article 9.19 (Submission of a Claim to Arbitration), Malaysia does not consent to the submission of a claim that Malaysia has breached a government procurement contract with a covered investment, below the specified contract value, for a period of three years after the date of entry into force of this Agreement for Malaysia. The specified contract values are: (a) for goods, SDR 1,500,000 (USD2,107,820); (b) for services, SDR 2,000,000 (USD2,810,427); and (c) for construction, SDR 63,000,000 (USD88,528,440) (Source: CPTPP Annex 9-K). (Note: SDR/USD exchange rate is as of July 2018.)

[10]The CPTPP side letter between Malaysia and New Zealand on ISDS states that an ISDS case "may be submitted to arbitration … provided that the Government … consents to the application of this Chapter to the dispute".

[11]Assuming that the education, health, communication and financial service sectors could together represent Malaysia's general level of trade in services commitments.

[12]As mentioned above, ACIA covers investment liberalization for five sectors and services incidental to these sectors. Therefore, ACIA's MFN clause would cover these sectors.

[13]Investment agreement means a written agreement that is concluded and takes effect … between an authority at the central level of government of a Party and a covered investment or an investor of another Party and that creates an exchange of rights and obligations, binding on both parties … on which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself, and that grants rights to the covered investment or investor with respect to specific activities. Source: TPPA, Article 9.1.

[14]Investment authorisation means an authorisation that the foreign investment authority of a Party grants to a covered investment or an investor of another Party. Source: TPPA 2016, Article 9.1.

[15]This approach was taken for the Free Trade Agreement between the European Union and the Republic of Singapore following from the European Court of Justice's Opinion 2/15.

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6

Between Regulatory Reforms, Trade Liberalisation and Technology Dependence: Intellectual Property Challenges in Malaysia

Ida Madieha Abdul Ghani Azmi[1]

INTRODUCTION

Malaysia is a strong proponent of trade liberalisation and aims to champion good governance, transparency and regulatory reforms at home. Since 2003, Malaysia has inked 7 bilateral preferential trade agreements (PTAs) and 7 regional PTAs, most of which are with her important export markets[2]. Most of these treaties contain provisions on intellectual property (IP) rights, with varying depth. Some have minimal reference to IP, some have moderate IP provisions, whilst some have full chapters on IP (Ida Madieha, 2017). The PTAs championed by the United States (US) were the ones with platinum standards on IP with obligations that go beyond the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). One example of the platinum standards on IP pushed by the US is the Trans-Pacific Partnership Agreement (TPPA), which was later renegotiated to be

the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) after the US exited from the Agreement. These platinum standards or TRIPS-plus standards continued to be used as a template in PTAs, particularly those led by the US. Even the Regional Comprehensive Economic Partnership (RCEP) Agreement have included some TRIPS-plus provisions on the negotiating table particularly by Japan and Korea. The CPTPP is expected to provide important reform impetus by accelerating the process of trade and investment liberalisation and rule-making which, in turn, will benefit Malaysia as an export-oriented economy. This applies not only with respect to other regulatory reforms, but also to IP rights, one of the most complex and contentious issues negotiated under the CPTPP. Unlike other trade issues, IP standards are inherently protective and potentially anti-competitive as they provide marketing exclusivity to IP owners and allow them to extract rents from IP users. If this is not counterbalanced with sufficient leeway to IP users, higher IP standards can result in obstacles to market access rather than generating trade-induced welfare gains.

This chapter commences with a brief foray into the role of IP in Malaysia's industrial policy. It seeks answers to questions such as: how relevant is IP to the economic development of the country? To what extent does IP play a role in the country's cross-border trade and investment activity? What industrial policies have been put in place to enhance the creation of IP in Malaysia? The chapter then discusses the binding commitments contained in the TPPA, the predecessor to the CPTPP, as an example of the most recent platinum standards on IP concluded by Malaysia and suggests the regulatory reforms such commitments would entail domestically. It goes on to explore whether and how the CPTPP's IP provisions are relevant to Malaysia. It should be noted at the outset that a fuller discussion of the implications of the TRIPS-plus nature of CPTPP provisions lie beyond the scope of this chapter. Rather it seeks to highlight some provisions that may have significant impact on two sectors of the Malaysian economy: the content and pharmaceutical industries. At the beginning of the negotiation of the TPPA, many platinum standards on IP rights were pushed by the US. With the withdrawal of the US from the TPPA and the conclusion of the CPTTP, most of the controversial provisions on IP have been suspended until further notice. Despite such developments,

this chapter looks closely at five important IP provisions, four of which have been suspended from the CPTPP's scope of application and one that would be enforced with the treaty's entry into force.

DOMESTIC POLICY ON IP

Malaysia has earmarked IP as an economic enabler from the Fifth Malaysia Plan (1986 – 1990) onwards. Several policy initiatives have been introduced to promote the creation of IP as well as strategic management of local IP created principally by publicly-funded institutes of higher learning and research.

Among the principal policy items is the National Intellectual Property Policy (NIPP). The Policy was launched in July 2007 to chart national IP initiatives, including laws and regulations, and to steer all government IP activities. One of the main objectives of the NIPP is to attain the highest standard of IP protection, which requires the constant updating of laws and regulations to keep abreast of international developments, new challenges and emerging issues. In line with this objective, Malaysia has adopted TRIPS-plus obligations on copyright and performers' rights by acceding to the World Intellectual Property Organization (WIPO) Copyright Treaty 1996 and to the WIPO Performances and Phonograms Treaty 1996.

The NIPP identified the promotion of IP-generated activities as one of the key initiatives to accelerate the creation of IP in Malaysia, by focusing on "the creation of a conducive environment that provides incentives, grants, management, finance, business transactions, enforcement and dispute settlement"[3].

Key to the promotion of IP is an enabling environment for its commercial exploitation. For this purpose, the government promotes the financing of IP activities through government-backed financial instruments such as Malaysia Debt Ventures Bhd, MyCreative Ventures and Malaysia Venture Capital. Without such seed financing, it is doubtful whether the country's small and medium-sized enterprises (SMEs) would be able to move forward in their business ventures. Additionally, if IP is not accepted as a class asset on its own, SMEs' growth may well be lastingly impeded.

One of the obstacles to the acceptance of IP for financing purposes is a lack of understanding of the methods of valuation of intangible assets. Unlike physical property that already has an established market and valuation, local financiers have a limited understanding of how to assess the true value of IP. The IP Valuation Model launched in 2013 was a move towards developing standards for use by financial institutions and industry.

With the intention of developing local expertise on IP valuation, as well as making IP valuation services more accessible and affordable for SMEs, the Intellectual Property Corporation of Malaysia (MyIPO) developed a training module which was launched in early 2013. Through such training programmes, the government hopes that a sufficient number of IP valuers will be qualified to meet market needs.

One prerequisite for the development of IP as an asset class used for security is the availability of a marketplace where IP can be traded. For this purpose, MyIPO launched its portal, IP Marketplace, in June 2014 as a platform to connect IP owners to businesses and investors in an effort to bring IP to the marketplace. This is in addition to MyIPO's previous venture partnering with the Hong Kong Trade Development Council to enable Malaysian IP owners to buy, sell, license and conduct transactions of their products, solutions and services via a collaborative platform (Bernama 2014).

Capacity building is another policy initiative designated by the government in the NIPP through the development of the IP management capabilities strategic initiative. The aim is to cover the whole chain of IP activities from creation, protection, exploitation, valuation, licensing and acquisition, to enforcement and dispute settlement. For IP to flourish in Malaysia, enough human resources are needed to support the whole IP ecosystem.

The National Biotechnology Policy is another related policy that regards IP as a mainstay of the growth of domestic industry. The Policy, which contains nine initiatives, outlines a legislative and regulatory framework, which includes having a strong IP protection regime to support research and development (R&D) and commercialisation efforts as one of its specific thrusts.

In addition to national policies, new organisations were set up to manage local IP more effectively. In the Tenth Malaysia Plan (2011 – 2015), Malaysia set innovation as the launchpad for its efforts to become a knowledge-based economy and a high-income nation. To realise this aspiration, the *Unit Inovasi Khas* (UNIK), a special innovation unit under the Prime Minister's Office, was set up. UNIK was responsible for overseeing an integrated innovation policy and commercialising research findings from universities. To spearhead this initiative, UNIK drafted the National Innovation Policy. The immediate outcome was the establishment of the National Innovation Agency (AIM), a statutory organisation set up specifically to implement the key initiatives identified under the National Innovation Policy. Between 2012 and 2013, Malaysia was ranked 25th in the World Economic Forum's 2017 – 2018 Global Competitiveness Index measuring the set of institutions, policies and factors that determine a nation's level of productivity. Malaysia's competitiveness ranking within the Association of Southeast Asian Nation (ASEAN) Member States was encouraging, placing it second behind Singapore.

From the various policy initiatives, it is clear that the creation of home-grown IP is imperative for Malaysia's economic growth and diversification. The way forward is to move towards higher value-added products (goods and services) and avoid the pitfalls of the so-called 'middle-income trap'. Arguably, this cannot be done without continuous innovation. So how much has the country achieved since the Fifth Malaysia Plan in terms of IP creation and ownership? This issue is dealt with in greater depth in the next section.

MALAYSIA'S PERFORMANCE IN INTELLECTUAL PROPERTY FILING

Malaysia's performance in Patent Cooperation Treaty (PCT) filings has improved over the years. From 2006 – 2018, a total of 2,635 Malaysian patents were filed under this treaty[4]. Malaysia was among the top 15 receiving offices among middle-income countries in 2012 and it ranked fourth after the Russian Federation, India and Brazil. Universiti Sains Malaysia emerged as one of the world's top 50 university PCT applicants (World Intellectual Property Office 2013)[5] and MIMOS[6] ranked sixth among the top 30 applicants from government and research institutes[7].

Malaysia has improved its share in the total selected ASEAN publications, with its contributions significantly increasing from 10.5% in 2001, to 29.2% in 2014 (MOSTI 2017, 207). The country ranked 46th in terms of total publications and 50th in citation terms in the world in 2011 (MASTIC 2014, 105). By 2015, Malaysia moved up to 39th in the world in terms of total articles published (MOSTI 2017, 205). The share of Malaysian patents granted to foreigners decreased from 92.3% in 2003 to 87.6% in 2015[8]. In 2017, the percentage of patents granted to foreigners amounted to 90.8%. Such a trend is indicative of growth in the number of patents granted to local innovators, a substantial number of which are institutes of higher learning (IHLs) and government research institutes (GRIs). The percentage share of patents applied for by IHLs in 2012 stood at 35.1%, as compared to 15.3% for research institutes (MASTIC 2014, 133). As a substantial share of R&D is conducted in IHLs and GRIs, the number of patent applications from them is correspondingly high. From the figures, chemistry and metallurgy fields contributed a total share of 27.4% of the total granted patents between 2011 and 2015 (MOSTI 2017, 216)[9]. In 2017, the share of chemistry and metallurgy fields stands at 29.8%[10].

Trends in the share of trademark applications of local origin are also encouraging. In 2017, foreign trademarks accounted for 52.6% of total applications, with the remaining 47.4% coming from local industries[11]. With respect to industrial design, foreign applicants filed 71.5% of total applications in 2017, with Malaysian companies submitting the remaining 28.5%[12].

Despite such positive trends, Malaysia is still largely a technology user, which is reflected in the country's trade statistics. Malaysia's deficit in regard to the payment of royalties and receipts of income for the usage of IP has been widening since 2010. For example, in 2014, Malaysia earned USD75.8 million while paying out USD1,467.7 million in license fees. The trade deficit for payments and royalties of income for IP usage in 2014 amounted to USD1,392 million (MOSTI 2017, 240).

The country's poor performance on IP creation can be attributed to the modest amount of gross expenditure devoted to research and development activities (GERD). Research intensity in 2014 was at 1.3% of gross domestic product (GDP). Of this amount, a total of 45.7% or RM6.4 billion was spent by business enterprises, 8.2% (RM1.1 billion) by GRIs and another 46.1% (RM6.4 billion) by IHLs (MOSTI 2017, 81).

The discussion above of key trends in Malaysia's IP performance suggests that although the amount of local IP is growing, the aggregate amounts remain too low to be considered as embodying a major offensive trade interest. Malaysia's transition to TRIPS standards in 2000 seems to have failed to bring significant improvement in terms of the numbers of IP filings by foreigners in the country. Instead, it is the domestic policy change in the management of IP created by academic institutions and research institutes funded by the government through the Ministry of Science that spurs domestic IP creation (MOSTI 2009).

THE CPTPP AND IP REFORMS IN MALAYSIA

Will the CPTPP lead to the right regulatory reforms in Malaysia, as anticipated by the country's policymakers[13]? How well-suited are the standards contained in the CPTPP to Malaysia's current IP reality? And can the CPTPP be expected to accelerate the process of industrial development in Malaysia? These are some of the key questions that need to be answered in order to understand the benefits of the CPTPP for the Malaysian economy.

Although it is generally difficult to predict the effect of more stringent IP standards on Malaysia's industrial development, this section first discusses the possible legal implications of the CPTPP by comparing the standards contained therein with prevailing domestic standards. The chapter goes on to examine whether CPTPP standards will be beneficial to the country by imposing much needed regulatory reforms. Whereas some of the assertions may not be supported by cost-benefit analysis, the chapter will take into account existing literature on the relevance of the CPTPP's IP disciplines.

Like many previous PTAs, the CPTPP contains a list of international agreements on intellectual property rights (IPRs) to which all countries must accede. This is to ensure that the member countries abide by the same international rules. By forcing member countries to accede to the same international treaties, such provisions embed international obligations in the domestic sphere, resulting in a *de facto* harmonisation of international and domestic norms. In addition, the CPTPP recalls shared principles, such as recognition of the Doha Declaration on the TRIPS Agreement and Public Health[14].

Furthermore, it features a list of binding commitments on important issues pertaining to IP. These commitments vary from one treaty to another. The EU-Canada Comprehensive Economic and Trade Agreement, for example, has a shorter list of IP issues and a strengthened provision on geographical indications (GI). Similarly, the draft IP Chapter of the currently suspended Transatlantic Trade and Investment Partnership (TTIP), recently under negotiation by the US and the European Union (EU), was also substantially shorter than that of the CPTPP. Likewise, the Malaysia-Australia FTA (MAFTA), which entered into force on 1 January 2013, has only 12 pages of binding commitments on IPRs as opposed to about 74 pages (including the annexes) text for the CPTPP IP chapter[15].

The minimum binding obligations can be further classified into several categories. The first consists of obligations in the form of TRIPS-plus standards. Second are obligations on areas not traditionally classified as IPRs under existing treaties, such as domain names, clinical data and internet retransmission. This entails the extension of the above subject matters protected under IP under the CPTPP. The third category comprises obligations relating to the administration and management of IP which are of interest to all Contracting Parties, such as registration systems, adjudication of disputes and enforcement of rights.

Table 1 summarises the new IP standards under the CPTPP not provided for under the existing Malaysian IP laws.

We now turn to the implications of the CPTPP disciplines for two sectors: the content and pharmaceutical industries. Two standards that are important to the content industry are the copyright extension terms and the treaty's enforcement provisions. It should be noted that

Table 1. New IP Standards Introduced by the CPTPP

IP subject matter	List of concerns	Extended obligations
Trademarks	Criteria for protection	No requirement for visual perceptiveness[16] for non-traditional marks
	Well-known trademarks	No Party may require as a condition for determining that a trademark is well-known that the trademark has been registered

IP subject matter	List of concerns	Extended obligations
		in the Party or is included on a list of well-known marks or given prior recognition as a well-known trademark
	Trademark licences	No Party may require recordal of trademark licences to establish validity or as a condition for use
Domain name cybersquatting	Dispute resolution	Appropriate procedure for the settlement of disputes, based on the Uniform Domain-Name Dispute-Resolution Policy
Geographical indications	Grounds for opposition and cancellation	Likely to cause confusion with a trademark with pre-existing good faith pending application or a pre-existing trademark The geographical indication is a term customary in common language as the common name for such goods in that Party's territory
	Term customary in the common language as the common name	To take into account how consumers understand the term in that Party's territory
Patents	Measures relating to the marketing of certain pharmaceutical products	Party must provide a system to provide notice to a patent holder, give adequate time for the patent holder to seek available remedies and procedures for the timely resolution of disputes concerning the validity or infringement of the patent
	Alteration of period of protection	Shall not alter the period of test data in the event that patent protection terminates on a date earlier
Industrial design	Subject matter of protection	Availability of protection over part of an article
Copyright and related rights	Exclusive rights	No hierarchy between the various right-holders for purposes of attainment of consent, i.e. author, performer or producer of a phonogram

IP subject matter	List of concerns	Extended obligations
	Presumption of subsistence of copyright	Article 18.72(1)(b) requires Parties to provide for a presumption that copyright subsists in a work unless proved to the contrary
Enforcement	Presumptions	The validity of copyright, trademarks and patents that have been substantively examined by the competent authority
	Enforcement practices	Judicial decisions and administrative rulings shall preferably be in writing, and published Publish information on enforcement of IPRs
	Damages	Damages may include lost profits, the value of the infringed goods or services measured by the market price, or the suggested retail price Availability of pre-established damages or additional damages Damages may not be available against a non-profit library, archives, educational institution, museum or public non-commercial broadcasting entity
	Criminal liability for aiding or abetting	Article 18.77(5) requires Parties to provide for criminal liability for aiding and abetting copyright infringement
	Border measures	Judicial authorities have the authority to order for infringing goods to be destroyed without compensation of any sort Availability of court order to obtain relevant information regarding person, means of production or channels of distribution of infringing goods Goods seized or suspended as a result of border measures—the right-holder must be informed of the names of the Parties involved

IP subject matter	List of concerns	Extended obligations
		as well as of the details of the goods Ex officio border measures available for imports, exports and goods in transit Border measures applicable to goods of commercial nature sent in small consignments
	Criminal procedures and penalties	On a commercial scale includes acts carried out for commercial advantage or financial gain and significant acts, though not carried out for commercial advantage or financial gain, that have a substantial prejudicial impact on the interests of the right-holder Also applicable to wilful importation
Government use of software	Legal regulation	Adopt legal measures to ensure that government agencies only use non-infringing computer software
Internet retransmission	Compulsory licensing	May permit the retransmission of television signals (whether terrestrial, cable or satellite) on the internet without the authorisation of the right-holder or right-holders of the content of the signal

Source: Extracted from TPPA text.

the copyright extension term obligation has been suspended in the CPTPP. The relevant (and controversial) TPPA provisions pertaining to the pharmaceutical industry concerned the patent adjustment and patent extension terms, new medical use and data exclusivity. All the three provisions on the pharmaceutical sector have been suspended in the CPTPP until further notice. The discussions on these five IP obligations are still relevant, even if CPTPP is abandoned by the Malaysian government as they constitute TRIPS-plus obligations that are normally put on the negotiating table by the developed countries in PTA negotiations.

The content and pharmaceutical sectors have been chosen because of the vocal opposition they have generated in many circles on two main grounds: access to knowledge and access to medicines. These two grounds are seen by many as global human rights and are inviolable interests except on narrowly justifiable grounds (UNITAID 2014, Quigley 2015, Australian Digital Alliance n.d.). The withdrawal of the US from the TPPA and the ensuing renegotiation of what would become the CPTPP saw the suspension of all three of the above provisions. Despite such developments, it is worthwhile to analyse the implications of the above provisions had they not been set aside.

THE ECONOMIC CONTRIBUTION OF COPYRIGHT INDUSTRIES

The Malaysian film, music and television industry is highly dependent on copyrighted materials. A study by Oxford Economics measured the economic contribution of the audiovisual sector to the Malaysian economy, estimating that it contributed RM2,910 million in revenues in 2013. This represents 0.3% of GDP. The sector also contributed to economy-wide employment, with 10,994 jobs, which represents 0.1% of total employment and some RM386 million in tax revenues, equivalent to 0.2% of total tax revenues (Oxford Economics 2013).

The audiovisual sector also contributes to the economy indirectly through purchases from other industries in the country and further transactions throughout various supply chains. According to the Oxford Economics estimates, this amounts to an additional contribution to GDP of RM2,690 million (Oxford Economics 2013), supporting a further 48,800 jobs and raising RM347 million in additional tax revenues.

Even though television, cinema and radio have a high dependence on foreign content, a significant amount of local content is created in Malaysia. Oxford Economics estimated that film production in 2013 contributed RM540 million to GDP and was directly responsible for creating 2,100 jobs. In particular, the television programming and broadcasting subsectors generated RM1,637 million of activity in 2013, directly supporting an estimated 4,500 jobs while generating RM124 million in tax revenues. Taking into account aggregate (i.e. direct and induced effects), the sector contributes RM3,764 million in GDP terms, accounting for 40,200 jobs and RM391 million in tax receipts.

Most encouraging is that a number of local productions have found an audience in foreign markets, and not only within diaspora networks. Notable Malaysian achievements that have had an impact worldwide include the animated feature *Geng: The Adventure Begins*, *War of the Worlds: Goliath* (a US-Korean co-production), *Saladin* (co-produced with Qatar/Al Jazeera), *Seefood* (co-production with Qatar) and *Bo Boi Boy*, all examples of home-grown IP content. Despite the economic value of productions by the Malaysian audiovisual industry, it is generally not considered to represent a major export interest. The TPPA featured a provision aimed at extending copyright protection to 70 years beyond the lifetime. While this provision has been suspended under the CPTPP, it was the cause of considerable concern to Malaysians, as discussed below.

Copyright Extension Terms

The harmonisation of copyright terms has been the subject of many international IP treaties. In 1886, the Berne Convention for the Protection of Literary and Artistic Works set the copyright term at lifetime plus 50 years for works of authorship and 50 years after publication for related rights or neighbouring rights. A century later, the copyright term in Europe was increased to 70 years. The change was effected on 29 October 1993, through Directive 93/98/CEE of the Council of the European Union. The Directive harmonised the term of exclusivity in copyright and related rights in Europe with effect from July 1995. In April 2009, the European Parliament approved the extension of the copyright term for music recordings from 50 to 70 years. The US followed suit. Through the Sonny Bono Copyright Term Extension Act of 1998, copyright was extended to lifetime plus 70 years, in line with the provisions of the EU.

Not surprisingly, one of the obligations under the TPPA concerned the extension of the copyright term. The adoption of a longer copyright term may not necessarily be in the interest of all signatories, and can be especially detrimental for an IP-dependent country like Malaysia. Setting the right term for copyright is essential in order to strike the delicate balance between two considerations:

- Broader and longer protection terms increase the returns to creators of new works and, in the long term, may encourage more creative work.
- Narrower and shorter protection terms increase the use of existing creative work and hence, increase the benefit to end-users. They may also facilitate new creations that build upon earlier work (Png and Wang 2006).

Copyright covers a wide range of subject matters and this raises the question of which works will endure long enough to benefit from extended copyright terms. Works like film, sound recordings and books may continue to have a market long after they are published or produced. This is so provided the film and sound recordings are continuously reformatted for viewing and listening using state-of-the-art technology and devices. Books may be reprinted again and again as long as there is sufficient demand to be met. Software, which becomes quickly outdated, however, requires a different analysis. The extension of copyright terms could therefore boost the production of new software, but this does not mean that the copyright owner will receive revenue for longer.

Economists have tried to measure the effect of copyright terms on the future production of copyrighted works. In one such study, Png and Wang (2006) found that on average, the extension of copyright terms was associated with an increase in film production ranging between 8.5% and 10.4%. These estimates are based on earlier findings that films and books have long-lasting commercial value. Liebowitz and Margolis (2005) further noted that, of the books published in the 1920s, 41% were still in print several decades later.

The idea is that if there is no commercial value in a given work long before the copyright term expires, then there is clearly no value in increasing copyright duration. The optimal duration of copyright protection is not easy to determine empirically. Pollock (2009) for example, found that:

a) The optimal copyright duration is likely to decrease as the production costs of 'originals' decline (for example as a result of digitisation); and
b) The optimal duration of copyright will, in general, decrease over time.

With advances in technology, the costs of production and distribution of most copyrighted goods have been substantially reduced. Naturally, this will reduce the optimal duration of a copyright and overly long copyright terms may lead to deadweight losses, reducing welfare (Pollock 2009). Based on his calculations, Pollock (2009) considered that the optimal copyright duration was around 15 years, which is substantially shorter than any current copyright term.

While economists debate the right method to measure the impact of copyright protection on the supply of new copyrighted works (Watt 2009), some critics evoke the social function of copyright as a basis for arguing against lengthy copyright terms. The faster copyright works get into the public domain, the more resources are available for others to build on them. Excessive protection can stifle cultural output, particularly in developing countries that consume a high percentage of imported (foreign) content.

The TPPA mandated an extension of copyright up to 70 years from the date of the publication of the work, performance or sound recording, or from the date of the creation or performance of the work for unpublished work. Such a mandated lifetime is prohibitively long for Malaysia, which has a small copyright industry. On this point, the Institute of Strategic and International Studies (ISIS) Report conceded that such an obligation would prove costly in Malaysia (generating net costs over benefits) since the country was a net content consumer (ISIS 2015). Although Malaysia had been granted a transition period of 4 years to implement such an obligation, this period is arguably too short to see a real growth in the industry. Even in the US, critics[17] argue that 70 years is simply too long a copyright term. It is no wonder that copyright extension ranked among the most contentious IP issues in the TPPA and CPTPP negotiations. Indeed, the controversy was such as to lead the CPTPP-11 signatories to suspend its inclusion in the Agreement.

Enforcement

The enforcement provisions envisaged under the CPTPP have been described as "capable of rewriting the global rules on enforcement" (Cox 2014). The TPPA provisions on enforcement stands as they have not been suspended under the CPTPP. Among the most controversial is the provision that would make border measures applicable to prevent

not only the exportation of infringing goods but also the importation of such goods as well as in-transit goods. Criminal procedures and penalties are applicable not only for acts carried out for commercial advantage but also for significant acts which, while not carried out for commercial advantage or financial gain, can still impart a substantial prejudice on the copyright owner. Further, in determining whether products are counterfeit trademark goods or copyright infringing goods, the law of the Party stipulating the procedures determines the applicable legal regime. This means that products which are neither counterfeit nor infringing in their country of origin or destination may still be confiscated if, in the country of transit, these goods are considered as manufactured or made without the consent of the trademark or copyright owner in that country. Equally controversial is that damages are available against innocent infringers who may have reasonable grounds to know that they have engaged in infringing activity, which goes against the normal rule of damages, i.e. they are available only upon proof of harm[18]. Commercial scale has been defined to include acts carried out not for commercial or financial advantage, which nevertheless have an impact on the copyright owner's interests. These acts, however, have to be substantial in nature and impacts must be substantial and prejudicial to them. Criminal procedures are also applicable to the performance of cinematographic works in a movie theatre. This chapter focuses on methods of assessment of damages which are seen to be heavily biased towards the copyright owner's interests. In the assessment of damages, the TPPA would have mandated the Parties to pay damages to the right-holder commensurate with the injury suffered. Suggestions as to what amounts to a 'legitimate measure' of value include lost profits, the value of the infringed goods or services measured by the market, or suggested retail price. Cox (2014) questions the setting of damages based on suggested retail prices, which, in her view, would overcompensate IP owners (Cox 2014). Suggested retail prices generally cover other costs, including production and overheads, which the right-holder would have paid in the ordinary sale of the product. She further cautions that, in developing countries, prices for branded products are often higher than for other products.

Further, the TPPA would have mandated Parties to provide pre-established damages. Such pre-established damages should be sufficient to compensate right-holders for the harm caused by the infringement, with a view to deterring future infringement. The issue of sufficiency of

damages is a contentious one. The traditional notion of damages is to put the right-holder in the position he or she would have been in had the infringement not taken place. In a normal assessment of damages, the actual harm suffered by the plaintiff must be proved. However, in the context of serious counterfeiting and copyright infringements, the cost incurred by the infringer and the income collected from the infringement is difficult to assess with certainty. At best it will be a rough approximation of the compensation due to actual harm or loss of profits.

In addition, such assessments of damages are often considered inadequate in the context of IP infringement as the IP owner has to bear the consequential costs of investigating, taking legal action and rectifying the infringement. As a result, counterfeiters would have an economic incentive to engage in counterfeiting and absorb the cost of damages as part of their operating costs. The recurring notion is that damages must also be high enough to discourage both repeat and would-be infringers. In other words, the amount of damages should be a strong enough deterrent to stop future infringements not only by the infringer but also by would-be infringers[19].

Samuelson, Hill and Wheatland (2013) questioned the US's move to export its statutory damages regime to other countries either through bilateral trade agreements or mega-regional ones like the TPPA. They noted that the US practice of awarding statutory damages has often been criticised as "arbitrary, inconsistent, unprincipled, and sometimes grossly excessive". They further noted that statutory damages under the TPPA would go beyond what is being practised in the US. For example, the provision does not envisage any reduced awards for innocent infringers. Furthermore, limitations contained in the US law are not incorporated into the TPPA text. This includes the remittance of damages in cases involving educational institutions, libraries and museums.

In Malaysia, statutory damages were introduced for copyright infringement via an amendment in 2012. Statutory damages are a form of pre-established damage made available as an option to the copyright owner when calculating the correct sum for damages is not feasible. However, unlike the US practice, the Malaysian Copyright Act 1987 stipulates the maximum amount of statutory damages instead of the minimum. This ensures that copyright owners do not over-calculate the predetermined

damages. Under section 37(1) (d) of the Copyright Act 1987, statutory damages should not be more than twenty-five thousand ringgit for each work, and no more than five hundred thousand ringgit in aggregate. In addition, the court must take into account several factors listed in the statute. These include:

a) The nature and purpose of the infringing or prohibited act, including whether the infringing or prohibited act was of a commercial nature or otherwise;
b) The flagrancy of the infringement or prohibited act;
c) Whether the defendant acted in bad faith;
d) Any loss that the plaintiff has suffered or is likely to suffer by reason of the infringement or prohibited act;
e) Any benefit shown to have accrued to the defendant by reason of the infringement or prohibited act;
f) The conduct of the parties before and during the proceedings;
g) The need to deter other similar infringement or prohibited act; and
h) All other relevant matters.

This non-exhaustive list of criteria offers guidance to the court in making its assessment as to whether statutory damages should be granted to the plaintiffs.

In Samuelson *et al.*'s view, provisions that set limits on the amount of statutory damages limit the imprecision, arbitrariness and excessiveness that might arise in the assessment of awards. The language of the TPPA text was broader. It gave judicial authorities the authority to award such additional damages as they considered appropriate, having regard to all relevant matters, including the nature of the infringing conduct and the need to deter similar infringements in the future. These statutory limitations may be considered by the US as unnecessary restrictions on the copyright owner's right to punitive damages in the form of pre-established damages.

The TPPA language, therefore, calls into question the wisdom of straying too far from the usual rule of damages in the context of IP infringement. Is the harm caused by IP infringement so deleterious to society that it justifies the awarding of damages to the copyright owner beyond what can be proven by normal rule; or beyond the wilful infringement standard? These are some of the key concerns that have

been raised in response to the TPPA's proposal to enhance damages for IP infringement (Cox 2014, Samuelson, Hill and Wheatland 2013). The TPPA provisions on enforcement stands as they have not been suspended under the CPTPP.

THE PHARMACEUTICAL SECTOR AND THE PATENT SECTION OF THE CPTPP

The pharmaceutical sector is earmarked for promotion under the National Key Economic Area. In particular, Malaysia is focusing on halal pharmaceutical markets and leveraging its local expertise with halal products to tap into the markets of member countries of the Organisation of Islamic Cooperation (OIC). Although pharmaceutical goods manufactured for the Malaysian market have found their way into export markets, the Malaysian market is essentially dominated by imports. Pharmaceutical goods exports are essentially generic products and Malaysia is banking on expanding its generics industry.

The TPPA, the predecessor to the CPTPP, featured numerous provisions which enhanced the position of patent owners with respect to pharmaceutical products. The ISIS Report does not regard TPPA provisions on pharmaceutical patents as materially affecting the competitiveness of local generic manufacturers (ISIS 2015), as local manufacturers do not have much interest in exporting to TPPA Parties. This appears to make little sense as it suggests that Malaysia would be willing to curtail its export market in non-TPPA member countries, thus reducing the size of export markets for local products. The following sections discuss some of the provisions relating to pharmaceuticals, including the patent adjustment term, patent extension term, new medical use and data exclusivity.

Patent Term Adjustment and Patent Term Extension

The TPPA recommended the adjustment and extension of patent terms to compensate patent holders for unreasonable delays in the granting of patents as well as to compensate patentees for delays during the marketing and regulatory approval process. A provision on the extension of patent terms was actually introduced in the US through the Drug Price Competition and Patent Term Restoration Act of 1984, Pub.

L. No. 98-417, 98 Stat. 1585 (codified at 21 U.S.C. 355 (b), (j), (l)). The objective was to compensate patent owners for delays that occurred as a result of having to wait for approval from the regulatory authorities for the marketing of a drug—a delay which was viewed as shortening the effective term of protection enjoyed by the product.

The obligation to provide patent extension terms is not seen to be a major concern in Malaysia, principally because the Drug Control Authority has shown considerable efficiency in its approval process. Malaysia is a member of the Pharmaceutical Inspection Co-operation Scheme (PIC/S) and has the competence to conduct inspections to an international standard. Thanks to its online product registration system, there is little risk of delay in approval for the marketing of drugs in Malaysia.

Similarly, the provision on patent term adjustment may not cause undue concern in Malaysia. Several amendments have been made to reduce the pendency period of patents in Malaysia and an expedited examination process has been introduced. However, there can be no guarantee that all patents will be granted within four or five years from the date of filing of the application or two to three years after the request for examination by the patent applicant has been made, as was stipulated under the TPPA.

Both the patent adjustment and extension terms are seen by many as a covert attempt to extend the lifespan of patented drugs. As Malaysia's growth in pharmaceuticals is largely based on the production of generic drugs, extending the lifespan of patented drugs would be counter-productive for local industry. Not only will the move delay the entry of generics into the domestic market and increase healthcare costs, it will also impede the growth of the country's generics industry. It is therefore to Malaysia's advantage that the TPPA provisions on patent adjustment and extension terms were suspended by the CPTPP signatories.

New Medical Use

The expansion of patents on medicines to new uses and new forms was another highly controversial TPPA provision. This was suggested in response to the practice of some countries of restricting patent applications for products that are merely modifications showing little or no therapeutic difference from existing patented ones. Scholars

disagree over the precise nature of new medical inventions and usage and when they should be eligible for patenting. The experience of the United Kingdom and the EU illustrates that even a change in dosage may amount to a new medical use.

Under the TPPA, the US and Japan proposed that a patent be granted when a patentee's invention exhibits a distinguishing feature that makes the product novel, even if the product does not offer enhanced therapeutic efficacy. Such a standard relates to the notion of evergreening, which in turn refers to the strategies adopted by pharmaceutical companies seeking patents on variations of an original drug. These products, which are also known as follow-on drugs, are either in the form of new releases, new dosages, new combinations or variations, or new forms. For example, an extended-release form of a known drug might be conferred a patent even though such a delivery method has been available for decades. Arguably, allowing evergreening represents a major distortion of the patent principle, which only allows the patenting of inventions that are truly inventive. It also delays the entry of generic drugs into the market and assists drug companies to maintain their market share. Critics have linked evergreening to escalating healthcare costs (Vernaz *et al*. 2013, Kesselheim 2013).

The widespread practice of second (or further) medical use in the pharmaceutical industry has resulted in allegations of evergreening in order to extend the patent life of pharmaceutical products. This is exacerbated by the fact that the TRIPS Agreement does not cover second medical use, thus neither explicitly allows nor forbids this practice.

In Europe, claims of the benefits of improved dosages have routinely been allowed. For example, in Abbott Respiratory/Dosage Regime[20], the Enlarged Board of Appeal held that patenting was possible even where the only novel feature of a treatment was the dosage regime.

The widespread filing of second and further medical use claims by pharmaceutical companies has met resistance from some countries. In India, the Patents Act specifically disallows the patenting of second medical use. Section 3 (d) of the country's Patents Act provides that:

> "… the mere discovery of a new form of a known substance which does not result in the enhancement of the known efficacy of that substance or the mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant.
>
> For the purposes of this clause, salts, esters, ethers, polymorphs, metabolites, pure form, particle size, isomers, mixtures of isomers, complexes, combinations and other derivatives of known substance shall be considered to be the same substance, unless they differ significantly in properties with regard to efficacy."

Not surprisingly, the Indian law has aroused much dissatisfaction among leading pharmaceutical companies. In one of the test cases, Novartis applied for a patent for 'Glivec' (imatinib mesylate), a cancer drug. Novartis claimed that the increased bioavailability of the salt form of imatinib meant increased efficacy, entitling the company to a patent on imatinib mesylate. The Indian Patent Office rejected the application[21]. Novartis brought the case before the country's High Court. The Madras High Court rejected Novartis's case on the basis that efficacy means 'therapeutic effect in healing a disease'.

The main reason behind the reluctance to allow the patenting of second medical use is the high (and rising) cost of patented drugs. It was noted during the trial in India that treatment with Glivec implied monthly costs of USD2,500 "a sum that the vast majority of Indians simply cannot afford", whereas local generic versions were available for around 10% of the price of Glivec.

Novartis appealed to the Indian Patent Appellate Board. The Board held that the salt form of imatinib mesylate did not pass the test of therapeutic efficacy, and therefore confirmed the rejection of Novartis's patent application. Novartis further appealed to the Supreme Court. On appeal, the presiding judge expressed doubt that imatinib mesylate was a new product as it was a known product from an earlier US patent[22]. The Indian Supreme Court Judge further observed:

> "It may be seen that the word 'efficacy' is used both in the text added to the substantive provision as also in the explanation added to the provision.

> What is 'efficacy'? Efficacy means; 1. 'the ability to produce a desired or intended result'. Hence, the test of efficacy in the context of section 3(d) would be different, depending upon the result the product under consideration is desired or intended to produce. In other words, the test of efficacy would depend upon the function, utility or the purpose of the product under consideration. Therefore, in the case of a medicine that claims to cure a disease, the test of efficacy can only be 'therapeutic efficacy'. The question then arises, what would be the parameter of therapeutic efficacy and what are the advantages and benefits that may be taken into account for determining the enhancement of therapeutic efficacy? With regard to the genesis of section 3(d), and more particularly the circumstances in which section 3(d) was amended to make it even more constrictive than before, we have no doubt that the 'therapeutic efficacy' of a medicine must be judged strictly and narrowly. Our inference that the test of enhanced efficacy in case of chemical substances, especially medicine, should receive a narrow and strict interpretation is based not only on external factors but there are sufficient internal evidence that leads to the same view. It may be noted that the text added to section 3(d) by the 2005 amendment lays down the condition of 'enhancement of the known efficacy'. Further, the explanation requires the derivative to 'differ significantly in properties with regard to efficacy'. What is evident, therefore, is that not all advantageous or beneficial properties are relevant, but only such properties that directly relate to efficacy, which in case of medicine, as seen above, is its therapeutic efficacy."[23]

In Argentina, a set of guidelines for the examination of patent applications for pharmaceutical inventions was approved. These guidelines enable patent examiners to reject new use, new form and new formulation patents. They also disallow claims which constitute a mere reformulation without any credible new inventive effect[24].

The Indian and Argentinian practices offer examples of countries that have taken overt action to restrict evergreening. If allowed under the CPTPP, evergreening would extend the monopoly rights enjoyed by patent owners and delay the entry of generics into the market, with adverse effects on consumers and healthcare spending.

Unitaid (2014) raised the concern that the TPPA provisions effectively constrain signatories from adopting provisions that implement a high threshold of patentability with regard to new uses and new forms of old medicines. Allowing evergreening would enable patent holders

to extend their periods of exclusivity for a product through successive modifications of its use and form (Unitaid 2014). It is therefore to Malaysia's benefit that this provision was suspended under the CPTPP.

Data Exclusivity

The TPPA required the protection of pharmaceutical data for at least five years from the date of the marketing approval of a new pharmaceutical product in the territory where the approval was sought. Pharmaceutical companies require clinical data exclusivity as it provides market exclusivity in addition to the patent, if the product is patented. As clinical data protection commences from the date of marketing approval of a particular drug, it is not dependent on a patent being granted and is equally available for non-patented drugs. Clinical data exclusivity is one way of delaying the entry of competing products into the market as any competitor is forced to conduct its own clinical trial if it wants its product to enter the market more quickly.

Malaysia practices its own data exclusivity regime. To enjoy a five-year data exclusivity period, a drug manufacturer has to obtain marketing approval in Malaysia within 18 months of product approval. The five-year period commences from the date the product is first marketed in the country of origin. The 18-month window forces the drug manufacturer to enter the Malaysian market as quickly as possible so as not to lose the five-year exclusivity. As the period runs from the date of marketing in the country of origin, the data exclusivity period enjoyed in Malaysia is actually shorter than five years. The TPPA text, however, proposed to circumvent such a practice by mandating that the data exclusivity period starts from the date of marketing in the country where marketing approval is sought. Such a provision would thus negate the existing data exclusivity practices followed by the Ministry of Health in Malaysia, resulting once more in greater health expenditures. Opportunely for Malaysia, this provision is also suspended under the CPTTP.

Biologics

The five-year data exclusivity period described above is for original drugs. For biologics[25], the TPPA provides for a maximum of eight years from the date of first marketing approval in Malaysia or five

years combined with other measures. Biologics include a wide range of products used for medical treatment that are derived from natural resources, whether human, animal or microbial, and are produced by biotechnology methods. Such products include vaccines, blood and blood components, allergenics, somatic cells, gene therapy, tissues and recombinant therapeutic proteins.

As biotechnology is one of the most research-intensive industries, the US Congress introduced a data exclusivity period of at least 12 years for innovative biologic drugs in the US. This move was the result of research by US economists demonstrating that developers of biologics required 12 – 15 years to break even on their investments. Under this system, the US Food and Drug Administration (FDA) will not approve a biosimilar that relies on prior FDA approval of the innovator's product until the term of data exclusivity is over. This is intended to provide a period of market exclusivity to the innovator during which to recoup the costs of R&D. As a result, companies that want to develop products will have to do their own clinical studies to prove their product's safety and efficacy if they wish to secure approval from the relevant regulatory body. Otherwise, they would have to wait until the expiration of the 12-year data exclusivity period.

In Malaysia, the registration of biosimilars is subject to the Ministry of Health's Guidelines for the Registration of Biosimilars[26]. Biologics in the guidelines refer to "biologics drug submission in which the manufacturer would, based on demonstrated similarity to a reference medicinal product, rely in part on publicly available information from a previously approved biologic drug in order to present a reduced non-clinical and clinical package in the context of a submission."[27] As is made clear in the Guidelines, the manufacturer of biologics will rely on the clinical data submitted by a previous biologics manufacturer in seeking approval for marketing as a biosimilar. The Guidelines state that the position of biosimilars is not comparable to that of generics. However, the marketing approval of biosimilars depends substantially on whether the product is similar to a reference product. In that sense, reliance on the data submitted by the biologics developer would be necessary for the assessment of the similarity in terms of quality, safety and efficacy. If the TPPA provisions were accepted, the clinical data on biologics would be subject to data exclusivity protection for a maximum period of 12 years. This would substantially delay the entry of biosimilars into the market.

What would be the consequence of the delay in the entry of biosimilars into the market? Would the situation be the same as for generic drugs? Gleeson, Lopert and Moir (2014) question the rationale of giving extended protection to biologics because such lengthy periods are not necessary to spur innovation. They claim that the distinction between biologics and other pharmaceutical drugs is not tenable and that the provision would cost the Australian Treasury several hundred million dollars each year (Gleeson, Lopert and Moir 2014).

Data exclusivity obligations for biologics is an entirely new concept for Malaysia as the current directive on data exclusivity is only applicable to new pharmaceutical products containing a new chemical entity (ISIS 2015). Malaysia has identified biologics as an area of future growth for the local pharmaceutical industry. The treaty obligation would therefore constrain Malaysia's projected expansion of the country's highly R&D-intensive biotechnology sector. The negative impact of the data exclusivity for biologics was noted by the Ministry of Trade and Industry (MITI) as "regulatory approval for the sale of biologics is usually granted late into the patent extension term" (ISIS 2015). However, MITI foresees no significant impact on the local pharmaceutical industry given that it currently lacks the necessary capital and technological capacity to produce biosimilars (ISIS 2015). This demonstrates Malaysia's willingness to curtail the future expansion of the R&D of its pharmaceutical industry simply on the basis of its current state of play.

The controversial extended patent standards examined in this chapter raise serious concerns as to whether committing to the TPPA-like provisions would be in the interests of Malaysia. With regard to both copyright and patents, the treaty's IP obligations raise a greater number of defensive concerns than respond to offensive Malaysian interests. Where would be the real trade-offs envisioned by policymakers in the CPTPP? Does Malaysia really have a choice in terms of proposing standards that would be commensurate with its level of economic development? These are serious but valid concerns regarding the IP standards initially envisaged under the TPPA. It is therefore heartening for Malaysia that most of the controversial copyright and patent provisions discussed in this chapter and proposed for inclusion in the TPPA have been suspended under the CPTPP.

IMPLICATIONS OF THE CPTPP'S IP PROVISIONS FOR MALAYSIA'S PARTICIPATION IN GLOBAL VALUE CHAINS

In what ways can the CPTPP's IP provisions improve Malaysia's participation in global and regional value chains in innovation-rich sectors? Would the CPTPP help to accelerate Malaysia's move up the value chain in sectors deemed to be priorities for the country's development? Can the regulatory reforms implied by the CPTPP create a legal environment conducive to boosting the growth of Malaysia's priority sectors? Can they provide added incentives for local companies to gain a competitive advantage? These are difficult questions to which definitive answers are equally difficult to provide.

Although a PTA of the CPTPP's magnitude may confer substantial economic advantages to the manufacturing and service sectors, especially for production and exports, little can be said with certainty in relation to IP rights. As Malaysia moves from high-volume, low-cost products to knowledge- and innovation-based products and services, there is a greater need for technology acquisition and this could well be hampered by the TRIPS-plus standards embedded in the CPTPP. Unless Malaysia focuses on developing local innovations, products and services that can be inserted into higher value global or regional value chains, the CPTPP's IP provisions contain little that appears *prima facie* supportive of this policy aim. Malaysia can no longer compete on cost for some manufactured products owing to the emergence of other low-cost manufacturing locations in its immediate neighbourhood and beyond. It is not likely that the CPTPP's IP provisions would enhance Malaysia's competitive advantages *vis-à-vis* such competitors. However, strengthened IP provisions, together with enhanced investment protection standards, may help to attract foreign direct investment from the more advanced manufacturers that prefer a jurisdiction which maintains strong standards of IP rights, on the basis that jurisdictions that lack such rights may pose a risk of misappropriation of IP processes or products. Unfortunately, there is scant evidence of that happening in Malaysia, even after the incorporation of TRIPS standards in the early 2000s. The above concerns are somewhat allayed to the extent that most of the TRIPS-plus provisions proposed for inclusion in the TPPA have been suspended in the CPTPP. The gain from the new provisions of CPTPP, however, remains to be seen.

Would adopting CPTPP standards on IP reverse the general reluctance shown by multinational corporations to share or at least perform higher level research in Malaysia? This is an even harder question as the behaviour of multinational corporations is difficult to predict and highly sector-specific, especially within fragmented value chains (OECD 2012). Whilst it is important to have an IP system that is based on global standards to lure investors into the country, there is little evidence that TRIPS-plus provisions would be luring them by the droves.

Despite some of the TRIPS-plus IP provisions under the TPPA have been suspended under the new CPTPP, and the possibility that the CPTPP may even be abandoned by Malaysia under the new government, there is still a real danger that these provisions will be reactivated through other PTAs. These platinum IPR standards are the darlings of the developed countries. It has been reported that the currently negotiated RCEP Agreement contains TRIPS-plus provisions such as patent term restoration, protection of test data, enforcement measures and certain civil and criminal liability such as criminal liability for aiding and abetting[28]. As such, it is important to understand the position that Malaysia may land in if these TRIPS-plus provisions were to be agreed upon in future trade treaties.

Endnotes

[1]The author would like to thank Nurul Aina Hayati Mohd Sharir for her assistance in updating data in this chapter.

[2]The Bilateral PTAs are: (1) Malaysia-Japan Economic Partnership Agreement (MJEPA) (2) Malaysia-Pakistan Closer Economic Partnership Agreement (MPCEPA) (3) Malaysia-New Zealand Free Trade Agreement (MNZFTA) (4) Malaysia-India Comprehensive Economic Cooperation Agreement (MICECA) (5) Malaysia-Chile Free Trade Agreement (MCFTA) (6) Malaysia-Australia Free Trade Agreement (7) Malaysia- Turkey Free Trade Agreement. The Regional PTAs are (1) ASEAN-China FTAs (2) ASEAN-Korea FTAs (3) ASEAN-Japan Comprehensive Economic Partnership (4) ASEAN-Australia- New Zealand FTA (5) ASEAN-India FTA (6) ASEAN-Hong Kong (7) ASEAN Trade in Goods Agreement; available at http://www.miti.gov.my

[3]Available online at https://www.kpdnkk.gov.my/kpdnkk/harta-intelek/?lang=en (accessed August 24, 2018).

[4]Data from the Malaysian Intellectual Property Office's web site available online at www.myipo.gov.my (accessed August 24, 2018).

[5]In 2014, University Sains Malaysia was overtaken by University Putra Malaysia with a total of 133 patents. See Bibliometrics Study (2015) (MOSTI 2016, 76).

[6]MIMOS Berhad is Malaysia's R&D centre for ICT under the purview of Ministry of Science, Technology and Innovation. It was first set up as the Malaysian Institute of Microelectronic Systems in 1985.

[7]See also Bibliometrics Study (2015) (MOSTI 2016, 78), where it was reported that as of 2014, MIMOS had filed a total of 788 patents under PCT.

[8]Data from the Malaysian Intellectual Property Office's website available online at www.myipo.gov.my (accessed October 24, 2016).

[9]Data from the Malaysian Intellectual Property Office's web site available online at www.myipo.gov.my (accessed October 3, 2016).

[10]Data from the Malaysian Intellectual Property Office's web site available online at www.myipo.gov.my (accessed August 24, 2018).

[11]Data from the Malaysian Intellectual Property Office's web site available online at www.myipo.gov.my (accessed August 24, 2018).

[12]Data from the Malaysian Intellectual Property Office's web site available online at www.myipo.gov.my (accessed August 24, 2018).

[13]Najib: Malaysia pursuing FTA, CPTPP to boost trade, *The Star Online*, Oct 16, 2014, available online at https://www.thestar.com.my/news/nation/2014/10/16/najib-fta-tppa/

[14]https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_trips_e.htm.

[15]Following the decision of the US government to withdraw from the TPPA, the agreement was renegotiated and the bulk of the TPPA's most contentious IP provisions were suspended.

[16]This refers to the ability of the mark to be perceived visually. There may be marks that are not visually perceptible but capable of distinguishing goods and services. Examples of such marks are sound marks, olfactory marks, taste marks and texture or feel marks. The challenge with these types of marks is to describe them sufficiently for the purposes of registration.

[17]Among others, Public Knowledge 2016.

[18]Innocent infringement occurs when someone engages in infringing activity not knowing that her conduct constitutes infringement.

[19]See the report prepared by European Observatory on Counterfeiting and Piracy. Accessed August 7, 2015. http://ec.europa.eu/internal_market/iprenforcement/docs/damages_en.pdf

[20][2010] EPOR 26.

[21]Civil Appeal No 2706-2716 of 2013. Accessed August 7, 2015. http://supremecourtofindia.nic.in/outtoday/patent.pdf.

[22]In the learned Justice's view, "the beta crystalline form of imatinib mesylate is a new form of a known substance of which the efficacy is well known. The beta crystalline form of imatinib mesylate certainly cannot be said to possess enhanced efficacy compared with imatinib mesylate."

[23]Paras 179 and 180 of the reported judgment.

[24]Joint Resolution 118/2012, 546/2012 and 107/2012 (Ministry of Industry, Ministry of Health and National Industrial Property Institute), "Don't trade our lives away, Argentina adopts guidelines to examine patent applications for pharmaceuticals." Accessed 7 August 2015. https://donttradeourlivesaway.wordpress.com/2012/05/31/argentina-adopts-guidelines-to-examine-patent-applications-for-pharmaceuticals/. In the Guidelines, the following claims are not allowed: polymorphs; pseudopolymorphs; enantiomers; Markush-type formula; selection patent; salts, esters and other derivatives of known substances; active metabolites; prodrugs; formulations and compositions; combinations; dosage/dose; second medical indication (new medical uses) and analogous processes.

[25]Biologics are medicinal preparations made from living organisms and their products, including serums, vaccines, antigens, antitoxins etc.

[26]Biotechnology Section, Centre for Product Registration, National Pharmaceutical Product Bureau, Ministry of Health Malaysia, August 2008. Accessed August 7 2015. http://www.moh.gov.my/.

[27]Guidelines for Registration of Bio-similars in Malaysia, para 1.3.

[28]This is based on leaked text of RCEP by Wikileaks, available online at https://www.keionline.org/23060

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7

Government Procurement in Preferential Trade Agreements: Key Considerations for Malaysia

Junaidi Mansor[1]

INTRODUCTION

The day-to-day administration and operation of governments require the purchase and use of a wide array of goods and services. Similar to private entities and businesses, governments procure these goods and services from the market. Goods procured range from stationery to complex transactions, such as the construction of a dam or the building of warships. The amount of goods and services procured by governments is influenced by various factors, such as the breadth and depth of the legal and social obligations of governments to provide them, the level of growth in the economy, and the socio-political leanings of governments. This chapter first explores the regulation of government procurement in the international trade arena, recalling the principles and objectives that influence the evolution of the regulatory framework on government procurement, both internationally and domestically. Based on these observations, the chapter then looks at the challenges that Malaysia would need to consider in liberalising its government procurement market through preferential trade agreements (PTAs).

BACKGROUND

As a trading nation, Malaysia considers PTAs an important tool to increase two-way trade and investment ties with key trading partners, enhance the competitiveness of Malaysian exporters and expand choices for consumers. Malaysia became a signatory of the General Agreement on Tariffs and Trade (GATT) shortly after gaining independence in 1957, and has been a Member of the World Trade Organization (WTO) since the body was established in 1995. Malaysia's foray into PTAs started much later, with a first bilateral trade agreement with Japan in 2005 (MITI 2014). Since then, Malaysia has concluded 14 PTAs, seven with bilateral partners, and seven through its membership of the Association of Southeast Asian Nations (ASEAN) (see Table 1).

While Malaysia continues to liberalise its trade either unilaterally, through PTAs, or multilaterally through the WTO, the country's government procurement market is to this day excluded from binding

Table 1. Malaysia's Bilateral and Regional PTAs

Bilateral PTAs	Regional PTAs
Malaysia-Japan (2006)	ASEAN Free Trade Area (1992)
Malaysia-Pakistan (2008)	ASEAN-India (2003)
Malaysia-New Zealand (2010)	ASEAN-Korea (2006)
Malaysia-India (2011)	ASEAN-Japan (2009)
Malaysia-Chile (2012)	ASEAN-China (2010)
Malaysia-Australia (2013)	ASEAN-Australia and New Zealand (2010)
Malaysia-Turkey (2015)	ASEAN-Hong Kong (2017)

Source: MITI (2010).

commitments under PTAs and the WTO's plurilateral Government Procurement Agreement (GPA) of which Malaysia is not a signatory but for which it secured the status of observer in 2012[2]. Malaysia's first effort to liberalise its government procurement market through a PTA was in 2006 during the negotiations of the Malaysia-United States (US) Free Trade Agreement (MUSFTA). Disagreements, particularly on policy exclusions for government procurement such as the broad application of preferential treatment under the *Bumiputera* policy, led

to the subsequent abandonment of the negotiations[3]. However, this position was revisited with Malaysia's participation in the Trans-Pacific Partnership Agreement (TPPA; subsequently the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP)) and in the Malaysia-European Union Free Trade Agreement (MEUFTA) negotiations[4]. Malaysia successfully concluded the TPPA in 2015; the agreement is now known as the CPTPP following the decision by the US government to withdraw from the original agreement.

WHY REGULATE? THE ECONOMICS AND LAW OF GOVERNMENT PROCUREMENT

The Economics of Government Procurement

Governments procure goods and services for two main reasons. One is for their own internal consumption, such as stationery, office furniture and services such as legal, accounting and financial services. These are general consumer goods and services openly available in the market that can be procured at home or abroad. As the central economic theme for government procurement is cost-efficiency by procuring the best quality product at the lowest price, procuring general consumer goods and services through open tendering may easily satisfy this objective.

The other type of procurement is for the consumption of the public at large, such as the bulk purchase of medicines for the country's healthcare system, as well as infrastructure such as schools and hospitals—mainly products that share public good characteristics. From an economic perspective, there could be some form of market imperfection or failure as the government may not always be able to gauge the exact price or value of such goods or services.

The economics of demand and supply placed the value or price on goods and services based on the satisfaction arising from consumption (Begg *et al*. 2014). However, government procurement processes depart from this system from a number of angles. Firstly, government as the purchaser may have purchasing objectives and satisfaction criteria that differ from those of private agents. Often, the government is also not the final consumer. The fact that procurement and consumption are divorced from one another complicates attempts by governments to place a value or price on the goods or services it procures.

Secondly, government purchases are funded through taxpayers' money and guided by various socio-economic, industrial or political objectives. For these reasons, the value placed on the goods or services being procured may differ in terms of the satisfaction gained from the purchases. The value placed on them by the government will typically be influenced by the ability of the procurement decision to fulfil specific policy objectives rather than being guided solely by cost-efficiency considerations.

Thirdly, government procurement decisions are rarely if ever based on perfect information even for products for which information on prices is widely available. This is because government procurement is undertaken based on the annual procurement planning and budget allocation of public entities at the time when the budgets are developed and approved. Therefore, market prices could have changed by the time an actual procurement transaction takes place. Prices are often guided by general observations of prices as provided by a panel of suppliers or from previous contracts. This means that budgetary allocations and the amount of procurement are commonly based on past information and, therefore, the final price may not always be consistent with market prices.

To close these gaps, government procurement disciplines are design to reflect perfectly competitive market conditions to the extent that this is possible (Trepte 2004). Open tendering, for example, aims to reach all potential suppliers through a notification process, and the most efficient suppliers are chosen based on lowest cost. Similarly, transparency can contribute towards greater alignment between the government's needs and market offerings.

If government procurement disciplines could contribute towards economic efficiency, why are there interventions by governments that depart from such disciplines? The reasoning behind this can be analysed from a broader macroeconomic and political economy perspective. The calculation of a country's gross domestic product (GDP) includes the amount of government spending. As such, the amount spent by government can play an important role in the growth of an economy. Governments often resort to procurement spending as a means of propping up domestic demand, and typically do so by extending preferential treatment to domestic suppliers. In doing so, governments

must be mindful that the ensuing GDP reflects an efficient allocation of scarce tax resources through purchases from the most efficient suppliers. Preferences accorded to suboptimal domestic suppliers can all too easily promote wasteful inefficiency and rent-seeking behaviour. This explains the attractiveness of opening up procurement decisions to more competitive international suppliers.

Legal Perspectives on Government Procurement

As government procurement is funded through taxation, the question of how taxpayers' money is spent is a constitutional matter in most jurisdictions[5]. While government procurement expenditure could also take into consideration the socio-economic and political objectives of the government of the day, processes have been introduced to ensure that this is undertaken in accordance with the law. Within the government, authority for the management of public funds and procurement is delegated. As a result, government procurement laws and regulations reflect the administrative nature of public fund management in a government as well as good governance principles of state conduct.

Without strong safeguards, delegation and discretionary authority in procurement decisions can all too easily attract abuse of authority and corruption (Coppier and Piga 2006). Thus, another key objective of government procurement laws and regulations is to combat such conduct. The recently revised WTO GPA incorporates specific references to anti-corruption obligations in its preamble:

> Recognizing the importance of transparent measures regarding government procurement, of carrying out procurements in a transparent and impartial manner and of avoiding conflicts of interest and corrupt practices, in accordance with applicable international instruments, such as the United Nations Convention against Corruption.

Transparency in government procurement has multiple dimensions. It helps to bring supply and demand closer through fuller information on prices. It can help expose corrupt and abusive procurement processes and actors. It is also a practical means of assessing the quality of suppliers where preferential treatment is given to a specific supplier through undue discretionary or corrupt means.

International Disciplines on Government Procurement

Initial efforts to introduce disciplines on government procurement under the GATT proved unsuccessful[6]. The issue was finally taken up during the Tokyo Round of trade negotiations within the GATT launched in 1976. The first international agreement on government procurement, known as the Tokyo Round Code on Government Procurement, was signed in 1979 and entered into force in 1981. Continued negotiations led to a revised agreement in 1996 (Blank and Marceau 2006). Membership in the WTO's GPA is voluntary, making the agreement plurilateral in character. The GPA was revised again in 2014, bringing membership under the Agreement to 47 WTO Members (WTO n.d. (a)). 41 of the 47 GPA signatories are high-income economies[7]. A further 31 Members participate in the WTO's GPA Committee as observers, including Malaysia since 2012. Of these, 10 Members are currently in the process of acceding to the GPA (WTO n.d. (a)).

Since 1996, the growth in GPA membership has been modest even among other developed and higher-income developing countries such as Australia, Mexico, Brazil and India (WTO 2015)[8]. A push by WTO Members to seek multilateral disciplines on procurement-related matters led to the inclusion of the issue of transparency in government procurement as one of the four new agenda items proposed for inclusion as part of the so-called 'Singapore Issues' (WTO n.d. (b))[9] emerging from the global trade body's first Ministerial gathering. This push came to a halt at the WTO's third Ministerial meeting, held in Cancun, Mexico, in late 2003, with only the issue of trade facilitation being carried forward (Arrowsmith and Anderson 2011). The stalemate has prompted powerful WTO Members, most notably the European Union (EU) and the US, to turn to preferential agreements as an alternative negotiating theatre on the procurement front[10].

The limited expansion of the GPA has also led procurement liberalisation advocates to take up various dimensions of the issue in other institutional settings, such as the Organisation for Economic Co-operation and Development (OECD), Asia-Pacific Economic Cooperation (APEC) and United Nations Commission on International Trade Law (UNCITRAL), although typically on a soft law basis (see Table 2). A further approach has been to link government procurement

disciplines to provisions on corruption and transparency by introducing uniform principles and procedures relating to these aspects within the government procurement framework (Hoekman 1998). Developed countries have also turned to international and regional institutions such as the World Bank Group, the International Monetary Fund (IMF) and regional development banks such as the Asian Development Bank (ADB), the African Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank, to further discipline procurement practices in client countries through their financial aid and capacity-building assistance (IMF 2010, World Bank 2014, ADB 2015). These alternative means of enhancing transparency, openness and due process in government procurement are regarded by some as a long-term means of indirectly preparing countries for GPA membership (Evenett and Hoekman 2006).

Table 2. Government Procurement Disciplines in International and Regional Fora

Institutions	Documents	Date of establishment	Legal status
World Trade Organization (WTO)	Government Procurement Agreement (GPA)	April 1994	Voluntary
Organisation for Economic Co-operation and Development (OECD)	Principles for Enhancing Integrity in Public Procurement	October 2008	Voluntary
Asia-Pacific Economic Cooperation (APEC)	APEC Government Procurement Experts Group—Non-Binding Principles on Government Procurement[11]	August 1999	Voluntary
United Nations Commission on International Trade Law (UNCITRAL)	Model Law on Public Procurement	July 2011	Voluntary

Source: Author.

The WTO Government Procurement Agreement (GPA)

Key Disciplines

The GPA is generally regarded as providing the accepted template for government procurement disciplines and forms the basis of government procurement negotiations for PTAs in most instances. The underlying principles in the GPA mirrored the basic principles under the GATT and the General Agreement on Trade in Services (GATS) (see Table 3).

The second, and equally important feature of the WTO GPA is the liberalisation of signatories' government procurement markets. The GPA's 19 parties, which together comprise 47 WTO Members, account for a combined annual government procurement market estimated at USD1.7 trillion (WTO n.d. (d)). The size of government procurement markets subject to GPA disciplines is calculated on the basis of four elements:

1. The schedule of entities:
    - GPA Members are required to list the entities that are subject to GPA commitments based on three categories—federal government entities, sub-central or regional government entities, and other entities which may include organisations and state-owned enterprises. The listing of entities operates on the basis of a positive-list approach[12].
2. Schedule of goods, services and works:
    - GPA Members commit to open up the procurement market based on the listing of the types of goods, services and construction works. Such listing is also based on a positive-list approach and is to be read together with the schedule of entities.
3. Thresholds:
    - The GPA sets out common thresholds for the procurement of goods, services and works. Only procurement above these thresholds is open to other GPA Members.
    - There are specific thresholds for different entities as well as for different procurement activities. The generally applicable thresholds are set out in Table 4. Similarly, the threshold must be read together with the schedule of entities and schedule of goods, services and construction works.

Table 3. Key Features of the WTO GPA

Principles	Description
National Treatment (NT) and Non-Discriminatory Treatment (NDT)	The WTO GPA provides foreign suppliers access to domestic procurement markets on a non-discriminatory basis. The signatories to the WTO GPA must also extend preferential treatment given to the suppliers from one party to all suppliers from other WTO GPA parties.
Transparency	The WTO GPA sets minimum standards for the national procurement process which require that parties to the Agreement process procurement in a transparent and competitive manner. Transparency and competitiveness are reflected in the procedural provisions of the WTO GPA: ➢ Procedural requirements regarding the procurement process designed to ensure that procurement covered under the WTO GPA is carried out in a transparent and competitive manner that does not discriminate against the goods, services or suppliers of other parties. ➢ Disclosure of conditions for participation for suppliers, publication of procurement plans, disciplines on technical specifications; and additional requirements regarding transparency of procurement-related information, such as relevant statutes and regulations. ➢ Disclosure of entities which are subject to the WTO disciplines.
Enforcement Mechanism	The WTO GPA requires parties to provide aggrieved suppliers a right of recourse through national courts or an impartial review body. In addition, the WTO GPA provides for disputes between parties to be brought before the WTO Dispute Settlement Mechanism.

Source: WTO (n.d. (c)).

4. General exclusions:
    - GPA Members may exclude policies which are deemed sensitive domestically such as the exclusion for the Treaty of Waitangi for New Zealand, agricultural support programmes and human feeding programmes for the EU, and urban rail and urban transportation for Canada, to name a few.

Table 4. The WTO GPA: Generally Applicable Thresholds (in Special Drawing Rights, SDR[13])

	Central government entities	Sub-central government entities	Other entities
Goods	SDR130,000 (USD182,678)	SDR200,000 (USD281,043)	SDR400,000 (USD562,085)
Services	SDR130,000 (USD182,678)	SDR200,000 (USD281,043)	SDR400,000 (USD562,085)
Construction Services	SDR5,000,000 (USD7,026,067)	SDR5,000,000 (USD7,026,067)	SDR5,000,000 (USD7,026,067)

Source: WTO n.d. (d).

The Treatment of Government Procurement in Preferential Trade Agreements (PTAs)

Countries generally follow open and high-quality procedures for government procurement undertaken with cross-border suppliers, in particular for purchases of specialised items such as healthcare products, weapons and aircraft. However, many countries are typically more concerned with the consequences of doing so on a reciprocal, non-discriminatory and legally-binding basis under trade agreements. It is no surprise that countries, particularly developing ones, are more willing to work with non-binding initiatives such as the UNCITRAL Model Law and the APEC Non-Binding Principles on Government Procurement, while expressing strong resistance to the idea of doing so within the context of legally binding and enforceable trade agreements. This largely explains the low growth observed in GPA membership, a reluctance that also often extends to procurement negotiations within PTAs, especially those concluded *between* developing countries.

A WTO Working Paper highlighted that 57% of notified PTAs featured no provisions on government procurement. Included in this category are several plurilateral regional economic integration agreements, including ASEAN. The majority of agreements without government procurement provisions are concluded between non-GPA parties, particularly developing countries. By comparison, 24% of notified PTAs feature detailed provisions on government procurement. These comprise 12 PTAs between GPA parties; 36 PTAs between GPA parties and non-GPA parties; and 20 PTAs between non-GPA parties (Anderson *et al*. 2014). As such, it is observed that the level of commitments on government procurement in PTAs is much influenced by GPA membership.

GOVERNMENT PROCUREMENT IN MALAYSIA – KEY CONSIDERATIONS

Prior to the negotiation of the TPPA, Malaysia had never agreed to binding disciplines on government procurement in any of its PTAs. As noted earlier, an attempt to include government procurement in Malaysia's PTAs had been made during the aborted negotiation of MUSFTA between 2006 and 2009[14]. In 2010, Malaysia decided to participate in the TPPA negotiations and agreed to include government procurement in the negotiating package (MITI 2010). As expected, government procurement re-emerged as one of the most contentious issues for Malaysia in these negotiations. In addition, Malaysia also encountered stiff resistance to its intention to preserve broad policy space for measures relating to its *Bumiputera* policy, for various economic development measures relating to industrial and rural development, and for strategic economic policies, particularly those discriminatory measures needed when Malaysia was faced with domestic and international challenges, such as those arising during the Asian Financial Crisis in 1998, the global financial crisis (GFC) in 2010 and turmoil in the oil market in 2014 (MITI 2015).

Domestically, TPPA critics argued that failure to defend such strategic policy aims would imply that Malaysia would be sacrificing major, politically-sensitive, policy space. In particular, vocal concerns were expressed regarding the risk that the TPPA posed for the *Bumiputera* policy (Alyaa 2015, MTEM 2015a, b, PERKASA 2015).

Malaysia successfully concluded the TPPA negotiation in 2015. The TPPA legal text, which later became the CPTPP without changes on the procurement disciplines, revealed that Malaysia had been able to carve out major aspects of its domestic procurement regime[15] (see Table 5). Malaysia sought and secured exceptions on all three core fronts—developmental, socio-economic and *Bumiputera*-related policies.

The final text of the TPPA/CPTPP, in particular, the extensive negotiated exclusions, reflects the key issues and challenges faced by Malaysia in liberalising its government procurement market in a trade policy setting. These issues and challenges could be broadly divided into the following categories—economic, legal, trade-related and domestic socio-economic needs. These issues and challenges are clearly not exclusive to Malaysia but are observed in other developing countries, and in some cases even some developed countries (Srivasta 2003). While Malaysia has addressed its core concerns through the numerous exclusions and exceptions under the TPPA/CPTPP, it took an extensive period of negotiations[16].

Looking ahead, and particularly in light of recent political changes, the country's concerns and expressed political need to maintain protective procurement policies may once again be open to challenge. This is because different trading partners may have different expectations and demands. In addition, the negotiation approach of some PTA trading partners, in demanding that the baseline for negotiations be above and beyond a specific recently concluded PTA, commonly known as PTA+, would mean that such a baseline could face an upward 'ratchet effect'. For these reasons, this chapter will now look at different scenarios and strategies that could be considered in reshaping Malaysia's domestic and trade policies on government procurement.

Managing Conflicting Objectives

The preamble of the GPA sets out as one of its core objectives "… achieving greater liberalization and expansion of, and improving the framework for, the conduct of international trade." To achieve this, the GPA adopts non-discriminatory treatment and transparency as its key principles. These principles are reflected in its rules, in particular its cornerstone rules on NT and NDT (see Table 3). The GPA also

Table 5. Matching of Key Policies and Exclusions for Malaysia on Government Procurement under the TPPA/CPTPP

Policies	TPPA/CPTPP Exclusions
Bumiputera Policy	• Set aside procurement of construction services contracts for *Bumiputera* up to 30% of the total value of construction services contracts above the threshold. • Price preference to *Bumiputera* suppliers and manufacturers calculated as a % to total value of procurement.
Development Policies	• Public-private partnership (PPP) contractual arrangements including build-operate-transfer and public work concessions. • Procurement for research and development. • This Chapter shall not apply to any procurement funded by an economic stimulus package in response to a severe nationwide economic crisis implemented within 25 years after entry into force of this Agreement for Malaysia. • Delayed application of its obligations under Article 15.4.6 (General Principles) on offsets for a period of twelve years following the date of entry into force of this Agreement for Malaysia with staggered threshold for application.
Socio-economic Policies	• Procurement in relation to rural development programmes in rural areas with less than 10,000 residents and poverty eradication programmes for households earning below Malaysia's Poverty Line Income. • Procurement for religious purposes, including that form a part of, or incidental to a procurement contract. • Procurement in relation to the *Program Perumahan Rakyat* (People's Housing Programme). • Procurement and distribution of inputs for agro-food production in Malaysia.

Source: MITI (n.d.)

recognises the need to accommodate the specific circumstances of countries as well as the need to take into account the development, financial and trade needs of developing countries, in particular the least developed countries. These considerations are reflected in GPA rules for special and differential treatment and the scheduling of market access commitments[17].

At the domestic level, countries have their own objectives in regulating and administering procurement practices. The objectives chosen by governments are often reflective of the domestic political economy and societal concerns. In Malaysia, government procurement is not just about procuring goods and services for consumption but is an important tool for the government to implement its socio-economic and industrial policy agenda (See Table 6). In order to achieve these objectives, the Malaysian Government has introduced various measures that provide preferential treatment to domestic industries and to local suppliers either directly by closing the market to foreign suppliers or by providing technical advantages such as price preferences or financial assistance to domestic suppliers.

The difference in the procurement objectives pursued by Malaysia domestically and those under PTAs is an obvious source of policy tension. PTAs embody the objective of progressively liberalising government procurement markets based on the underlying logic of achieving greater market efficiency. However, as noted earlier, in the domestic context, procurement policy objectives often go well beyond concerns of economic efficiency. This is because governments operate within political ecosystems that require consideration of multiple objectives—socio-economic well-being, collective preferences, labour and employment, and domestic industrialisation and growth. As such, it could be argued that the underlying objectives of PTAs, as reflected in the twin principles of national and MFN treatment, focus on market access and economic efficiency considerations. GPA-like disciplines limit the government's space to assign to procurement practices non-economic or efficiency-departing objectives, such as relief of poverty, inequality or unemployment, and social development.

Table 6. Government Procurement Objectives and Principles in Malaysia

Objectives	Principles
• To stimulate the growth of local industries through maximum utilisation of local materials and resources; • to encourage and support the advancement of *Bumiputera* entrepreneurs in line with the nation's aspiration to create a *Bumiputera* Commercial and Industrial Community; • to increase and enhance the capabilities of local institutions and industries through transfers of technology and expertise; • to stimulate and promote service-oriented local industries such as freight and insurance; and • to accelerate economic growth by using government procurement as a tool to achieve socio-economic and development objectives.	The government procurement process in Malaysia is guided by five main principles: 1. Procurement must reflect public accountability. 2. All procurement regulations, conditions, procedures and processes are transparent. 3. Procurement should yield the best return for every Malaysian ringgit spent in terms of quality, quantity, timeliness, price and source. 4. The procurement processes should offer fair and equitable opportunities to participants. 5. All acceptable bids are processed fairly based on current rules, policies and procedures.

Source: MOF (n.d.).

Balancing Objectives

Adopting PTA-anchored disciplines implies (subject to negotiated exceptions) that governments maintain a non-discriminatory procurement framework that is globally recognised. Uniformity and coherence in both the principles and processes of government procurement encourages cost-efficiency as suppliers would confront similar conditions in cross-border procurement.

However, adopting PTA-anchored disciplines would also mean that governments might need to sacrifice existing measures and policies that are inconsistent with those set out under PTAs. It would also entail the loss of future policy space. In addition, countries would have to contend with differences arising from governance, legal and political

structures[18]. As such, a perfect alignment of domestic and trade-mandated procurement practices may prove challenging and, in some cases, quite impossible[19].

Governments need not necessarily adopt PTA disciplines fully. While it is true that the overall objective of PTAs is to promote better overall allocative efficiency through progressive market liberalisation, this does not necessarily mean that socio-economic and other developmental issues are ignored. Such policy objectives in government procurement have been incorporated into PTA disciplines in a number of ways. These include:

a. Scope and coverage of trade agreements:

The definition of government procurement under the GPA sets out specific elements which would be captured, and others which are excluded. For example, grants, loans and assistance are excluded from the GPA's reach. As such, providing financial assistance to poor communities to help them set up businesses, for example, is not deemed as a covered form of procurement under the GPA.

b. Text-based exclusions:

The GPA provides exclusions for developing countries through Article V, whereby specific programmes which are considered inconsistent with the principles of non-discrimination, such as price preferences to local suppliers and offsets, may be allowed for a specific period. Although these are typically transitional and temporary in nature, such exclusions reflect acceptance of the use of government procurement as a development tool. Governments would have to negotiate and justify the need to secure and possibly extend such exclusions.

c. Negotiated exclusions:

i. The level of participation by government entities in PTAs is based on the 'positive-list' approach. Under this approach, governments would list entities and activities that would be subject to the disciplines of a trade agreement's procurement disciplines. Countries can thus negotiate the exclusion of entities deemed to be of strategic importance or politically sensitive. Governments can also exclude specific entities and procurement measures through the scheduling of commitments.

ii. Another consideration for governments is to determine the level of threshold values below which procurement markets escape liberalisation commitments and other treaty obligations. Smaller contracts for instance are automatically excluded from the scope of the GPA. Governments could also negotiate higher procurement thresholds for sensitive areas.

The multiple sources of breathing or policy space afforded by trade agreements can facilitate the continued implementation of various preference-granting objectives by signatory governments in the procurement field. However, the extent to which such options could be used depends on negotiations, for instance between GPA Members and GPA-acceding countries, and between trading partners in PTAs. The ability to secure the various opt-outs on offer would vary depending on the level of skills and expertise of negotiators, the nature of the trade relationship between partners and the commitments already made by existing Parties. In general, the negotiation space for GPA-acceding countries would not deviate far from the existing commitments made by GPA countries. As such, GPA-acceding countries would also be constrained by the overall level of market access already committed by the GPA countries.

An Alternative Argument

The argument can be made that the objectives of economic efficiency and getting the most value from government procurement can be achieved outside the realm of trade agreements, be it the WTO or in PTAs. As mentioned earlier, the policy rationales for regulating government procurement span both economics and law. At the same time, objectives such as value for money, transparency and anti-corruption commonly underpin trade agreements. Still, governments can observe and implement domestic rules consistent with the above trade aims and principles without recourse to legally binding and enforceable treaty-based commitments. An example of this is the adoption of the UNCITRAL Model Law on government procurement. This approach can allow a government to seek value for money in procurement without curtailing its ability to pursue priority socio-economic objectives. Such thinking has led many governments, including of developed nations, to eschew the trade negotiating path and embrace a policy of unilateralism in regulating the domestic procurement market.

Complementary policy objectives, such as transparency and anti-corruption, can be pursued by governments as part of their domestic regulatory frameworks. Transparency in the context of ensuring good governance under the domestic regime differs somewhat from transparency in government procurement under the GPA and in PTAs insofar as the latter chiefly focuses on providing the necessary information to trading partners to secure compliance with trade rules. As such, the approach taken to implement transparency disciplines may differ.

While the details of government procurement decisions are not made public in Malaysia, the annual government audit process offers a means to verify compliance with domestic procedures[20]. Cases of procurement mismanagement would be highlighted in the annual audit reports, which are presented to the Parliament and later made public. Thus, there are existing internal mechanisms of checks and balances. However, the efficiency and effectiveness of supervision and the disciplinary process of government procurement in Malaysia would still require further development[21].

Real versus Theoretical Economic Benefits of Liberalising Government Procurement

According to the WTO, government procurement in most countries accounts for 10% to 15% of GDP[22]. Among the member countries of the OECD, procurement accounts for an average of 29% of total government expenditure, representing an average of 12.1% of GDP (OECD 2015). The average among EU Member States stands at 13% of GDP (EU 2014). Within ASEAN, the lack of a mature government procurement regime means that disclosure of government procurement expenditure is minimal[23]. In general, government expenditure among ASEAN Member States ranged from 5% to 15% of Member States' GDP in between 2014 to 2017 (see Table 7).

Actual, Potential and Negotiated Size of Government Procurement Markets

Government expenditure generally involves direct and indirect procurement of goods, services and works. However, the actual and total value of government procurement is rather elusive, mainly because

Table 7. Government Expenditure of ASEAN Member States as a Percentage of GDP in 2014 – 2017

Country	Percentage of GDP (%)			
	2014	2015	2016	2017
Malaysia	13.3	13.1	12.6	12.2
Cambodia	5.5	5.4	5.2	5.1
Indonesia	9.4	9.8	9.5	9.1
Lao PDR	15.2	15.1	14.0	12.9
Philippines	10.6	10.9	11.1	11.3
Singapore	9.9	10.4	10.7	10.9
Vietnam	6.3	6.3	6.5	6.5

Source: World Bank[24].

of lack of transparency in the data. Even the most developed countries do not provide full disclosure on the value of their procurement, notably in respect of defence purchases. A possible assessment of the size of a country's procurement expenditures could be established based on the data obtained from the Systems of National Accounts (SNA)[25]. However, SNA data only captures intermediate consumption, including of goods and services purchased by the government for its own use. Usually, defence procurement expenditures are excluded from such estimates. Transfer payments to agencies and state governments, which would also lead to procurements by the recipients, are also excluded as is procurement by state-owned enterprises.

The political and economic structure of government can also influence the level of disclosure and quality of data on government expenditure. The accounting framework of the government creates layers of transfer payments from the federal government to ministries and agencies, and to state and local authorities in federal states. Countries with a high number of state-owned enterprises would escape government procurement statistics as funding is commonly recorded as a direct transfer under an annual funding allocation for the administration of these enterprises. The fund could be used for infrastructure contracts, which could technically be government procurement.

Assessing the Size of the Government Procurement Market in Malaysia

While there are no specific disclosure requirements on government procurement expenditure by the government of Malaysia, information is available on the size of government procurement in the annual budget and in the government's annual financial statement[26]. Transactions covered under the government's e-procurement portal also contribute towards the transparency and greater accuracy of procurement data[27].

According to the WTO's Trade Policy Review of Malaysia 2018, the size of the country's government procurement market was estimated to be around RM92.8 billion (USD20.7 billion), representing about 12.6% of the GDP (WTO 2018). The estimation observed under the WTO Trade Policy Review of Malaysia 2018 represents only the development expenditure and goods and services expenditure. As a result, this value may underestimate the total value of government procurement in Malaysia. Understanding Malaysia's national account and government structures could help to shed light on this observation as discussed below (see Figure 1).

The government's public expenditure account consists of the operating and development expenditure accounts. The operating expenditure account includes expenditure on emoluments, grants, subsidies, and supplies and services. The details of the expenditure account and its classification are set out in Table 8. The development expenditure account sets out the expenditure for the country's various development activities.

In assessing the overall value of government procurement in Malaysia, other parts within the operating expenditure should also be considered:

- Code 10000 (Emoluments)—Employment of individuals is procurement of services. In particular, when government appoint consultants or advisers, this may constitute a procurement of services.
- Code 30000 (Acquisition and maintenance of assets)—The acquisition and maintenance of asset may also constitute procurement of goods and services which is in addition to the procurement of goods and services under Code 20000.

Table 8. Ministry of Finance – Classification Codes for Expenditure

Code	Classification of Expenditure
10000	Emoluments
20000	Supplies and services including expenditures on: • travel allowances; • communication services such as postal and telecommunications; • utilities such as water, electricity and gas; • rental of premises; • food and beverages; • purchases of raw materials for maintenance; and • minor contracts for maintenance of premises.
30000	Acquisition and maintenance of assets including land, buildings and investments
40000	Grants and assistance
50000	Other expenditures which may include fees and charges, and duties and impairment.

Note: See PS1.1/2-13 for Categorisation of Code for Income and Expenditure (*Penjenisan Kod Bagi Hasil dan Perbelanjaan* (PS1.1/2013), *Kementerian Kewangan Malaysia*).

Source: MOF (n.d.).

- Code 40000—This value should be taken into consideration as funds to statutory bodies could also involve procurements. Not including this value, on the other hand, could underestimate the size of government procurement. It is worth noting that the transfer of funds under this Code is for the operation of statutory bodies as a whole. As such, it also includes non-procurement expenditures such as emoluments, grants and subsidies.

A further point to note is the exclusion of self-funded agencies and state-owned enterprises (SOEs). The underlying principle of government procurement in Malaysia is to capture only state purchases funded by the government. Agencies and some self-funded SOEs are not subjected to the government procurement regime[28]. This is potentially confusing, as a lack of understanding of the relationship between the

government and its agencies could explain why Malaysia's trading partners felt that the size of government procurement in the country was underestimated.

The Mirage-Effect of Market Access

'Covered procurement', which is the value of the government procurement contracts that are open to trading partners in PTAs, is indicative of the level of *negotiated* liberalisation of the government procurement market of a country. This value is based on the procurement value of listed entities, the level of threshold agreed minus the exceptions and exclusions secured.

Based on the above considerations, significant gaps typically exist between the full value of government procurement and the value of covered procurement, which is the value committed to trading partners under PTAs or the GPA. According to a study by the US Government, the government procurement market between 2008 and 2012 in the GPA countries and in US PTA partners represents approximately USD19 trillion, but only about USD4.4 trillion of the total is actually captured as 'covered procurement' (GAO 2015). The percentage of government procurement out of total government expenditure is not necessarily reflective of the real size of a country's total procurement spending.

Another perspective on the size of government procurement relates to competitiveness. While it is true that developed countries are more likely to open up a larger share of their domestic procurement markets to foreign suppliers, the actual contracts that are awarded to foreign suppliers are often rather low. According to the European Commission, the amount of government procurement that lies above the WTO GPA threshold for the EU is about EUR370 billion, 95% of which is internationally committed. By comparison, the total US procurement above the WTO GPA threshold is about EUR 559 billion, but only 32% is internationally committed (EU 2012) (see Table 9).

As mentioned above, the main attraction for the government to open up its government procurement market to its trading partners is that it would enjoy reciprocal terms of access. This was part of the appeal for Malaysia of joining the TPPA. The size of the TPPA government procurement market between 2008 and 2012 was about USD2.6

Table 9. A Comparative Look at Foreign Firm Participation in Selected Government Procurement Markets

	EU	US	Japan	Canada	South Korea
Total Procurement Above WTO GPA Threshold (EUR billion)	370	559	96	59	25
Percentage of GDP (%)	3	3	3	6	3
Percentage of Procurement Internationally Committed (%)	95	32	28	16	65

Source: EU (2012).

trillion, with the US alone accounting for 65% of the total, at USD1.7 trillion[29]. However, a trading partner like Malaysia must also consider the potential or possible amount that is accessible to Malaysian suppliers. One point to note is that the US government procurement market is open not only to Malaysian suppliers through the TPPA, but also to the GPA member countries and the 20 countries that have concluded FTAs with the US[30].

Furthermore, the procurement of goods differs from the procurement of services for cross-border supply. Suppliers from Malaysia could supply goods directly or through an agent in the US, subject to the approval process as required under US procurement procedures[31]. For activities such as construction works, it would take longer for Malaysian companies to participate in the construction procurement market of the US or of other CPTPP Parties outside the ASEAN region as they would first need to establish themselves in order to be cost-competitive. For example, a construction company in Malaysia would need to enter into local partnerships and supply sources in the US before it could compete competitively with other bidders from the US, other North American countries, and even the EU which may have a longer historical footprint in the US market.

The extent of procurement market access under the CPTPP could thus be somewhat of a mirage, particularly in the more developed CPTPP Parties such as Australia, Canada or Japan, where effective access may be much lower due to the high level of competitiveness prevailing among suppliers in these markets and among traditional trading

partners. In assessing the potential benefits of PTA disciplines and commitments on government procurement, the Malaysian government must take into consideration the readiness of Malaysian companies to participate or even be competitive in the government procurement market of its trading partners. Consideration must also be given to geographical considerations, such as distance, which could influence the efficiency and costs of cross-border supply of procured goods. For services, the oft-needed requirement for a local presence can involve demands for substantial capital and investments before domestic suppliers can venture into new markets.

Government Procurement as a Policy Tool

The economic development of Malaysia has long been influenced by government procurement policies and embedded in long-term national policies (listed in Table 10). Under the government's expenditure account, development expenditure is often directed to infrastructure projects such as schools, universities, hospitals and roads. The government has also undertaken various infrastructure developments which are considered as high-capital investments by the private sector, such as in the areas of civil aviation, telecommunications, water and other transportation services. The Malaysian government has also used procurement to develop rural areas, not only in terms of providing infrastructure but also economic opportunities to economic agents operating in more remote locations[32].

Government Procurement as a Tool for Social Harmony

The multi-racial character of Malaysian society requires a special policy approach for economic development, particularly where income gaps between social or ethnic groups have been the cause of social disharmony throughout the country's history. In 1957, the average monthly income for Chinese citizens was RM272, as compared to RM144 for Malays and RM217 for Indians (Muhammed 2014, 76). With the stated aim of increasing the level of income of Malays and *Bumiputera* in general, the New Economic Policy was introduced in 1970, followed by a series of policy initiatives focusing on support for *Bumiputera* entrepreneurs, enhancing the capabilities of *Bumiputera* companies, and accelerating *Bumiputera* participation in the economy[33].

Table 10. Key National Policies in Malaysia

Time Period	Policies
1971 – 1999	National Development Policy: The New Economic Policy focused on poverty eradication irrespective of ethnicity and eliminating identification of ethnicity by economic function.
1991 – 2000	The National Development Policy focused on ensuring the balanced development of major sectors of the economy and regions, as well as reducing socio-economic inequalities across communities.
2001 – 2010	The National Vision Policy focused on building a resilient and competitive nation.
2011 – 2020	The National Transformation Policy maintains the people-centric focus through the New Economic Model, which sets the goal of becoming a high-income economy that is both inclusive and sustainable.

Source: PMO (n.d.)

Preferential treatment of *Bumiputera* companies for goods, services and works is implemented through allocation of contracts by threshold value and price preference formulas. Allocation of contracts for goods and services for *Bumiputera* companies are mainly for lower value contracts.

Government Procurement as an Economic Management Tool

In addition to using government procurement for development purposes, the government has also employed it as a tool to manage the economy when it felt that its intervention was needed. For instance, when Malaysia was faced with the GFC in 2008 – 2009, the government introduced two stimulus packages aimed at mitigating the effect of the crisis on the Malaysian economy (EPU 2017, MOF 2017). As in many other countries, these expenditure packages were mainly directed towards construction works, involving the upgrading, repair and maintenance of public amenities such as schools, hospitals, roads and police stations[34]. As a result, the construction sector registered

positive growth in 2009, largely attributable to the above-mentioned activities. The stimulus packages further allowed the Malaysian economy to contract at a slower pace than would have otherwise been the case (MOF 2010).

Policy Space under the WTO GPA and PTAs

It is common for governments to use procurement as a tool for social and economic development. From a development perspective, market failures and positive externalities have been the main justifications invoked by governments that intervene in the economy through government procurement activities and policies. From a socio-economic perspective, both developed and developing countries have implemented government procurement policies to encourage the employment, development of skills and promotion of equal economic opportunities among their citizens, with particular attention to selected groups such as single mothers, war veterans and other selected disadvantaged groups. Examples of such policies are as follows:

- In the US, the 'Buy American Act' applies to direct purchases by the federal government of more than USD3,000[35].
- Australia implements measures that promote employment and training opportunities for its indigenous people under its government procurement regime[36].
- New Zealand excludes obligations and rights under its Treaty of Waitangi from government procurement commitments under the WTO GPA[37].

Developing countries are generally more active than their developed country counterparts in using government procurement as a development tool and do so for a variety of economic and political reasons. Malaysia often stands out in this respect, particularly as regards the preferences conferred by its *Bumiputera* policy (McCrudden 2004, 2007, McCrudden and Gross 2006)[38].

From an economic perspective, the use of government procurement as a development policy tool is generally considered as clashing with economic efficiency aims. However, procurement preferences have long been argued to generate positive externalities as well as

socio-economic benefits to society, thus making them a particularly popular policy tool[39]. Accordingly, many countries, in particular developing ones, continue to actively advocate the need to preserve developmental policy space in the procurement area. This is hardly a new area of policy debate. It has been deliberated, and recognised since the GATT's Tokyo Round (1973 – 1979) when government procurement disciplines were first agreed. Apart from recognising the development, financial and trade needs of developing countries, the Tokyo Round Code on Government Procurement (Tokyo Code) also introduced capacity-building assistance provided by developed countries to developing countries into the negotiating and implementation equation[40]. The Tokyo Code also provided special treatment for least-developed countries (LDCs) with respect to products originating from them[41]. This approach continued under the WTO GPA 1994. Under the revised WTO GPA 2012, special and differential treatment provisions for developing and LDCs were maintained. However, their scope was restricted to circumstances in which special and differential treatment policies and measures were shown to be aligned to the developmental needs of the requesting country. In addition, agreed exclusions are only applicable within the time frames agreed by GPA Parties. The transitional measures made available to developing countries and LDCs under the WTO GPA 2012 are set out in Table 11.

The challenge is whether the above exclusions are sufficient for a country to continue pursuing its domestic agenda. In the case of Malaysia, from a technical perspective, the country could manage the *Bumiputera* policy for procurement under a combination of approaches available under the WTO GPA:

- ***The preference policy approach***: The current system of preferences based on pricing could still be applied in the country's PTAs. The extent of this exclusion might allow for the continued application of the existing *Bumiputera* policy if the contract is below the threshold level for market access as per current practice.
- ***Offsets exclusion***: The acquisition of knowledge and expertise through procurement could still be undertaken. However, the process is stricter. The advantage of the GPA process in relation

Table 11. WTO GPA Exclusions for Developing and LDC Members

Exclusions	Explanation
Price Preference Policy	Provides a preference only for the part of the tender incorporating goods or services originating in the developing country applying the preference, or to goods or services originating in other developing countries to which the developing country applying the preference has an obligation to provide national treatment under a preferential agreement, provided that where the other developing country is a party to this agreement, such treatment would be subject to any conditions set by the GPA Committee; is transparent, and the preference and its application in the procurement are clearly described in the notice of intended procurement.
Offsets	Offsets are measures to encourage local development or improve the balance-of-payments by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements imposed as part of a government procurement approval package. The WTO GPA explicitly prohibits the use of offsets in government procurement contracts. Notwithstanding this, developing countries may negotiate, at the time of their accession, conditions for the use of offsets provided these are used only for the qualification to participate in the procurement process and not as criteria for awarding contracts (WTO n.d. (e)).
Phase-in Periods for Specific Entities and Sectors	Countries are allowed to exclude specific entities and sectors. However, exclusions are transitional. Countries commit to include these excluded entities and sectors upon the ending of the transitional period, or to their staggered application during the transitional period.
Threshold for Covered Procurement that is Higher than the Country's Permanent Threshold	Countries can negotiate higher thresholds for procurement of goods, services or works than the generally agreed thresholds for WTO GPA Parties. However, this is only applicable during the transition period as agreed.

Source: WTO (n.d. (d)).

to the inclusion of offsets is that there is transparency and control. Foreign suppliers, in most cases, are owners of the knowledge and expertise that is sought and are likely to be able to manage their costs.

- ***Phase-in periods and positive-listing***: The Malaysian government can also temporarily exclude entities or contracts that are viewed as crucial to the attainment of its key domestic policies. In the case of the *Bumiputera* policy, the government could list out key entities involved in the implementation of this policy.

Not All Policies are Created Equal

The ready availability in trade agreements of exclusions and transitional periods as described above arguably provide the necessary space for Malaysia to manage its procurement policy sensitivities. However, it is important to consider the types of policies that could fit into this model. Industrial or commercial development policies could be argued as having quantitative goals, making them probable targets for exclusion. This is so because, at the end of the exclusion or transition period, it is possible to quantify the growth of the specific sector as evidence to either end the exclusion or to negotiate a longer transition period. An example of this is the exclusion of procurement preferences granted to small- and medium-sized enterprises (SMEs). Such support is facilitated by the high probability that applicable procurement contracts are small and lower than the agreed thresholds.

Secondly, supporting the growth and contribution of SMEs is quantifiable. By comparison, the *Bumiputera* policy is a socio-economic policy embedded in the sociology, politics, demography and economy of Malaysia, all of which complicate attempts at quantifying policy outcomes. A further consideration is that such a policy is closely linked to the legal framework of Malaysia. Where transition tools are available, consideration must be given to the extent to which it can meet the requirements of any socio-economic policy, such as the *Bumiputera* policy, as compared to a pure economic policy, such as an industrial policy. Recognition of such different types of policies is acknowledged under the GPA. Policies relating to human rights, labour, environment and SMEs have found their way into the GPA as well as into the procurement rules of many developed countries as

'horizontal policies' that justify the need to depart from core principles of economic efficiency in government procurement (Arrowsmith 2010, Arrowsmith and Kunzlik 2009). It bears recalling that recognition of the above policy aims arose from different development philosophies and evolved through different legal and economic paths. As such, the treatment of domestic policies in PTAs should provide adequate space for such policies to evolve and progressively align with the core principles of government procurement, rather than becoming a rigid mould applicable to all countries.

A bigger concern for government is the changing nature of socio-economics, which in turn could require the government to take different measures and actions. The experience of the Malaysian government in tackling the GFC through the use of government procurement illustrates the importance of maintaining sufficient flexibility and policy space in managing the economy.

Varying Political, Legal and Administrative Structures and Different Mechanisms for Government Procurement

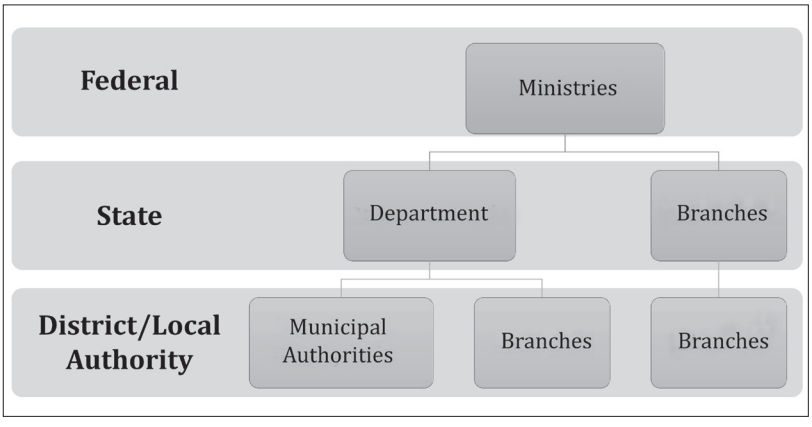
The set-up and administration of governments differs across countries, as do legal frameworks and institutions. Such differences may raise GPA-related challenges. As in many other countries, the legal and administrative structure in Malaysia presents a number of challenges in committing to and implementing procurement disciplines under trade agreements. Such challenges include:

Authority Structure and Delegation

Under the Federal Constitution of Malaysia (1957), the Parliament delegates its authority to the executive branch on matters relating to the administration of the country as a whole, such as external affairs, defence, energy, the legal system and citizenship. Trade and industry, transport, healthcare, education, finance and taxation are also delegated to the federal government[42]. In terms of structure, the organisation of the government of Malaysia is centralised at the Federal Ministries. The delegation of authority to the federal government in regard to most administrative tasks means that the federal government is responsible for these activities at both the federal and state levels in Malaysia (see Figure 1). This is important in the context of government

procurement as purchases by departments, branches, and federal agencies operating at the state level are still considered as procurement by the federal government. However, in the context of government procurement, the procedure is decentralised from the Ministry of Finance whereby each Federal Ministries would undertake their own procurement subject to the threshold limit[43].

Figure 1. Structure of the Malaysian Government



Source: Author.

The administration and management of the funding provided by the government to ministries and agencies are set out under the Financial Procedure Act 1957 (FPA 1957). In general, the supervision, control and direction of all matters relating to the financial affairs of the federal government is vested in the relevant Ministers[44]. Each Minister has to appoint 'Controlling Officers' to oversee the overall financial management of a Ministry. Usually, the Controlling Officers are the Secretary General of the Ministry. The Controlling Officer is the authority that administers and regulates procurement activities within a Ministry[45]. In terms of operating procedures, the laws and regulations relating to government procurement in Malaysia are set out in Table 12. The FPA 1957 is the parent legislation, which names the Ministry of Finance as the main regulator for government procurement in Malaysia. The administration of government procurement is regulated through the Treasury Instructions as issued under the FPA 1957 by the Ministry of Finance from time to time.

Table 12. Laws and Regulations Relating to Government Procurement in Malaysia

Legislation	Description
Delegation of Powers Act 1956	This Act provides general authority to a Minister to delegate to any person subject to the limitations set out under this Act. In delegating this authority, the Ministry may limit the source authority or introduce conditions. The delegation must be made through a publication in the national Gazette.*
Government Contracts Act 1949	Ministers and public officers may enter into contracts on behalf of the Government in accordance with the relevant authorisation. This Act also excludes public officers from any liabilities arising from the contract entered into in their official capacity.†
Financial Procedure Act 1957	This Act provides the authority for the Government to control and manage the public finances of Malaysia. It also provides the authority for the Government to introduce and administer financial and accounting procedures, including procedures for the collection, custody and payment of public monies.
Treasury Instructions	These instructions are issued under the Financial Procedure Act 1957.‡ The Treasury undertakes the supervision of the expenditure of all ministries, including all matters relating to accounting and financial procedures.§ The Treasury Instructions include the supervision of the expenditure through the Controlling Officers for: o the submission of proposals for expenditure to the Treasury; o the reporting of implementation and administration of programmes or projects; o supervision activities by the Controlling Officers; and o reporting to the Auditor General.‖

Notes: * Section 5 of the Delegation of Powers Act 1956.
† Section 2 and 8 of the Government Contracts Act 1949.
‡ Section 6 of the FPA 1957.
§ As set out under Treasury Instruction 7 (Arahan Perbendaharaan 7).
‖ As set out under Treasury Instruction 13 (Arahan Perbendaharaan 13).

Source: MOF (n.d.).

The legal foundation for the government procurement framework in Malaysia is the government's funding legislation, mainly the FPA 1957. As a result, procurement activities undertaken by the government or its agencies and entities not funded by the government are not captured under the government procurement regulatory framework as administered by the Ministry of Finance. One prominent area is public-private partnership (PPP). The government procurement regulations in Malaysia as administered by the Ministry of Finance are not applicable to procurements undertaken under the PPP programme. PPPs are administered by the PPP unit known as UKAS (*Unit Kerjasama Awam Swasta*) that is responsible for coordinating the privatisation and PPP projects which are key to Malaysia's economy. The PPP unit, which is administered under the Prime Minister's Department, establishes and administers its own policies and procedures for procurement for PPP projects[46].

There are also agencies and entities with reporting obligations to the Minister or Ministry of Finance that are not subjected to the procurement regulations issued by the Ministry of Finance as they are not directly funded by the government.

The FPA 1957 is also not applicable to SOEs that are funded by their own capital and are not subjected to the government procurement regime[47]. Government ownership in enterprises does not automatically lead to the application of the government procurement regulations in Malaysia.

Historically, the GPA made specific reference to the procurement of entities under the direct or substantial control of the government[48]. However, the reference to ownership was removed in the WTO GPA 1994 text. As such, Malaysia is consistent in not including public corporations, particularly privatised utility companies, in its covered procurement regime. This is also consistent with the United Nations Systems of National Accounts 1993 (SNA 1993), where public corporations are considered as not being part of the government[49]. This is an issue for Malaysia as the scheduling of entities includes SOEs[50].

The regulatory landscape described above provides a general view of government procurement practices in Malaysia. The segregation between government procurement and commercial transactions in Malaysia is based on the source of funding under the law. Based

on this, the scope of government procurement in Malaysia is much stricter. This in turn reduces the size of actual government procurement in Malaysia. In terms of market access negotiations, Malaysia's trading partners may not be able to fully or easily comprehend the landscape as presented above as it reduces the size of the government procurement market that is effectively contestable in Malaysia.

PTAs and Sovereignty

Under Malaysia's legal framework, international treaties would only be legally binding after being enacted through an Act of Parliament. The extent to which the government can introduce disciplines and commitments under international treaties and PTAs is dependent on the authority granted to the government by the Parliament under the Federal Constitution. As such, it is argued that enacting laws based on international treaties or PTAs would remove the policy space delegated by the Parliament to the government.

Two aspects of the argument on sovereignty are worth mentioning. The first relates to the power to impose tariffs and duties delegated by the Parliament to the government. It is argued that the commitment not to impose tariffs on goods agreed under PTAs would be denying the authority granted by the Parliament. The second aspect concerns the putative loss of future policy space. Agreeing to commit not to introduce future tariffs and duties would limit the ability of the government to use such fiscal policy tools to manage its economy.

Another argument on restricting policy space arises in the context of economic development. It is common for countries to introduce various policies to promote their social and economic development. PTAs are often seen as constraining the sovereignty of countries, particularly when the ability of governments to implement key social and economic policies is restricted. The legal challenge under the investment provision of a PTA of healthcare regulations targeting the marketing of tobacco products in Australia has been described as a case in point (Mitchell and Wurzberger 2011, Gleeson, Tienhaara and Faunce 2012, Fooks and Gilmore 2014).

While reducing tariffs and customs duties means that a government is ceding some regulatory power and hence is curtailing sovereign rights, the extent to which a government deliberately constrains its policy

space is dependent on its constitutional framework as well as the political choices it may be willing to make. Some measures or policies are written into countries' constitutions and, as such, do not provide governments with much leeway. In some countries, even the authority to negotiate or enter into PTAs may require a referendum[51]. Cross-country differences in ratification procedures also reflect the different constitutional processes confronting PTAs. Domestic laws ultimately determine what constitutes sovereignty and the extent to which it can be curtailed. The government, through the democratic process and the Parliament, is entrusted with decision-making on such sensitive matters based on open and inclusive discussions and engagement with key stakeholders.

Another sovereignty-related issue concerns the challenge process. Currently, the challenge process for government procurement in Malaysia is minimal as compared to the GPA[52]. A major concern relates to the *Bumiputera* policy and its relationship with the Federal Constitution. It is arguable that a challenge of the *Bumiputera* policy is indirectly a challenge to the Federal Constitution, hence making it a sovereignty issue for Malaysia. This concern however could be minimised with the recognition of domestic interpretation of specific terms, including *Bumiputera*. As such, the challenge would be only to the government procurement procedures and not to the policy itself. Delineating the extent to which treaties prevail over domestic laws, and assessing to what extent foreign suppliers could challenge the process, would provide the necessary balance to manage sovereignty-related concerns.

Balancing between Trade Policy and Trade-Negotiation Strategy

Malaysia is a key player in the global and regional trading environment. However, in terms of government procurement, Malaysia's suppliers are still predominantly domestic, with minimal Malaysian participation in overseas procurement markets. In order for Malaysia's suppliers to become more competitive, they need to expand abroad. At the same time, the government continues to place emphasis on using procurement preferences to lend support to indigenous industrial development. Doing so represents a challenging balancing act for the country's policymakers.

Finding the 'Comparative Advantage' in the GP Market

The benefits and costs of opening up a government procurement market should be assessed from both the demand and supply sides. Thus far, the arguments have focused chiefly on achieving economic efficiency through an open procurement process. An important additional consideration is the extent to which a trade agreement confers genuine new market access opportunities abroad to domestic suppliers. From an export perspective, the actual potential benefits need to be distinguished from the absolute size of foreign procurement markets. Commitments under PTAs suggest indicative benefits as Malaysian suppliers must still compete with other foreign suppliers in realising potential market entry gains. The difference between the potential and effective ability to access foreign procurement markets reflects the real-life application of comparative advantage principles. To secure benefits from reciprocal procurement liberalisation, Malaysia needs to identify those goods and services procured by its trading partners that could be competitively provided by Malaysia's suppliers. An example of this is the actual ability of Malaysian suppliers to compete with domestic and other foreign suppliers in the procurement markets of OECD members. In the case of the US, for instance, this can be shown through a snapshot comparison between the US government's demand for goods and services and Malaysia's leading exports to the US market (see Tables 13 and 14). Such a comparison is indicative of Malaysia's current positioning in the US market and the level of competition it would need to contend with in satisfying US procurement needs.

In discussing matters of comparative advantage, another important point to consider is that PTAs are not just about government procurement. PTAs feature a range of chapters dealing with trade in goods, services, intellectual property, technical barriers to trade, trade facilitation and competition as well as cross-border investment, among others. Governments need to assess the costs and benefits of trade agreements by examining their overall effects, taking into consideration the potential impacts on all sectors and modes of supply. Seen this way, 'comparative advantage' may be derived not solely through the exports of goods and services, but also be secured through the movement of factors of production—capital and labour. Therefore, governments need to consider all economic impacts of trade pacts and not focus only (vertically) on government procurement provisions.

Table 13. Leading Goods Procured by US Defence and Civilian Agencies, Fiscal Year 2015

Defence Agencies	Percentage of Total Defence Obligations on Products (%)	Civilian Agencies	Percentage of Total Civilian Obligations on Products (%)
Airspace Craft and Structure Components	23.6	Medical, dental, veterinary equipment and supplies	38.8
Guided Missiles	9.2	Information technology equipment (including firmware) software, supplies and equipment	15.8
Ships, Small Craft, Pontoons and Floating Docks	8.7	Subsistence	7.7
Communication, Detection and Coherent Radiation Equipment	7.6	Ores, minerals and their primary products	6.9
Fuel, Lubricant, Oil and Waxes	6.6	Ground effect vehicles, motor vehicles, trailers and cycles	3.8

Source: Contracting Data Analysis—Assessment of Government-wide Trends, United States Government Accountability Office Report to Congressional Addressees, March 2017.

Table 14. Malaysia's Top Ten Exports to the US, 2017

Products (HS-2)	Value RM (USD) billion
Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	40.4 (10.0)
Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	14.7 (3.6)
Rubber and articles thereof	6.3 (1.6)
Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	6.3 (1.6)
Furniture, bedding, mattress, lamps and lighting fittings, etc.	3.7 (0.9)
Animal or vegetable fats and oils	2.3 (0.6)
Miscellaneous chemical products	1.8 (0.5)
Plastics and articles thereof	1.2 (0.3)
Articles of apparel and clothing accessories, knitted or crocheted	1.2 (0.3)
Aircraft, spacecraft, and parts thereof	1.1 (0.3)

Source: DOS (n.d.)

CONCLUDING REMARKS

The inclusion of government procurement disciplines in trade agreements has proven a challenging policy matter for many countries, including Malaysia. The limited increase in the number of WTO GPA signatories and the constrained nature of additional commitments made even by developed countries under the GPA, together with the rejection of the Singapore issue addressing transparency in public procurement, attest to the sensitivities that surround the treatment of government procurement in trade diplomacy. At the same time, countries are more successful in negotiating on government procurement bilaterally

or plurilaterally among 'like-minded partners', as was illustrated by the TPPA/CPTPP experience. The complex interlinkages between governance, politics and attractive market access opportunities lie behind the observed policy sensitivities and may well offer a compelling rationale for limited *negotiated* traction in procurement liberalisation. Countries show a greater readiness to engage in unilateral domestic reforms of their procurement regimes, notably through the UNCITRAL Model Law, where market access issues do not arise as they do under trade agreements[53].

A further issue arising from the TPPA/CPTPP experience which may inform the substance of future trade rule-making is the clear recognition of the need for developing countries to secure procurement policy space while they progressively accept liberalising standards and processes in their domestic sphere. The TPPA/CPTPP Parties, representing as they did an interesting sample of the world economy, showcased the ability of modern agreements to preserve needed development policy space for developing country signatories. This is something the WTO GPA has arguably not done as well, with clear implications for the Agreement's stalled membership. The question arises of whether the TPPA/CPTPP approach represents the 'new normal' that subsequent PTAs will replicate, which in turn could influence the future path of WTO rule-making in the procurement area.

The TPPA/CPTPP was most assuredly a game-changer for Malaysia as it sets the benchmark for future negotiations in the procurement area. Other major trading partners, such as the EU or China, are likely to be expecting the bar to be set at the level of the CPTPP. From here on, Malaysia may wish to consider the efficiency gains that continued efforts at procurement liberalisation may generate, not least in ratcheting up the competitiveness of domestic suppliers and their ability to gain a larger share of foreign procurement markets. The TPPA/CPTPP experience has shown that doing so need not entail the dramatic loss of regulatory sovereignty that many had feared would materialise. The experience gained from negotiating TPPA/CPTPP has also shown that Malaysia is capable of making treaty commitments on government procurement and may be able to at least replicate its positions in the current trade negotiations, such as the Regional Comprehensive Economic Partnership (RCEP) negotiations between ASEAN and its six foreign partners.

Malaysia must thus not only prepare itself for progressively greater international disciplines on its government procurement regime, it must also take active steps to enhance the competitiveness of domestic suppliers that will face increasing competition at home and abroad.

For Malaysia to benefit from more open procurement markets, it must keep reforming its domestic procedures, buttress local supply chains and keep pace with the competitive strengths of foreign suppliers. It is doubtful that preserving the country's protective procurement regime will get Malaysia where it needs to be in a more globally contestable environment. Above and beyond this, greater policy attention needs to be paid to the overall—economy-wide—benefits that trade agreements can bring to the Malaysian economy and its citizens rather than focusing on procurement matters in an unduly defensive and stand-alone manner.

Endnotes

[1]The author would like to thank Afifah Sahib (Ministry of Finance, Malaysia) for her views on this chapter.

[2]18 July 2012. WTO n.d. (a).

[3]The Proposed U.S.-Malaysia Free Trade Agreement, CRS Report for Congress, 10 January 2007. https://digital.library.unt.edu/ark:/67531/metadc807939/m2/1/high_res_d/RL33445_2007Jan10.pdf. Malaysia's strong preferential regime in government procurement has been documented in a number of articles for example McCrudden 2004, McCrudden and Gross 2006, McCrudden 2007.

[4]Malaysia started the negotiations with the EU in 2010, almost simultaneously with the negotiations of the TPPA. However, the negotiations with the EU were suspended in 2012. Source: http://fta.miti.gov.my/index.php/pages/view/malaysia-eu

[5]Part VIII of the Federal Constitution of Malaysia 1957.

[6]Government procurement was excluded from the basic WTO national treatment and most-favoured nation obligations under the government procurement exclusion in Article III.8, XVII.2 GATT and Article XIII.1 GATS.

[7]World Bank (2018). Bulgaria and Romania are treated as one party.

[8]An example is Australia. Australia joined as an observer in 1996 and has yet to become a member of the WTO GPA. After almost 10 years, in June 2015, Australia started negotiating accession to the GPA.

[9]During the 1996 WTO Ministerial Conference in Singapore, the WTO Members agreed to set up three new working groups to work on matters relating to trade and investment, competition policy and transparency in government procurement. These became known as the 'Singapore issues'.

[10]The US trade policy for the inclusion of government procurement is reflected in the May 2007 Bipartisan Trade Deal. https://ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf

[11]The Expert Group has since been dissolved. This group is now administered under the Committee on Trade and Investment.

[12]A positive-listing approach is where countries list entities or activities which would be subjected to the agreement. As a result, only the listed entities or activities are captured. The negative-listing approach is where countries list entities or activities which are exempted or excluded from the agreement. Any entities or activities not mentioned would automatically be subject to the agreement.

[13]The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. As of the average rate in the month of July 2018, 204.1 billion SDRs (equivalent to about USD288 billion) had been created and allocated to members. SDRs can be exchanged for freely usable currencies. IMF (2018). The author would like to thank Nurul Aina Hayati, a research intern at Khazanah Research Institute for her assistance.

[14]FTA Malaysia (2009) and Utusan Malaysia (2009). The MUSFTA negotiations were suspended in January 2009.

[15]In addition, Malaysia also successfully secured transitional clauses for the following measures:

- Procurement funded by an economic stimulus package in response to a severe nationwide economic crisis implemented within 25 years after entry into force of the TPPA; and
- Delayed application of prohibition on offsets for a period of twelve years following the date of entry into force of the TPPA.

[16]The TPPA negotiations took 5 years to complete.

[17]Article 5 WTO GPA (revised).

[18]This is discussed in detail under 'Key consideration 3: Policy space for development'.

[19]An example of this is the *Bumiputera* policy in Malaysia, which is sourced from the Federal Constitution. Similar situations could be argued in the context of the Waitangi Treaty for New Zealand.

[20]The Auditor General and the National Audit Office, established in accordance with Articles 105, 106 and 107 of the Federal Constitution of Malaysia and the Audit Act 1957, prepare and submit the annual audit report of the Government to the Parliament.

[21]The TPPA, upon coming into force, would require a domestic review process.

[22]https://www.wto.org/english/tratop_e/gproc_e/gproc_e.htm

[23]With the exception of Singapore. This is because Singapore is the only ASEAN Member State that is a signatory to the WTO GPA.

[24]This is based on general government final consumption expenditure (formerly general government consumption), which includes all government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditure on national defence and security, but excludes government military expenditures that are part of government capital formation. Source: https://data.worldbank.org/

[25]SNA is an international standard for compilation of national account statistics and for the international reporting of comparable national accounting data published jointly by the United Nations, the Commission of the European Communities, the International Monetary Fund, the Organisation for Economic Co-operation and Development and the World Bank.

[26]The Malaysian Government's annual financial statements are published by the Accountant General's Department of Malaysia (http://portal.anm.gov.my/en/main.php?Content=sections&SectionID=78).

[27]General statistical information on e-procurement in Malaysia is available at the official portal for Malaysian Government procurement (http://home.eperolehan.gov.my/statistik-sistem-ep).

[28]Listed government-linked companies such as Tenaga Nasional Berhad and Telekom Malaysia are not subjected to the procurement regime of Ministry of Finance.

[29]PwC in its report on Malaysia estimated that about 20% of a country's government procurement market is generally open to foreign competition, estimating that the cumulative value is about RM700 billion of opportunities to foreign businesses. The US is estimated to account for about RM650 billion of these potential opportunities.

[30]Out of the 20 PTAs, 4 are also signatories to the WTO GPA.

[31]For common consumption, the US catalogue system requires products to be tested and approved before inclusion in the catalogue.

[32]Annual Budget 2017. See http://www.treasury.gov.my/index.php/bajet/anggaran-perbelanjaan-persekutuan.html

[33]*Bumiputera* are the local natives of Malaysia. Article 53 of the Federal Constitution of Malaysia sets out that it shall be the responsibility of the *Yang di-Pertuan Agong* to safeguard the special position of the Malays and natives of any of the States of Sabah and Sarawak.

[34]The first stimulus saw the funding for 53,571 projects worth RM6.1 billion. The second stimulus package of RM60 billion was introduced in 2009. This package awarded 31,158 projects funding worth RM7.6 billion. Similar to the first stimulus package, the focus was on general development and infrastructure. For example, RM8.4 billion was allocated to accelerate the implementation of various projects under the Ninth Malaysia Plan, and RM2.0 billion to build and improve facilities in 752 schools, particularly in rural areas, as well as in Sabah and Sarawak.

[35]Buy American Act 1933, providing their purchase is consistent with the interest, the items are reasonable in cost, and they are for use in the US.

[36]Mainly in all Australia's FTA, see for example the Government Procurement Chapter in the Australia-Singapore FTA. http://dfat.gov.au/trade/agreements/safta/Documents/SAFTA-chapter-06.pdf

[37]Annex 7 to New Zealand's WTO GPA commitments. New Zealand reserves the right to accord more favourable treatment to Māori in respect of matters covered by its commitments under the WTO GPA including in fulfilment of its obligations under the Treaty of Waitangi.

[38]The impact of the *Bumiputera* policy under Malaysia's PTAs is discussed in detail later in this chapter.

[39]Srivastava (2003), 237 highlighted the possible justification for preferential treatment based on earlier studies by Krugman and Helpman.

[40]Article III of the Tokyo Round Code on Government Procurement (1979).

[41]Paragraphs 11 and 12 of Article III of the Tokyo Round Code on Government Procurement (1979).

[42]The authority of the Federal Government is set out in Articles 74 and 80, read together with Schedule 9.

[43]See PK2 Kaedah Perolehan Kerajaan – Paragraph 10(viii). Access at http://1pp.treasury.gov.my/

[44]Section 6 of the FPA 1957.

[45]Section 15A of the FPA 1957.

[46]UKAS (2018): 698 PPP projects in various economic sectors had been signed from 1983 to 2014. The PPP projects have enabled the government to make savings on both capital and operating expenditures amounting to RM204.9b (USD65b). Source: "PPP facilitation fund 'adjustments' to bring more impact." *The Sun Daily* accessed March 3, 2015. http://www.thesundaily.my/news/1343298

[47]These are companies where the government is the shareholder, as minority, substantial or wholly-owned. However, SOEs that are fully funded by the Government are subjected to the regulations issued by the Ministry of Finance.

[48]Article I(1)(c) of the Tokyo Round Code on Government Procurement (1979) and Article I(1)(c) of the Revised Tokyo Round Code on Government Procurement (1988).

[49]System of National Accounts 1993 at p. 124. http://unstats.un.org/unsd/nationalaccount/docs/1993sna.pdf

[50]Based on the WTO GPA template and as applied in PTAs, Schedule C of the Annex is for the listing of other entities, which includes state-owned enterprises.

[51]An example is Costa Rica's referendum to join the Central American Free Trade Area.

[52]Under the Treasury Circular, this is an internal complaint process.

[53]Smaller and developing countries are more open to adopting or following the UNCITRAL Model Law. For a list of countries, see: http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/2011Model_status.html

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8

Emerging Rules for State-Owned Enterprises: Chapter 17 of the CPTPP[1]

Wan Khatina Nawawi

INTRODUCTION

On 23 January 2017, President Trump signed a presidential memorandum to direct the United States Trade Representative (USTR) to withdraw the United States (US) as a signatory to the Trans-Pacific Partnership Agreement (TPPA) and to permanently withdraw the US from the TPPA negotiations. Despite this, the remaining eleven TPPA signatory Parties decided to proceed with the agreement without the US. From 17 March 2017 onwards, they met regularly to renegotiate parts of the TPPA and their efforts culminated in the signing of a new agreement on 8 March 2018. This new agreement is known as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

The CPTPP text was mainly based on the US free trade agreement (FTA) model as the US was previously the major *demandeur* for most of the agreement's thirty chapters. During the TPPA negotiations, the US had introduced a new stand-alone chapter, Chapter 17, to regulate state-owned enterprises (SOEs) and designated monopolies of the signatory Parties. The eleven signatory Parties agreed not to renegotiate the text

of the TPPA Chapter 17—rather, as explained later in this chapter, the current CPTPP Chapter 17 has minor amendments in terms of some of the Parties' dates of enforcement for their commitments as laid out in the chapter annexes.

Chapter 17 of the TPPA (and now of the CPTPP) was one of the more difficult chapters for Malaysia to negotiate and agree to as the subject matter was one of its redlines alongside concerns in the areas of intellectual property rights, labour, environment and government procurement. However, this was no longer the case during the CPTPP negotiations, although Malaysia had managed to gain some concessions from the other ten signatory Parties for some of its commitments in the CPTPP Chapter 17 annex.

Malaysia is already a Party to other international trade agreements that incorporate SOE-related commitments—these include preferential trade agreements (PTAs) at both the regional and bilateral levels, as well as various agreements under the auspices of the World Trade Organization (WTO). However, the TPPA Chapter 17 and the CPTPP Chapter 17 were by far Malaysia's most comprehensive and substantive commitments on SOEs[2]. The commitments incorporated into the chapter raise many questions. Is this a new direction for Malaysia's SOE governance? Will Malaysia agree to a similar level of disciplines on SOEs in its future PTAs? And how do such disciplines and commitments fit into the existing national regulatory and governance landscape of Malaysian SOEs?

This chapter aims to kick-start a discussion on the regulation and governance of the Malaysian SOE landscape with a focus on the provisions contained in Chapter 17 of the CPTPP. The discussion is organised as follows:

- The first section looks at the development of SOEs and SOE governance in Malaysia and discusses the different types of SOEs currently in existence in Malaysia.
- This is followed by an introduction to the multi-layered regulatory and governance mechanism for SOEs highlighting the various national measures aimed at regulating such enterprises. These include self-regulation via the Government-Linked Companies Transformation (GLCT) programme, domestic regulations and governance via golden shares, sector-specific regulations, and the

Bursa Malaysia's rules for publicly-listed companies (including publicly-listed SOEs).

- The next section discusses the various international SOE-related commitments that Malaysia has undertaken to date and focuses on commitments made in the country's PTAs. This section also looks at SOE rules found in the PTAs of Australia, the European Union (EU) and the US.
- The penultimate section looks at Chapter 17 of the CPTPP, including its genesis, key provisions and elements, and the flexibilities for Malaysia as agreed by the signatory Parties.

This chapter concludes by observing that the Chapter 17 of the CPTPP, once it comes into force, will change the existing regulatory and governance landscape for Malaysian SOEs and influence the SOE-related commitments it makes in the future.

THE DEVELOPMENT OF SOES AND SOE GOVERNANCE IN MALAYSIA

Historical Development of SOEs and Their Regulatory and Governance Mechanisms

The historical development of SOEs in Malaysia can be traced all the way back to the British Malaya, or the pre-independent times. Such enterprises were then known as 'agency houses', which were involved in the key sectors of the Malayan economy, notably, plantations, tin mining and commercial trading. Agency houses in the rubber industry, such as Harrisons & Crosfield, Boustead-Buttery, Guthrie, and Sime Darby owned and managed vast tracts of plantation land, which they managed to secure from their close relationship with the British Civil Service in Malaya (Putucheary 2004). In the early 1970s to 1980s, the Malaysian government took control of many of these agency houses. These SOEs, or government-linked companies (GLCs) as they are more commonly known in Malaysia, are now owned by government-linked investment companies (GLICs)—for example, Boustead is a GLC under the Armed Forces Fund Board or Lembaga Tabung Angkatan Tentera (LTAT), which in turn is a GLIC; and Sime Darby is a conglomerate GLC under Permodalan Nasional Berhad (PNB), a GLIC incorporated in 1978.

The period after independence saw the development of a regulatory and governance mechanism for SOEs, which in the beginning, was mainly intended to clarify the powers and responsibilities of the government, both at the federal and state levels, as regards their relationship with these entities. In 1957, the Minister of Finance (Incorporation) Act 1957 established the Minister of Finance (MOF) Incorporated (MOF Inc.) as a corporate body and provided authority to this entity to enter into contracts, manage acquisitions, purchases, possessions and holdings, and maintain tangible and intangible assets. Meanwhile, the Federal Constitution empowered the state governments to manage land- and water-related matters within their jurisdictions. As such, state governments can enact laws to regulate the agriculture, mining, fisheries and forestry sectors within their state boundaries. This resulted in many state governments taking steps to establish state economic development corporations (SEDCs) to manage their natural resources. In 1969, the Government established a Committee for the Coordination of the SEDCs but despite its name, the Committee's task was mainly to supervise federal loans to such SEDCs, rather than coordinating their activities (Gale 1981, 181).

In 1970, following the race riots in Kuala Lumpur in May 1969, the Federal Government developed and introduced, the National Economic Policy (NEP), an economic programme of affirmative action for the *Bumiputeras*[3]. The NEP has broad socio-economic objectives including increasing the domestic participation, especially of *Bumiputeras*, in the economy. The NEP set target equity ownership levels of 30% for foreigners, 40% for other Malaysians, and 30% for *Bumiputeras* to be reached by 1990. The establishment and development of SOEs were considered crucial to achieving the NEP targets. It was from 1970 onwards that Malaysia saw a significant growth in the number of SOEs established in the country, at a rate of more than 100 SOEs annually by the mid-1970s (Adam, Cavendish and Mistry 1992, 216).

It was only in 1974 that the government decided to establish a Ministry for the Coordination of Public Corporations. However, even then, other government ministries were still responsible for some of the SOEs deemed to be under the purview of their administrative areas—for instance, the former Malaysian Airline System (MAS) operated under the purview of the Ministry of Power and Technology. The Ministry was renamed Ministry of Public Enterprises (MPE) in early 1976 and given a wider mandate with the following functions (Gale 1981, 183):

- Monitor and coordinate corporations within its jurisdiction to ensure their policies, programmes and projects were consistent with the NEP objectives.
- Identify and resolve problems in the operation of the corporations and in terms of inter-corporation relationships.
- Promote cooperation among these entities as well as with other government agencies.
- Undertake policy analyses and introduce policy changes.
- Stimulate expansion of corporations consistent with NEP objectives.

Privatisation of SOEs—1980s to mid-1990s

In the 1980s, as the so-called 'Washington Consensus' gained worldwide currency, it was *de rigueur* for governments to embrace market liberalisation reforms and the Malaysian government was no exception to this trend. In 1983, the Malaysian government embarked on a privatisation programme as part of the wider Malaysia Incorporated (Malaysia Inc.) policy. The Malaysia Inc. policy was developed to promote the increasing role of the private sector in the Malaysian economy (Government of Malaysia 1991). In 1985, the government launched the Guidelines on Privatization and subsequently, in 1991, the government introduced the Privatization Master Plan to guide the implementation of the programme. The plan, to be executed in phases, represented a new approach to development which complemented earlier policies, notably the 1983 Malaysia Inc. policy—developed to underscore the increased role of the private sector in the development of the Malaysian economy. The government's intention was to reduce its presence in the economy, decrease both the level and scope of public spending and allow market forces to govern economic activities (Government of Malaysia 1991).

The Development of MOF Inc.

As the government focused on privatising its SOEs, the MPE underwent several transformations and was given a new mandate. In 2004, the MPE became the Ministry of Entrepreneur and Cooperative Development but following a cabinet reshuffle in 2009, this Ministry was later disbanded and its roles and responsibilities were absorbed by other ministries, including the Ministry of Domestic Trade, Cooperatives and Consumerism. Since then there has been no single Ministry

in the federal government that is responsible for coordinating SOE activities in Malaysia. However, the Investment, MOF Incorporated and Privatization Division (commonly known as MOF Inc.) came close to having similar policymaking functions to those of the MPE as it owned the majority of federal SOEs. The MOF website highlights that the Division's functions include coordinating; assessing financial positions and business plans; reviewing and formulating SOE-related policies; managing the corporatisation and privatisation activities; and managing the investment and divestment of shares in MOF Inc.'s SOEs. Under the Treasury Transformation programme in 2014, MOF Inc. was restructured and renamed the Government Investment Companies (GIC) Division. A new division was also established—the Statutory Body Strategic Management (SBSM) Division, which is responsible for the statutory bodies established by the MOF.

Different Types of SOEs in Malaysia

Malaysian SOEs are no longer restricted in terms of their activities, customers or clients. Apart from undertaking development activities, they can also provide commercial goods and services, often in the same markets as non-SOEs, as is evidenced in the banking and finance, manufacturing, leisure and tourism, and agricultural sectors. Examples of SOEs in these sectors include Maybank, Chemical Company of Malaysia Berhad, Rangkaian Hotel Seri Malaysia Sdn. Bhd. and TH Plantations. Their customers and clients have become more diverse, ranging from the government, other SOEs and non-SOEs to the public. Some SOEs have also internationalised their commercial activities by operating in regional and international markets.

Malaysian SOEs can generally be described as belonging to five distinct categories. Government ownership in SOEs can be both direct and indirect by either the federal or state governments. At the federal level, government ownership can be exercised directly by a government ministry, department or agency and indirectly through a government-linked investment company, statutory body or a public-sector agency. Examples of Malaysian SOEs include:

a. *Companies under direct ownership of the government*. Various government ministries may have direct ownership of SOEs. Some SOEs owned by the GIC Division of the MOF include the national

rail company (Keretapi Tanah Melayu Berhad), the Multimedia Development Corporation and the Port of Penang.

b. *Government-linked companies (GLCs)*. The term GLC was first used as part of the GLC Transformation Manual, which was initially developed to identify specific SOEs held by federal-level GLICs that came under the GLCT programme launched in 2004. Although the term was initially meant only for the programme, use of the term, albeit erroneously, is now widespread. There is a misconception that the GLC universe encompasses all the other entities that have some 'linkage' with the government. GLCs are incorporated under the Companies Act 1965 (CA1965, Act 79)[4] and although they may have some public policy objectives, they are private or public, for-profit, corporations. Many of the larger GLCs are also listed on the Malaysian stock exchange (Bursa Malaysia) and regulated by the rules of the stock exchange and the Securities Commission. These companies are treated the same way as any other publicly-listed company from a legal and regulatory perspective. Examples of GLCs include MAS, Telekom Malaysia (TM), the national telecommunications service provider, and Tenaga Nasional Berhad (TNB), the national power company.

c. *Government-linked investment companies (GLICs)*. GLICs are companies that hold stakes in other companies on behalf of the government. There are two distinct categories of GLICs—those fully owned by the government, such as Khazanah Nasional Berhad (KNB), and the GIC Division of the MOF and the GLICs that are 'privately funded' but where the government plays an important statutory and/or guarantor role. The latter category includes the Employees Provident Fund (EPF), the LTAT, the PNB, Lembaga Tabung Haji (LTH), and the Retirement Fund Incorporated (KWAP).

d. *Statutory bodies*. SOEs could also take the form of statutory bodies that undertake commercial activities. Each of these statutory bodies has been created by a special Act of Parliament and report to a Minister, who is then responsible to the Parliament for the body's performance. While they are monitored by the SBSM Division of the MOF, they are independent legal entities and have flexibility in their day-to-day administrative matters—unlike a government department. Interestingly, some of the GLICs are also statutory

bodies through their legal incorporations. These include the LTAT, EPF and LTH, which were established by the *Tabung Angkatan Tentera*[5] Act 1973 (TATA1973, Act 101), the Employees Provident Fund Act 1991 (EPFA1991, Act 452), and the *Tabung Haji*[6] Act 1995 (THA1995, Act 535), respectively.

e. *Non-financial public enterprises (NFPEs)*. The NFPEs have similar commercial functions and ownership to those of the other SOEs described above. They can be government-owned, government-controlled or agencies owned by statutory bodies. The government monitors the financial positions of NFPEs, which have minimum annual sales of at least RM100 million and these details are compiled and made public in the annual Treasury Report by the MOF.

f. *Sovereign wealth funds (SWFs)*. Some SOEs are SWFs, which are "special-purpose investment funds owned by governments" (International Working Group of Sovereign Wealth Funds 2008, 3). An example would be KNB, which is also known as a GLIC in Malaysia (see above).

g. *State-level GLCs and GLICs*. Similar entities also exist at the state level, when a state government has direct holdings, or through a state-level GLIC. These have very similar legal and structural identities to federal-level GLCs.

NATIONAL REGULATORY AND GOVERNANCE MECHANISMS FOR SOES

The commercial activities undertaken by SOEs in Malaysia are subject to multi-level regulatory and governance mechanisms—self-regulation, domestic regulations and governance, and international regulations and governance. This section discusses *national-level* regulatory and governance mechanisms for SOEs in Malaysia.

Self-regulation: the GLC Transformation (GLCT) Programme

The Malaysian government, under the administration of Prime Minister Abdullah Ahmad Badawi, introduced a new SOE-related policy in 2004. This included, among others, the introduction of guidelines on key performance indicators (KPIs) for the GLCs, reform of GLC Board composition, a revamp of KNB (from a passive to an

active investor) and changes to the senior management and board members of the GLCs. This was followed by the launch of the ten-year GLCT programme in 2005. This programme aimed to improve the performance of selected GLCs (also known as the G20[7]) based on these three key principles (PCG 2005):

- **National development foundation**: Growing with equity, improving total factor productivity and developing human capital.
- **Performance focus**: Creating economic and shareholder value through improved performance.
- **Governance, shareholder value and stakeholder management**: Implementation of various initiatives, engaging and managing stakeholders.

The GLCT programme could be viewed as the GLICs' effort to self-regulate their GLCs. While the programme was overseen by the Putrajaya Committee on High Performing GLCs (PCG), which was chaired by the Prime Minister, its members were the heads of GLICs, as well as representatives of the then MOF Inc. and the Prime Minister's Office.

The GLCT programme comprised ten initiatives (known as coloured books) which were rolled out in stages over a ten-year period—see Table 1. Both the GLICs and the G20 set their own KPI targets and their progress reviews were carried out at the PCG-level. Indeed, their respective boards of directors were accountable for programme implementation.

On 7 August 2015, the G20 graduated from the GLCT programme. They had shown significant improvements in all key financial areas between 14 May 2004 and 28 July 2015. For example, their market capitalisation grew from RM134 billion to RM386 billion during the ten-year period while the total shareholder return increased by 11.1% annually. The G20's net profit came to RM26.2 billion in the financial year (FY) 2014, growing annually by 10.2% in the ten years. They had undertaken RM153.9 billion worth of domestic investments from FY 2004 to FY 2014, employing 225,050 Malaysians in 2014 (PCG 2015).

Apart from acknowledging all the achievements, the Prime Minister also announced the establishment of a successor entity to the GLCT programme at the 'graduation ceremony'. This entity is envisaged to be a 'GLIC and GLC club'.

Table 1. The Ten Initiatives of the GLCT Programme

Initiative	Key programme
Enhance Board effectiveness	Green Book
Strengthen directors' capabilities	Malaysian Directors' Academy
Enhance GLIC monitoring and management functions	GLIC Monitoring & Management Framework
Managing regulatory environment	White Book
Clarifying social obligations	Silver Book
Review and revamp procurement	Red Book
Optimise capital management practices	Purple Book
Manage and develop leaders and other human capital	Orange Book
Intensify performance management practices	Blue Book
Enhance operational improvement	Yellow Book

Source: PCG website.

Domestic Regulations and Rules for SOEs

Malaysian SOEs are governed by a number of *domestic* legislative and regulatory measures which are administered and enforced by various government ministries, agencies and regulators. These include:

- **Government ownership**: The government can regulate SOEs via ownership or shareholding rights in these entities. Such rights may include 'special' or 'golden' shares which accord the government the right to impose effective control disproportionate to the number of shares it holds. SOEs with golden shares are mainly those operating in strategic industries with significant national interest implications. In the case of MAS, the national airline, such special shares were first proposed and later introduced when it was privatised in 1985. The golden share in MAS provides the government with the right to control the enterprise's board of directors, with priority in capital repayment in the event of winding up the company, and obliges MAS to redeem the special share at par at any time (Tan 2008).

As mentioned earlier, apart from the government being their shareholders, SOEs are also answerable to the Malaysian Parliament and may be asked to appear before the Public Accounts Committee on any issues of public interest when required.

The Auditor General's Office also audits SOEs and the outcomes of these audits are made public in its annual report. Meanwhile, SOEs that receive government guarantees for their fund-raising exercises need to be gazetted as a corporate body under the Loans Guarantee (Bodies Corporate) Act 1965 (LGA1965, Act 96). The LGA1965 authorises the government to guarantee loans raised by certain corporate bodies and restricts the borrowing powers of these entities so long as they have the guarantee outstanding. In the event of a possible default, arrangements must be made to ensure that these entities can assume all their obligations under the guarantee. Except for any confidential information, the SOE's relevant line minister needs to provide all the details of the guarantee to Parliament.

Additionally, the MOF's Treasury Circular Letter No.11/1993 provides the policy and guidelines on dividend payments by SOEs to the government as a shareholder of these entities. SOEs are required to pay at least a 10% dividend annually to the government and this percentage may be higher if the SOE records excess profits in a particular financial year. The dividend payment must also meet the provisions incorporated in Articles 98 to 107 of CA1965 (MOF 1993).

- **General legislations and regulations**: As mentioned earlier, when SOEs feature government ownership, they are usually incorporated under the CA1965 (now CA2016). This Act is currently enforced by the Companies Commission of Malaysia (CCM) and regulates the constitution of companies, their management and administration as well as their financial reporting, among others. Thus, as with all other companies, incorporated SOEs are obligated to file their annual financial returns to the CCM and these are accessible to the public upon payment of a small administrative fee.

  As noted above, many of the larger SOEs are listed on—and regulated by—Bursa Malaysia and the Securities Commission. As with other listed companies, these SOEs are subject to corporate law and notification requirements, including the stock exchange requirement of publishing their annual reports and making public information deemed material to investment decisions.

- **Sector-specific regulations**: Sectoral regulators in Malaysia have been enforcing their respective regulatory requirements on all the entities falling under their purview regardless of their ownership structures. These may include some SOEs and GLCs—for example, TM and TNB are regulated by the Malaysian Communications and Multimedia Commission (MCMC) and the Energy Commission (EC), respectively. It must be noted that the banking and financial sector, as well as the capital markets, are relatively more developed and so their regulators—the Bank Negara Malaysia (BNM), the Securities Commission, and Bursa Malaysia—are also comparatively more mature and sophisticated in their enforcement capacities. Additionally, sectoral regulators in Malaysia assume multiple regulatory functions as they are responsible for both economic and technical regulations. The BNM, for instance, also develops and implements the country's monetary policy, while the Public Land Transport Commission also enforces safety regulations for the public land transport sector (notably for public buses and trains).
- **Competition law**: The Competition Act 2010 (CA2010, Act 712) and the Competition Commission Act 2010 (CCA2010, Act 713) are currently in their sixth year of enforcement. CA2010 applies to all commercial activities[8] that have effects on competition in markets in Malaysia.[9] These include SOEs and GLCs. However, entities that are already subject to the Communications and Multimedia Act 1998 (CMA1998, Act 588), the Energy Commission Act 2001 (ECA2001, Act 610), and the Malaysian Aviation Commission Act 2015 (MAC2015, Act 771) are excluded from the application of CA2010. Before MAC2015 entered into force, the Malaysian Competition Commission (MyCC) had investigated and decided on an aviation-related SOE case involving the Air Asia-MAS share swap deal of 2012[10].

INTERNATIONAL REGULATORY AND GOVERNANCE MECHANISMS FOR SOES

Malaysia also enforces *international* SOE-related regulatory and governance mechanisms, which are developed, established and implemented by a number of multilateral organisations (Mott and Wan Khatina 2014, 291–297):

- **World Trade Organization (WTO)**: Various SOE-related rules can be found in WTO agreements, most notably, the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the Agreement on Subsidies and Countervailing Measures (ASCM). These include GATT Article XVII on State Trading Enterprises; GATS Article VIII dealing with monopolies and exclusive service suppliers; GATS Article IX dealing with Business Practices; and Articles 1, 3 and 25 of the ASCM. These SOE-related provisions aim to ensure that SOEs adhere to the non-discriminatory principle of international trade, operate on the basis of commercial considerations and are transparent in their activities. As a WTO Member, Malaysia has been adhering to these SOE-related provisions. The WTO also provides additional measures or rules on SOEs for newly-acceded Members, as highlighted by the accession protocols of China and Vietnam.
- **Organisation for Economic Co-operation and Development (OECD)**: The OECD has worked together with the International Monetary Fund (IMF) and the World Bank Group to develop guidelines and best practices on corporate governance for SOEs. It also established a Working Party on State Ownership and Privatization Practices under the auspices of the Corporate Governance Committee to work on SOE-related issues and monitor the implementation of the OECD Guidelines on Corporate Governance for State-Owned Enterprises. The guidelines focused on the promotion of equitable treatment, transparency of information and activities, and sound governance, as well as on the integrity and competence of boards. The OECD has recognised Malaysia's GLCT programme as consistent with the best practices and recommendations that its guidelines aim to promote. KNB is a regular participant in the OECD-Asia Network on Corporate Governance of State-Owned Enterprises (OECD n.d.).

- **International Monetary Fund (IMF)**: In recent years, the IMF has taken a special interest in the activities of a new breed of SOEs—SWFs. The main concern expressed by IMF members related to the lack of transparency of SWF objectives and activities. The IMF established an International Working Group (IWG) on SWFs, which is coordinated by the International Monetary and Financial Committee (IMFC). In 2008, the IMFC adopted the Generally Accepted Principles and Practices for SWFs, better known as the 'Santiago Principles'. The 24 principles cover three main areas—legal, institutional, as well as investment and risk management frameworks. As a member of the International Forum on Sovereign Wealth Funds, KNB has voluntarily endorsed the Santiago Principles.

SOE-related Provisions in PTAs

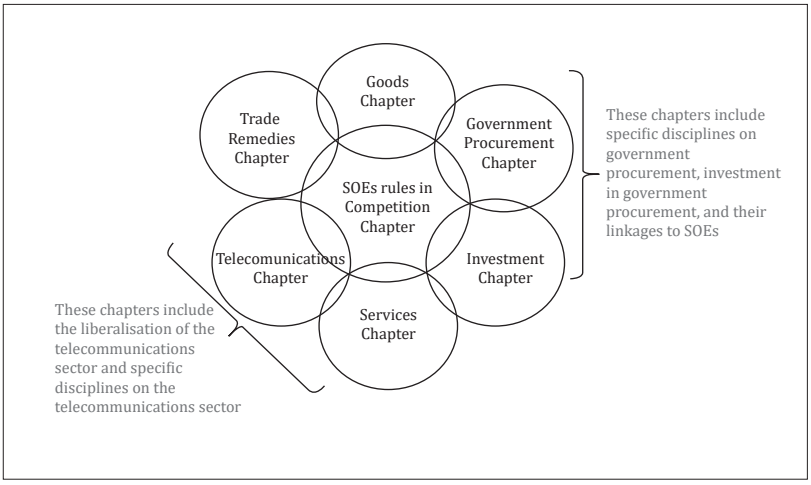
Except for Chapter 17 of the TPPA and subsequently, the CPTPP, (discussed in the next section), Malaysia has to date only committed to indirect disciplines on SOEs in the relevant chapters of its previous PTAs (see Table 2). The main reason justifying Malaysia's comfort level in committing to such SOE-related disciplines was that they were broadly aligned to the ones that Malaysia had already agreed to under various WTO agreements, notably GATT Articles VII and IX. The incorporation of such SOE rules was mainly intended to clarify the scope of the chapters, that is, whether the rules in those chapters would apply to SOEs. Table 2 shows how most of the SOE rules were incorporated into the investment and services chapters of Malaysian PTAs. Interestingly, the Malaysia-Australia FTA had included SOE-related provisions not only in its investment and services chapters but also in its telecommunications services and competition policy chapters.

Table 2. SOE-related Provisions in Malaysia's FTAs

	Indirect rules and obligations on SOEs			Competition chapter
	Investment chapter	Services chapter	Other chapters	
Malaysia–Japan	X	X		
Malaysia–Pakistan	X	X		
Malaysia–Chile				
Malaysia–India	X	X		
Malaysia-Australia	X	X	X	X
Malaysia-New Zealand	X	X		
Malaysia-Turkey				
ASEAN-Japan				
ASEAN-India				
ASEAN-China		X		
ASEAN-Korea	X	X		
ASEAN-Australia-New Zealand	X	X		

Source: Ministry of International Trade and Industry (MITI).

Figure 1. SOE–related Provisions in the Various PTA Chapters



Source: Author.

Indeed, the placement of SOE-related provisions in the various chapters of Malaysia's PTAs is similar to that in the WTO agreements described above. However, the PTA templates of developed economies, such as those of Australia, the EU and the US, have also included specific competition chapters featuring SOE-related provisions. Figure 1 illustrates how the rules on SOEs found in the competition chapters of PTAs are linked to other treaty chapters.

The incorporation of SOE-related provisions in PTAs can trace its origin in the gaps and weaknesses of SOE-related provisions found in the multilateral instruments of the WTO, OECD, and IMF. These include:

a. *Narrow scope and coverage*. The existing multilateral instruments surveyed incorporate disciplinary elements that address only specific types of SOEs. This reflects the specific mandates of the various organisations and instruments concerned—state-trading enterprises (STEs) are covered by the GATT, monopolies and exclusive service suppliers by the GATS and SWFs are addressed by the Santiago Principles. While the OECD Guidelines seem to cover all SOEs, they are enforced on a voluntary basis by OECD Members and so are not legally binding.

b. *Limited relevance*. The SOE-related provisions found in existing WTO Agreements have limited relevance and have generally not kept pace with the changing structure, functions and growing complexity of contemporary SOEs. For instance, GATT Article XVII only covers the trading function of SOEs—although the production function of SOEs, which is not covered by the Article, could also adversely affect and limit international trade or distort international competition. Moreover, GATS Article VIII was drafted at a time when infrastructure, utilities and telecommunications services were typically provided by government-owned (natural) monopolies or exclusive service suppliers. Rapid changes in technology and the subsequent introduction of competition and new business models have greatly limited the relevance of Article VIII disciplines under current market conditions.

c. *Weak commitments*. International and multilateral organisations do not generally impose strong (i.e. legally binding and enforceable) commitments on their members to discipline their SOEs. Both the OECD Guidelines and the Santiago Principles are non-binding and

> voluntary for their respective members. At best, these provide best/good practice (and soft law) recommendations on the governance of SOEs. Indeed, as mentioned earlier, the voluntary approach taken by the OECD did not compel its key members (Japan and the US) to support its project to better understand the role of SOEs in national economies. Meanwhile, WTO agreements mostly focus on improving the transparency of SOE structures, functions and behaviour by requiring WTO Members to notify the relevant details of the covered SOEs in their jurisdictions. Unfortunately, the notification track records of WTO Members have been weak as many have taken advantage of the exclusions provided for in the Agreements[11]. Some WTO Members were also unsure about the definition of STEs and the scope and coverage of the relevant articles (United States General Accounting Office 1995, 9–10).

In view of the above challenges in developing, establishing and enforcing SOE-related disciplines at the multilateral level, economies, especially developed ones such as the US, the EU and Australia, have been working towards incorporating such disciplines in their PTAs, notably those with developing countries or countries with a significant SOE footprint in their economies. Among the developed countries, the US leads in designing and incorporating SOE-related disciplines in its PTAs. For this reason, the first part of the section that follows details the SOE-related provisions found in US PTAs before turning to the SOE-related provisions found in the PTAs of other major trading partners.

US PTAs incorporate more SOE-related provisions as they tend to have more specific chapters than those found in the PTAs of other countries, notably those of Australia and the EU. While most PTAs acknowledge the rights of governments to establish state monopolies, public or state enterprises, as well as enterprises with special or exclusive rights to operate in the various sectors or industries in the economy, they also incorporate relevant commitments to discipline such entities. These disciplines aim to ensure that SOEs adhere to the non-discriminatory principle of international trade, commit to consistent procurement rules, focus on commercial considerations and do not behave anti-competitively. While Parties to PTAs tend to exclude their competition chapters from the scope of application of the dispute settlement mechanism (DSM), the DSM provisions are usually applicable to such entities in other PTA chapters, such as in the services or investment chapters.

Table 3. SOE-related Provisions in US FTAs

US FTA	Date signed	Effective date	Chapters with SOE-related provisions				
			G	S	I	CP	GP
Israel	24 Apr 1985	19 Aug 1985					
Canada*	2 Jan 1988	1 Jan 1989	X	X	X		
NAFTA	6 May 1992	1 Jan 1994		X	X	X	
Jordan	24 Oct 2000	17 Dec 2001					
Singapore	6 May 2003	1 Jan 2004		X	X	X	X
Chile	6 Jun 2003	1 Jan 2004		X	X	X	X
Australia	18 May 2004	1 Jan 2005		X	X	X	X
DR-CAFTA	28 May 2004	1 Mar 2006			X		X
Morocco	15 Jun 2004	1 Jan 2006	X		X		X
Bahrain	14 Sep 2004	1 Aug 2006					X
Oman	19 Jan 2006	1 Jan 2009			X		X
Peru	12 Apr 2006	1 Feb 2009	X		X	X	X
Colombia	22 Nov 2006	15 May 2012	X	X	X	X	X
Panama	28 Jun 2007	31 Oct 2012	X		X		X
South Korea	30 Jun 2007	15 Mar 2012			X	X	

Note: * The Canada-US FTA was later expanded to become the North American Free Trade Agreement (NAFTA). NAFTA: Canada, Mexico and the USA; DR-CAFTA: Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

Source: Office of the United States Trade Representative (USTR) website; G, goods (or equivalent); S, services; I, investment; CP, competition; GP, government procurement.

SOE-related Provisions in US PTAs

Table 3 highlights the incorporation of SOE-related provisions in the existing US PTAs. Interestingly, no discernible pattern can be found. For example, it is understandable that the first US PTA with Israel contained no explicit SOE-related provisions, as the first preferential agreements of countries tend to be simple and light in commitment terms (such PTAs could be considered as 'practice' or 'testing ground' PTAs). The US's subsequent PTAs with Jordan and Bahrain also contained no explicit or else negligible SOE-related provisions. Its PTAs with Singapore, Chile and Australia, however, featured extensive SOE-related provisions,

which were incorporated into the key chapters surveyed, an approach mirrored in the Colombia-US PTA of 2006. Somewhat surprisingly, the US-Korea PTA did not contain as many SOE-related provisions as may have been expected given the significance of SOEs in the Korean economy (where some 57 SOEs have been reported, employing nearly 130,000 people with a turnover valued at over USD209 billion in 2012 according to the OECD) (OECD 2014).

How then does the US decide which SOE-related provisions to incorporate into its PTAs? These decisions could be based on the following three key factors.

Filling the Gaps between WTO Agreements and Previous PTAs

The NAFTA contained more extensive SOE-related provisions, as the US trade negotiators had learnt from the problems caused by the 'gaps' in the earlier Canada-US FTA (CUSFTA) and the WTO GATT Article XVII:

- The CUSFTA was mainly focused on removing agricultural tariffs, notably for grains and grain products, as well as disciplining government support for agriculture-based STEs such as the Canada Wheat Board (CWB) (Schedule 2.B.7). US wheat growers viewed these provisions as enhancing rather than curbing the CWB's monopsony power (Alston, Gray and Sumner 2001, 143–63). Meanwhile, rules governing the establishment of monopolies (Article 2010) simply reaffirmed, and did not expand on, what was committed to under GATT Article XVII[12].

- The US viewed the key objective of GATT Article XVII as requiring notification (rather than strict governance) of the STEs of WTO Members so as to provide transparency regarding their existence and behaviour and to ensure consistency with other GATT obligations (United States General Accounting Office 1995, 6). Unfortunately, GATT Article XVII is considered ineffective in meeting its objective in view of the confusion over the definition of STEs and a lack of effective remedies for non-compliance.

In NAFTA, the bulk of the SOE-related provisions were incorporated into a separate chapter entitled 'Competition Policy, Monopolies and State Enterprises' featuring two detailed articles on 'Monopolies and State Enterprises' (Article 1502) and 'State Enterprises' (Article 1503). While

these articles made clear that Parties could maintain or establish state enterprises within their jurisdictions, the Parties agreed that such entities not act inconsistently with their obligations under the agreement; that they adhere to the non-discriminatory principle in the purchase or sale of goods or services; act solely in accordance with commercial considerations; and not engage in anti-competitive behaviour.

Parts of these elements use the language taken from both GATT Article XVII and GATS Article VIII, as well as from the SOE-related provisions in the text of the failed Multilateral Agreement on Investment that had been negotiated at the OECD in the mid-1990s. For instance, the wording of Article 1502.3(b), "solely in accordance with commercial considerations in its purchase or sale of the monopoly good or service in the relevant market, including with regard to price, quality, availability, marketability, transportation and other terms and conditions of purchase or sale", is similar to the wording found in GATT Article XVII.1(b), "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale". However, while GATT Article XVII.1(b) recognises the use of customary business practice when competing in the national market, the equivalent NAFTA Article was silent on this issue, thus highlighting the latter's stricter obligation.

Article 1502.3(c) of the NAFTA also requires that non-discrimination be extended to cover "investments of investors, to goods and to service providers of another Party in its purchase or sale of the monopoly good or service in the relevant market", and not just the import and export (or cross-border) activities as incorporated into the GATT Article XVII.1(a). The NAFTA Article seems to expand the non-discriminatory principle to include both national treatment and most-favoured nation treatment and not just most-favoured-nation treatment as per the GATT Article. The former also linked these provisions to those found in the Agreement's investment chapter. The term 'investments of investors' was replaced by 'covered investments' in subsequent US PTAs.

Additionally, unlike GATT Article XVII and GATS Article VIII, NAFTA Articles 1502 and 1503 both recognised that some SOEs could play many roles, for instance, Telmex, the telecommunications service provider in Mexico, used to have the dual role of sectoral regulator and service provider in the wake of its privatisation. Such roles may clearly

conflict when an SOE exercises regulatory or administrative functions delegated to it by the government. Such risks were borne out in the first dispute brought under the GATS (the WTO US-Telmex case).

Furthermore, unlike GATT Article XVII in which there is no definition of STEs, the NAFTA defined a state enterprise in Article 1505 as "an enterprise owned, or controlled through ownership interests, by a Party". This definition, agreed upon by the PTA partners, offers clarification, which is particularly useful for notification purposes.

The Anticompetitive Business Conduct, Designated Monopolies, and Government Enterprises Chapter (Competition Chapter) in the subsequent US-Singapore PTA (USSFTA) further clarified the definition of SOEs or government enterprises as also including 'effective influence', and not just ownership and control (Article 12.8.5)[13]. This acknowledges the different structure of SOEs that could exist in other jurisdictions.

Compliance with Relevant Stakeholder Mandates

The US negotiating teams have ensured that the SOE-related provisions embedded in the country's PTAs are in accordance with the mandates provided for by their relevant stakeholders, notably, the US Congress and the private sector (including business, trade and industry associations). The points below illustrate some of the stakeholder concerns that affected the drafting of SOE-related provisions in US PTAs:

a. *The US Congress*. Unlike the previous fast-track authority, the negotiating objectives in the 2002 Trade Promotion Authority Act (TPA 2002) mandated the US negotiating teams to address SOE-related issues especially in reciprocal trade in agriculture, which include:

> "(vii) eliminating state trading enterprises whenever possible; (viii) developing, strengthening, and clarifying rules and effective dispute settlement mechanisms to eliminate practices that unfairly decrease United States market access opportunities or distort agricultural markets to the detriment of the United States, particularly with respect to import-sensitive products, including - (I) unfair or trade-distorting activities of state trading enterprises and other administrative mechanisms, with emphasis on requiring price transparency in the operation of state trading enterprises and such other mechanisms in order to end cross subsidization, price discrimination, and price undercutting"[14];

The US negotiating teams have since gone beyond this negotiating mandate to also embed rules that discipline SOEs other than the agriculture-based STEs specifically mentioned in the TPA 2002. This is highlighted by the incorporation of SOE-related provisions in the non-agricultural chapters of PTAs, notably those on services and telecommunications. The competition chapters of US PTAs also address the anti-competitive behaviour of all SOEs, not just agriculture-based STEs.

b. *Private sector*. US investors and businesses were concerned with the extensive market share of GLCs in Singapore's economy, fearing that the potential anti-competitive behaviour of such entities would go unchecked and adversely affect competitive conditions in the market. Hence the competition chapter in the USSFTA also requires Singapore to introduce and enact a generic competition law and to reduce (eventually 'substantially eliminating') the government's "aggregate ownership and other interests that confer effective influence" in such entities (Article 12.3.2(f)). Also, unlike in NAFTA, the USSFTA allows for the application of the DSM to address inconsistencies with SOE-related obligations (Article 12.7). This more binding approach has been maintained in subsequent US PTAs.

Application of Domestic Laws to Address SOE-related Issues

As mentioned above, SOEs typically maintain special connections and relations with home country governments. Such a special status may exclude or exempt them from the application of domestic laws and regulations, including competition laws or other sector-specific regulations. For instance, in the US, the state action doctrine allows for sovereign activities of the state, including SOEs, to be exempted from antitrust law in the event that they engage in anti-competitive conduct which is consistent with a 'clearly articulated' policy and which has been 'actively supervised' by the state (Zywicki 2003, 1). The special status may also 'confer' preferential treatment to SOEs in terms of government guarantees, subsidies or preferential loans, thus providing them with a competitive advantage over other private sector entities, including foreign investors and businesses.

The SOE-related provisions in the competition chapters of the USSFTA and the Australia-US FTA (AUSFTA) addressed such a special status:

- To counterbalance the 'exempt private company' status conferred on Temasek and other GLCs by the Singapore Companies Act, which exempted these entities from making public their financial details, Article 12.3.2(g) of the USSFTA requires the Singapore government to,

  "1. at least annually, make public a consolidated report that details for each covered entity:

  (A) the percentage of shares and the percentage of voting rights that Singapore and its government enterprises cumulatively own;

  (B) a description of any special shares or special voting or other rights that Singapore or its government enterprises hold, to the extent different from the rights attached to the general common shares of such entity;

  (C) the name and government title(s) of any government official serving as an officer or member of the board of directors; and

  (D) its annual revenue or total assets, or both, depending on the basis on which the enterprise qualifies as a covered entity…".

- Articles 14.4.2 and 14.4.3 of the AUSFTA commit both the US and Australia to ensure the applicability of domestic competition or antitrust laws to their respective SOEs:

  "2. The United States shall ensure that anti-competitive activities by sub-federal state enterprises are not excluded from the reach of its national antitrust laws solely by reason of their status as sub-federal state enterprises, to the extent that their activities are not protected by the State Action Doctrine.

  3. Australia shall take reasonable measures, including through its policy of competitive neutrality, to ensure that its governments at all levels do not provide any competitive advantage to any government businesses simply because they are government-owned. This paragraph applies to the business activities of government businesses and not to their non-business, non-commercial activities. Australia shall ensure that its competitive neutrality complaints offices treat complaints lodged by the United States, or persons of the United States, no less favourably than complaints lodged by persons or government bodies of Australia."

SOE-related Provisions in other PTAs

Other countries have not been as ambitious as the US in terms of the development, incorporation and enforcement of SOE-related provisions in their PTAs. However, there is now a perceptible trend of applying and transplanting domestic laws and principles to address SOE-related matters at the regional and international levels via PTAs.

The Competitive Neutrality Principle in Australia-based PTAs

Like most countries, Australia undertakes policy reforms to ensure that its policies stay relevant and consistent with its evolving economic conditions. In the 1990s, the Australian Government reviewed its competition policy and law. The outcome of this review, known as the Hilmer Report, was published in 1993, and proposed the incorporation of the competitive neutrality principle into the national competition policy (Hilmer, Rayner and Taperell 1993, 293–310).

The competitive neutrality principle aims to ensure a level playing field for all players in the market, regardless of their ownership, by ensuring that the government does not provide any advantages to its SOEs that could create distortions in the market via lower costs, better margins or lower prices for SOEs. These advantages can take many forms, including government guarantees, government loans (at below-market rates), tax advantages and debt forgiveness, among others.

Since then, Australia has been actively promoting the competitive neutrality principle in various international fora such as the OECD and the Asia-Pacific Economic Cooperation (APEC). The 2005 OECD Guidelines on Corporate Governance for State-Owned Enterprises mentioned earlier acknowledge the implementation of the principle as a best practice (Paragraph F)[15]. The OECD has also been working on other projects intended to achieve competitive neutrality in its member countries and they have been gaining traction and support (OECD 2015). For example, the principle was also recognised in the APEC-OECD Integrated Checklist on Regulatory Reform (APEC-OECD 2005, 22).

However, as mentioned earlier, guidelines, best practices or recommendations established by the likes of the OECD and APEC are typically voluntary and non-binding, or enforceable in character. For this reason, Australia began to incorporate the competitive neutrality principle into its PTAs to ensure legal obligations on the part of its PTA partners to implement this principle in their national economies.

While the competitive neutrality principle was not incorporated into Australia's first trade agreement with New Zealand in 1983 (which pre-dated the Hilmer Report), it appeared in the country's second PTA with Singapore, which was signed and entered into force in 2003. The competitive neutrality principle was incorporated as a separate Article (Article 4) in the competition policy chapter (Chapter 12) of the latter agreement. Article 4 states:

> 1. The Parties shall take reasonable measures to ensure that governments at all levels do not provide any competitive advantage to any government-owned businesses in their business activities simply because they are government-owned.
>
> 2. This Article applies to the business activities of government-owned businesses and not to their non-business, non-commercial activities[16].

However, similar to the SOE-related provisions found in US PTAs, there is no discernible pattern for such provisions in the Australian PTAs. While the competitive neutrality principle was explicitly incorporated into Australia's PTAs with Singapore, the US and Korea, it was implicitly stated in its PTAs with Chile and Japan and excluded in its PTAs with Malaysia, Thailand and ASEAN.

In the case of Australia's PTAs with Chile and Japan, the Parties agreed "to ensure that governments do not provide competitive advantages to [Japan: state-owned enterprises; Chile: government-owned business] simply because they are state-owned"[17], which alluded to the competitive neutrality principle. Australia's PTAs with Malaysia, Thailand and ASEAN excluded the principle because Australia's partners were not yet ready to enforce such a principle in their national markets and in light of the nascent stages of their competition regimes. Interestingly, Australia did not manage to get the US to enforce the competitive neutrality principle in the AUSFTA. Rather, the Parties agreed that only Australia would enforce the principle in its jurisdiction. Meanwhile, the Korea-Singapore FTA, signed in 2005, also incorporated the principle into its competition chapter, reaffirming the relevance of including such provisions in PTAs[18].

State Aid Rules in EU PTAs

The EU's state aid rules are yet another SOE-related set of disciplines that are being transplanted internationally via PTAs. Such disciplines are based on Articles 107 to 109 of the Treaty on the Functioning of the European Union, which are aimed at disciplining subsidies or state aid that could distort competition in the EU market (Whish and Bailey 2012, 246–7). In addition to the SOE-related provisions commonly incorporated into its PTAs, the EU has also included its state aid rules. As with the US and Australia, the level of commitments demanded from the EU's PTA partners on SOE-related and state aid obligations vary in depth and breadth.

The state aid-related provisions in EU PTAs aim to ensure that state support measures do not distort or threaten to distort competition (thus affecting trade between the Parties). Such provisions further aim to ensure and promote transparency when the EU's trading partners provide state aid or subsidies to entities in their jurisdictions. For the latter, the EU's PTA partners are required to annually report to the EU the total amount, distribution and details of their state aid practices. Examples include provisions in the Euro-Mediterranean Association Agreements with the Palestinian Authority[19] and Egypt[20]; the Trade, Development and Cooperation Agreement with South Africa[21]; the Stabilisation and Association Agreements with Albania[22] and Montenegro[23] and the Interim Agreement with Bosnia and Herzegovina[24].

Meanwhile, the EU-Korea FTA had incorporated rules on subsidies, which are based on the WTO ASCM[25], besides the commitment to transparency and notification as in the EU's other PTAs[26]. These rules are additional to traditional provisions which ensure the applicability of national competition laws to public enterprises and enterprises entrusted with special rights or exclusive rights as well as state monopolies. Another variation in the EU's PTAs is the incorporation of traditional competition-related provisions, as in the EU-Korea FTA, without additional provisions on subsidies or state aid. These can be found in the EU Economic Partnership Agreement with the CARIFORUM States[27], its Association Agreements with Chile[28] and Central America[29], and its trade agreements with Colombia and Peru[30].

CHAPTER 17 OF THE CPTPP

The previous discussion highlighted the evolution of SOE-related provisions in existing PTAs. Interestingly, none of the PTA models discussed—those of Australia, the EU and the US—show any discernible patterns or trends in incorporating SOE-related provisions. Indeed, the depth and breadth of such provisions seem to depend on the readiness and ability of their respective PTA partners to undertake SOE-related commitments. The incorporation of such provisions also depends on the significance of SOEs in the other Parties' jurisdictions. Nevertheless, what emerges is the increasing frequency with which SOE-related provisions are embedded in PTAs. Such a trend seems a durable reality, as can be seen in the previous TPPA Chapter 17 and the current CPTPP Chapter 17.

This section discusses CPTPP Chapter 17 in detail, including its genesis, key provisions and elements, and the flexibilities for Malaysia as agreed by the other signatory Parties.

The US Negotiators' Mandate for the CPTPP's Predecessor, the TPPA

When the US Trade Representative Susan Schwab notified Congress in 2008 of the President's intention to initiate negotiations with other TPPA negotiating Parties, she outlined a number of specific negotiating objectives which were subsequently expanded to include SOE-related commitments, "[t]o seek to discipline state trading enterprises, state-owned enterprises and designated monopolies, as appropriate, to enhance transparency and eliminate market distortions.[31]"

The expanded objectives for the US TPPA negotiating mandate have since been recast as the overall US ambition for the agreement to be a '21st century PTA' with high-quality rules and commitments. The inclusion of extensive SOE-related provisions is important to the US because:

- The TPPA could be the new template for future PTAs, not just for US PTAs.

- The TPPA could include new Parties in the future—it bears recalling that China and Russia are also APEC Members and have significant SOE sectors in their domestic economies. Should they apply to become TPPA (now CPTPP) Parties, then their SOEs would be bound by the disciplines incorporated in the agreement.
- Most of the original TPPA Parties have significant SOEs operating in their domestic economies. While the US has already concluded PTAs with several of its TPPA partners, including Australia, Canada, Chile, Mexico, Peru and Singapore, it could use the TPPA as a forum to discipline the SOEs established and maintained by Brunei, Malaysia, New Zealand, and Vietnam (Rushford 2012).

The [Trade Promotion Authority (TPA) for the Trans-Pacific Partnership (TPP) and] Defending Public Safety Employees' Retirement Act (TPA2015)[32] committed US trade negotiators to:

- Eliminate STEs (for trade in agriculture) whenever possible.
- Develop, strengthen and clarify rules to address unfair or trade-distorting activities of STEs, and to subject these rules to DSM provisions.
- Eliminate or prevent trade distortions and unfair competition favouring SOEs and state-controlled enterprises in the course of their commercial activities.
- Ensure that SOEs and state-controlled enterprises base their activities solely on commercial considerations.
- Ensure commitments that promote transparency.

On the surface, the TPA2015 demanded similar SOE-related rules to those that were incorporated into previous US PTAs. However, it also highlighted deeper commitments, especially in terms of eliminating STEs whenever possible and ensuring the incorporation of transparency provisions to monitor SOEs and state-controlled enterprises. The former, if incorporated into the TPPA, would roll back the flexibility provided for under GATT Article XVII, which allows for the establishment of STEs. Additionally, the US observed that governments not only own but also control enterprises, thus expanding the definition of state enterprises. Indeed, this is an acknowledgement of the various types of SOEs found in countries around the world, notably in China.

Development of a Stand-alone Chapter on SOEs in the TPPA

As discussed above, previous US PTAs incorporated SOE-related provisions and rules into the respective competition chapters of such agreements. This was the case at the start of the TPPA Competition Chapter negotiations. The TPPA Competition Chapter was divided into two sections—the first one contained 'standard' generic competition rules while the second one contained specific competition rules directed towards SOEs and designated monopolies. Later, in Round 9 of the TPPA negotiations, the US proposed that the rules on SOEs be moved into a stand-alone chapter (which would become CPTPP Chapter 17). This emphasised the priority placed by the US on ensuring that signatory Parties discipline their SOEs in line with US policy aims. Indeed, this was reflected in the preamble of the TPPA, which featured the following text:

> Affirm that state-owned enterprises can play a legitimate role in the diverse economies of the Parties, while recognizing that the provision of unfair advantages to state-owned enterprises undermines fair and open trade and investment, and resolve to establish rules for state-owned enterprises that promote a level playing field with privately owned businesses, transparency and sound business practices[33];

The introduction of the TPPA Chapter 17 posed a conundrum for some of the negotiating Parties, notably, Malaysia and Vietnam. While Malaysia was comfortable with traditional (competition policy-anchored) SOE-related provisions, this new chapter posed a challenge inasmuch as deeper disciplines on SOE conduct were one of the country's negotiating redlines alongside concerns in the areas of intellectual property, labour and environmental standards and government procurement. A particular concern about TPPA Chapter 17 was that it might unduly constrain the ability of Malaysian SOEs to pursue and implement their stated development and nation-building objectives and activities.

Key Elements of the CPTPP Chapter 17

Chapter 17 of the TPPA was a significant departure from how the US had previously addressed SOE-related rules in its PTAs. It would be no surprise if the US and other developed countries were to use the Chapter 17 as a template for SOE disciplines in future PTAs. Indeed, the signatory Parties to the CPTPP agreed and committed to retaining key elements of TPPA Chapter 17 in the CPTPP equivalent. These include:

a. *Acknowledgement of different types of SOEs*. CPTPP signatories acknowledged that SOEs can exist in different forms according to their mandates, objectives and functions. This was highlighted in the definition section at the start of the chapter, which features definitions for SOEs, SWFs and independent pension funds (IPFs).

b. *Non-application of CPTPP Chapter 17*. Chapter 17 of the CPTPP may not apply to some SOEs either at the scope-level or the non-conforming measure (NCM)-level. The scope-level exclusion was incorporated into the main text of the chapter while the NCM-level exclusion was incorporated into the country annexes of the chapter. Unless stated otherwise, the scope-level provides a blanket exclusion for the SOEs concerned. An SOE or government activity may thus be excluded from having to undertake all the commitments in the chapter. For example, the chapter does not apply to the procurement decisions of particular SOEs. Meanwhile, the NCM level provides for a narrower exclusion allowing SOEs to maintain existing non-conforming measures. However, other provisions in the chapter, for example on transparency, would still apply to the SOEs concerned.

   Chapter 17 of the CPTPP excluded both SWFs and IPFs at the scope-level. In the case of SWFs, however, it is not enough for them merely to declare themselves as SWFs to be excluded from the scope of the chapter. Rather, SWFs must be:

   > Member(s) of the International Forum of Sovereign Wealth Funds or endorses the Generally Accepted Principles and Practices ("Santiago Principles") issued by the International Working Group of Sovereign Wealth Funds, October 2008, or such other principles and practices as may be agreed to by the Parties.[34]

KNB meets the SWF definition of this chapter by virtue of its membership of the International Forum of Sovereign Wealth Funds (IFSWF) and because it endorses the Santiago Principles. Meanwhile, other GLICs, such as the EPF, LTAT, and KWAP were defined as IPFs under the chapter and were therefore excluded from its scope. One of the conditions the latter entities must meet to be excluded from the chapter's scope is that they must be "free from investment direction from the government of the Party"—footnote 3 of the chapter provided clarification of this concept[35].

c. *Soft law to hard law approach*. Essentially, the CPTPP's SOE provisions upgrade a voluntary principle into a legally binding commitment for the SWFs of the signatory Parties, thus transforming the soft law approach in the international regulation of SWFs into a hard law approach. This is interesting as the China Investment Corporation (CIC), a Chinese SWF, may not have to endorse the Santiago Principles if it chooses not to (as it is only on a voluntary basis), but KNB (as well as the Australia Future Fund, the New Zealand Superannuation Fund and the Singapore GIC Private Limited) would now be legally bound to endorse the Santiago Principles to ensure they are excluded from the chapter's scope as their governments were CPTPP signatories.
d. *Application of the CPTPP Dispute Settlement Chapter*. If enforced, the signatory Parties must ensure compliance with their obligations under the CPTPP Chapter 17 as failure to do so could trigger recourse to the CPTPP's Dispute Settlement Chapter (CPTPP Chapter 28). The levels of obligations found in Chapter 17 of the CPTPP are thus arguably higher than those typically found in a traditional PTA competition chapter. In fact, Chapter 28 of the CPTPP does not apply to the Agreement's competition chapter (CPTPP Chapter 16). In line with past PTA practice, CPTPP signatories decided to retain both the application and exclusion of CPTPP Chapter 28 in regard to Chapters 16 and 17. The rationale during the TPPA negotiations was that the US was keen to ensure a level playing field between US-owned companies and those of other signatories operating in TPPA countries. Benefiting from the explicit ascent of its CPTPP partners, Malaysia decided to retain the flexibility accorded to signatories in footnote 10 of CPTPP Chapter 17:

> "Malaysia shall not be subject to dispute settlement under the Dispute Settlement Chapter (Chapter 28) with respect to enterprises owned or controlled by Khazanah Nasional Berhad for a period of two years following the entry into force of this Agreement, in light of ongoing development of state-owned enterprise reform legislation[36]".

e. *Level playing field between SOEs and non-SOEs*. Recalling the TPPA context, Chapter 17 aims to create a level playing field between SOEs and non-SOEs operating in CPTPP markets. This is done by including rules on non-commercial assistance (NCA), which are essentially subsidies. Basically, the provision of NCA must be done on a non-discriminatory basis to companies regardless of their ownership. SOEs, SWFs and IPFs are subject to the NCA rules found in Chapter 17.

   Additionally, the injury test for NCA was based on the WTO ASCM, which would be relevant to goods-producing SOEs as opposed to services-producing ones[37].

f. *Size and level of SOEs*. Chapter 17 of the CPTPP provides exceptions for SOEs with annual revenue derived from their commercial activities of less than SDR500 million in any one of the three previous fiscal years. Such SOEs are only obliged to meet certain Chapter 17 provisions. Additionally, SOEs operating at the sub-national level—state-level SOEs in the case of Malaysia—are currently excluded from the scope of application of Chapter 17. However, such coverage could be subject to negotiations within five years of the Agreement's entry into force.

g. *Recognition of the developing country status of some CPTPP Parties*. The levels of economic development of the CPTPP Parties differ widely. This implies that some signatories may require more time to comply with the rules and commitments of the CPTPP. As noted above, Malaysia was given some flexibility in meeting some of its Chapter 17 obligations. This relates to the non-application of the CPTPP Chapter 28 for KNB for two years and the size threshold for some SOEs, as well as sub-national SOEs. Additionally, as with Vietnam, Malaysia has five years from entry into force of the CPTPP to make the list of its SOEs publicly available[38].

h. *NCM list*. As mentioned above, CPTPP signatories preserved the ability for some of their SOEs to continue to undertake activities which would otherwise be inconsistent with Chapter 17 obligations. To do so, however, Parties must provide details on the nature of the non-conforming measures in country-specific annexes (NCM list) appended to Chapter 17. Parties may subsequently eliminate NCMs when they are ready and willing to do so. Malaysia has listed some of its economic sectors and policies in its Chapter 17 NCM annex. This list includes certain measures in the oil and gas, agriculture, and investment and asset management sectors as well as certain policies including the *Bumiputera* policy, the small- and medium-sized enterprise policy, and the economic development policy for Sabah and Sarawak (two Malaysian states situated on Borneo Island). In the case of Malaysia's NCM list for its oil and gas sector, Malaysia committed to a transition period for Petroliam Nasional Berhad (PETRONAS), its subsidiaries or any new, reorganised or successor enterprise, to gradually eliminate preferences accorded to Malaysian enterprises to commence on the date of entry into force of the Agreement rather than the date of signing (as in the TPPA).

CONCLUSION

Chapter 17 of the CPTPP differs from the SOE rules incorporated in previous PTAs generally, and US PTAs specifically, in view of the depth and breadth of its scope. The chapter takes a broad approach to disciplining SOEs when they engage in cross-border trade and investment in goods and services alike. Such obligations are pro-competitive in character, requiring SOEs to adhere to the non-discrimination principle for their commercial activities (for example, on subsidies or NCA), to act solely in accordance with commercial considerations in their purchase or sale of goods or services, and not to engage in anti-competitive conduct, including abuse of dominant and/or monopoly position. These provisions echo those found in the PTA models of Australia and the EU, as well as those found in US PTAs. However, Chapter 17 went beyond traditional competition rules in addressing general

governance issues for SOEs, such as the transparency of their existence and behaviour. Additionally, the CPTPP's SOE disciplines are subject to the Agreement's dispute settlement provisions (found in Chapter 28) in instances of non-compliance.

The many exclusions and flexibilities incorporated into the main text and annexes of the chapter reveal how challenging agreeing on such rules proved during the TPPA and subsequent CPTPP negotiations. In the end, Chapter 17 may be viewed as providing a balance between setting meaningful good governance principles for SOEs while showing flexibility in operationalising the Chapter's provisions among signatories with highly varied levels of economic and institutional development and capacity. However, the Agreement must first come into force in its current form before a definitive judgement on whether such balancing was successful can be made.

In the case of Malaysia, a few observations are worthy of note:

- The rules in the CPTPP Chapter 17 will add another layer to the already comprehensive set of domestic and international SOE-related regulatory mechanisms and instruments governing Malaysian SOEs. Currently, whenever required, Malaysian SOEs report to their shareholders (including the government), to various regulators such as the Securities Commission, Bursa Malaysia, BNM, MyCC, MCMC, EC, and the Malaysian Aviation Commission (MAVCOM), as well as to multilateral organisations such as the WTO for subsidy practices and the IWG for SWFs. If the CPTPP Chapter 17 is enforced as envisaged under the Agreement, the Malaysian authorities would also have to report to the CPTPP-established Committee on State-Owned Enterprises and Designated Monopolies, comprising government representatives of each Party.

- In enforcing CPTPP Chapter 17, the government of Malaysia will need to ensure that its SOEs undertake activities which are consistent with the provisions of the chapter, as any major inconsistency could result in recourse to the CPTPP's dispute settlement provisions under Chapter 28. This could prove costly and reputationally damaging for both the government and the SOEs concerned.

- Malaysia's other (non-CPTPP) trading partners are likely to consider its SOE-related commitments under Chapter 17 as offering the basis for negotiating any SOE-related provisions in future PTAs with third countries. Additionally, Malaysia will need to undertake some reforms, including in regard to the development of SOE reform legislation, prior to the CPTPP's entry into force. Malaysia is currently negotiating the Regional Comprehensive Economic Partnership (RCEP) with other ASEAN Member States, Australia, China, India, Japan, New Zealand and South Korea, as well as a comprehensive bilateral PTA with the EU. RCEP partners—Australia, Japan and New Zealand—were also signatory Parties to the CPTPP. In a 'maximum' case scenario, these partners could seek CPTPP parity in regard to SOE-related provisions to be incorporated into RCEP. In conclusion, negotiating both the TPPA and CPTPP generally, as well as, TPPA Chapter 17 and CPTPP Chapter 17 specifically, has provided significant lessons for a developing country like Malaysia. Recent statements emanating from the US pointed at the country's renewed interest in linking up to the CPTPP, thereby reversing the permanent withdrawal enacted in the early days of the Trump administration. Additionally, there have been reports that Thailand is considering becoming a Member of the CPTPP by the end of 2018. Meanwhile, the implications of the recent general elections in Malaysia and the desire expressed by the newly-elected Prime Minister to reopen certain aspects of the CPTPP prior to its ratification by the Malaysian Parliament, introduces new uncertainty into what has been a decade-long rule-making journey. Whatever the outcome of the above developments, the fact remains that, as things currently stand, implementing Chapter 17 of the CPTPP would bring change to the existing domestic regulatory and governance landscape for Malaysian SOEs. It would also be likely to influence the nature and scope of future SOE-related obligations assumed by Malaysia in its PTAs with third countries.

Endnotes

[1]This chapter is an updated and expanded version of the two chapters written by the author for an earlier publication. See Wan Khatina Nawawi and Somchit, Saovanee Chan. 2014. "SOE Regulation in Malaysia and the Competitive Neutrality Principle." and Mott, Graham and Wan Khatina Nawawi. 2014. "SOE Provisions in International Agreements." In *Competitive Neutrality and its Application in Selected Developing Countries*, Project Coordinator Deborah Healey, 190–222 and 289–308. Geneva: UNCTAD Research Partnership Platform Publication Series.

[2]Admittedly, although the CPTPP was already signed, like the rest of the ten signatory Parties, Malaysia has yet to enforce its commitments under the CPTPP generally, and the CPTPP Chapter 17, specifically.

[3]Translated as 'sons of the soil', *Bumiputeras* are the indigenous groups in Malaysia, within which the Malay predominate.

[4]CA1965 has since been repealed and the Companies Act 2016 (CA2016, Act 777) has now entered into force, albeit on a phased basis, since 1 January 2017. Future reference in this chapter will refer to CA2016.

[5]English translation: Armed Forces Fund.

[6]English translation: Pilgrimage Fund.

[7]There were initially 20 GLCs at the start of the programme in 2005 and the number has since been reduced to 17 following mergers, demergers, divestments and other corporate exercises. Of these, only UEM Group Berhad is not listed (PCG 2013).

[8]In CA2010, 'commercial activity' means any activity of a commercial nature but does not include:

a) any activity, directly or indirectly in the exercise of governmental authority;
b) any activity conducted based on the principle of solidarity;
c) any purchase of goods or services not for the purposes of offering goods and services as part of an economic activity.

[9]Article 3: Application, CA2010.

[10]Air Asia is a non-SOE. Both Air Asia and MAS have since decided to terminate the share swap deal (Sidhu 2012).

[11]The Chairman of the Working Party on State Trading Enterprises had expressed concern over the poor compliance by Members with the requirement to notify their state trading activities. For instance, only 12 Members provided updated notifications in 2003 while only 48 Members had provided new and full notifications in 2001. See World Trade Organization (2003, 2).

[12]See <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/cusfta-e.pdf> accessed 11 August 2015.

[13]"**Effective influence** exists where the government and its government enterprises, alone or in combination:

(a) own more that 50 percent of the voting rights of an entity; or

(b) have the ability to exercise substantial influence over the composition of the board of directors or any other managing body of an entity, to determine the outcome of decisions on the strategic, financial, or operating policies or plans of an entity, or otherwise to exercise substantial influence over the management or operation of an entity. Where the government and its government enterprises, alone or in combination, own 50 percent or less, but more than 20 percent, of the voting securities of the entity and own the largest block of voting rights of such entity, there is a rebuttable presumption that effective influence exists…".

[14]See Section 3802: Trade negotiating objectives of Chapter 24: Bipartisan Trade Promotion Authority <http://uscode.house.gov/view.xhtml?path=/prelim@title19/chapter24&edition=prelim> accessed 11 August 2015.

[15]"SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds." (OECD 2005, 21–22).

[16]See Article 4: Competitive Neutrality in Chapter 12: Competition Policy of the Australia–Singapore Free Trade Agreement (2003).

[17]See Article 14.5: State Enterprises in Chapter 15: Competition Policy of the Australia-Chile Free Trade Agreement (2008) and Article 15.4: State-Owned Enterprises in Chapter 15: Competition and Consumer Protection of the Agreement Between Australia and Japan for an Economic Partnership (2014).

[18]See Article 15.4: Competitive Neutrality in Chapter 15: Competition of the Korea–Singapore Free Trade Agreement (2005).

[19]See Paragraphs 1(iii) and 5 in Article 30 of Chapter 2: Competition, Intellectual Property and Public Procurement in the Euro-Mediterranean Interim Association Agreement on Trade and Cooperation between the European Community, of the one part, and the Palestine Liberation Organization (PLO) for the Benefit of the Palestinian Authority of the West Bank and the Gaza Strip, of the other part (1997).

[20]See Paragraphs 1(iii) and 3 in Article 34 of Chapter 2: Competition and Other Economic Matters in the Euro-Mediterranean Agreement Establishing an Association between the European Communities and their Member States, of the one part, and the Arab Republic of Egypt, of the other part (2004).

[21]See Article 41: Public Aid in Section E: Public Aid in the Agreement on Trade, Development and Cooperation between the European Community and its Member States, of the one part, and the Republic of South Africa, of the other part (2000).

[22]See Paragraphs 1(iii), 5, 6, and 7 in Article 71: Competition and other economic provisions in the Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Albania, of the other part (2009).

[23]See Paragraphs 1(iii), 5, 6, 7 and 8 in Article 73: Competition and other economic provisions of the Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Montenegro, of the other part (2010).

[24]See Paragraphs 1(c), 5, 6, 7 and 8 in Article 36 (SAA Article 71): Competition and other economic provisions of the Interim Agreement on Trade and Trade-Related Matters between the European Community, of the one part, and Bosnia and Herzegovina, of the other part (2008).

[25]See Articles 11.10: Definitions of a subsidy and specificity and 11.11: Prohibited subsidies of Section B: Subsidies, Chapter 11: Competition in the Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part (2010).

[26]*Ibid*, Article 11.12: Transparency.

[27]See Article 129 in Chapter 1: Competition, Title IV: Trade-Related Issues in the Economic Partnership Agreement between the CARIFORUM States, of the one part, and the European Community and its Member States, of the other part (2008). The CARIFORUM is a group of 15 Caribbean countries.

[28]See Article 179, Title VII: Competition in the Agreement Establishing an Association between the European Community and its Member States, on the one hand, and the Republic of Chile on the other part (2005).

[29]See Article 280, Title VII: Trade and Competition in the Agreement Establishing an Association between the European Union and its Member States, on the one hand, and Central America on the other (2012). The Central American countries include Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

[30]See Article 263 in Title VIII: Competition in the Trade Agreement between the European Union and its Member States, of the one part, and Colombia and Peru, of the other part (2012).

[31]In the notification letter dated 22 September 2008 from the USTR Susan Schwab to the US House of Representatives Speaker Nancy Pelosi and US Senate President Pro Tempore Robert C. Byrd <http://www.ustr.gov/archive/assets/World_Regions/Southeast_Asia_Pacific/Trans-Pacific_Partnership_Agreement/Other_Documents_(Letters,_etc)/asset_upload_file775_15142.pdf> accessed 11 August 2015.

[32]See the H.R. 1890: Bipartisan Congressional Trade Priorities and Accountability Act of 2015, as of 1 May 2015. This bill was passed on 22 May 2015, signed by the President on 29 June 2015, and enacted as the [Trade Promotion Authority (TPA) for the Trans-Pacific Partnership (TPP) and] Defending Public Safety Employees' Retirement Act <https://www.govtrack.us/congress/bills/114/hr1890> accessed 11 August 2015.

[33]See Preamble of the Trans-Pacific Partnership Agreement (2016). This was retained in the Preamble of the Comprehensive and Progressive Trans-Pacific Partnership Agreement (2018).

[34]See Article 17.1: Definitions in Chapter 17: State-Owned Enterprises and Designated Monopolies in the Comprehensive and Progressive Trans-Pacific Partnership Agreement (2018).

[35]*Ibid*.

"Investment direction from the government of a Party: (a) does not include general guidance with respect to risk management and asset allocation that is not inconsistent with usual investment practices; and (b) is not demonstrated, alone, by the presence of government officials on the enterprise's board of directors or investment panel."

[36]See footnote 10 in Article 17.2: Scope in Chapter 17: State-Owned Enterprises and Designated Monopolies in the Comprehensive and Progressive Trans-Pacific Partnership Agreement (2018).

[37]See paragraph 3 in Article 17.6: Non-commercial Assistance of Chapter 17: State-Owned Enterprises and Designated Monopolies in the Comprehensive and Progressive Trans-Pacific Partnership Agreement (2018).

[38]See footnote 29 for paragraph 1 in Article 17.10: Transparency of Chapter 17: State-Owned Enterprises and Designated Monopolies in the Comprehensive and Progressive Trans-Pacific Partnership Agreement (2018).

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Glossary

African Development Bank is part of the African Development Bank Group, which began its operations in 1966. The primary role of the Bank is to support economic and social development of member countries, comprising 53 African countries and 25 non-African countries (https://www.afdb.org).

Agreement on Government Procurement (GPA) is a WTO Agreement intended to ensure that the competition conditions for government procurement market are open, fair and transparent. The first Agreement came into force in 1996 and the revised Agreement came into force in 2014. Presently, the Agreement has 19 Parties, comprising 47 WTO members, with 32 WTO Members participating in the Agreement Committee as observers (https://www.wto.org).

Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) is a WTO Agreement concluded in the Uruguay Round. The Agreement was negotiated to address the growing tension in international trade due to heterogenous standards in the protection and enforcement of intellectual property rights. It also sets multilateral rules for internationally traded counterfeit goods (Goode 2005, 18).

ASEAN Comprehensive Investment Agreement (ACIA) is an ASEAN-specific Agreement to create an open and free environment for investment in the region, to achieve economic integration under the ASEAN Economic Community in accordance with the AEC Blueprint (www.asean.org).

ASEAN Economic Community (AEC) represents the realisation of ASEAN integration through a single market and production base. The region is envisioned to be competitive, sustainable, inclusive, and fully plugged into the global economy (http://www.aseansec.org).

ASEAN Framework Agreement on Services (AFAS) is an Agreement adopted by ASEAN Members in 1995. The Agreement seeks to eliminate restrictions to trade in services, to improve the efficiency and enhance competitiveness of ASEAN service providers (http://investasean.asean.org).

ASEAN Free Trade Area (AFTA) was established in 1992 to create a regional single market and production base, encourage foreign direct investments, as well as expand intra-region trade and investments (http://www.miti.gov.my).

ASEAN Member States (AMS) refer to Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam (http://www.aseansec.org).

Asian Development Bank (ADB) is a financial institution established in the 1960s. Presently, it has 67 Members, with 47 Members from the Asia and Pacific region. The Bank's focus has evolved—food production assistance and rural development in the 1960s, energy projects in the 1970s, infrastructure developments in the 1980s, poverty reduction in the 1990s, and assistance for Members to achieve Millennium Development Goals in the 2000s (https://www.adb.org/).

Asian Financial Crisis (AFC) is a financial crisis affecting many Asian economies between 1997 and 1998. The crisis started in Thailand after the collapse of the country's currency and subsequently affected other Asian economies (Wan Khatina *et al*. 2010, 297).

Asia-Pacific Economic Cooperation (APEC) is a regional economic forum consisting of 21 Members in the Asia and Pacific region, established in 1989. Its primary mission is to support the region's sustainable economic growth and prosperity. Among others, APEC champions open and free trade and investment, regional economic integration, as well as economic and technical cooperation. Members include Australia, Brunei, Canada, Chile, China, Chinese Taipei, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Thailand, the United States and Vietnam (http://www.apec.org).

Association of Southeast Asian Nations (ASEAN) was formed in 1967 to encourage economic growth and political stability in the region. Members include Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam (Goode 2005, 47).

Bumiputera refers to the Malay people and others of native origin in Malaysia (Wan Khatina Nawawi *et. al*. 2010, 297).

Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is a preferential trade agreement between eleven countries—Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. It contains the elements negotiated in the Trans-Pacific Partnership Agreement and concluded in January 2018 (https://www.mfat.govt.nz/).

Comprehensive Economic and Trade Agreement (CETA) is a trade agreement between Canada and the European Union, signed on September 2017. The Agreement aims to facilitate export of goods and services (https://ec.europa.eu).

Dispute settlement mechanism (DSM) provides a mechanism for WTO Members to settle trade disputes. The procedure includes bilateral consultation between the relevant Members, establishment of a three-persons panel that hears the case and issues a report, and establishment of an Appellate Body to hear appeals (Deardorff 1996, 29).

Doha Round (Doha Development Agenda) is the current round of multilateral trade negotiations which commenced in 2001. It aims to reform the international trading system by lowering trade barriers and revised trade rules, covering about 20 trade areas (https://www.wto.org).

General Agreement on Tariffs and Trade (GATT) is a WTO Agreement signed in 1947. It is a multilateral Agreement regulating trade in goods among approximately 150 countries. The Council for Trade in Goods (Goods Council) is responsible for the workings of the Agreement. The Council consist of representatives from all WTO Members and has 10 committees dealing with specific areas (http://www.wto.org).

General Agreement on Trade in Services (GATS) is a WTO Agreement concluded in the Uruguay Round. The Agreement aims to create a system of international trade rules that is reliable and credible, ensure the non-discrimination principles, stimulate economic activity via guaranteed policy bindings and promote trade through progressive liberalisation. The Agreement consists of all WTO Members. In principle, the Agreement applies to all services, with some exceptions (http://www.wto.org).

GLC Transformation Programme (GLCT) was the programme that coordinated initiatives to improve the performance of GLCs between 2005 and 2015. The Programme was part of Malaysia's larger development strategies, aimed to enhance GLC performance and focused on governance, shareholder value and stakeholder management (http://www.pcg.gov.my).

Global financial crisis (GFC) refers to the crisis between mid-2007 and early 2009 of the global financial markets and banking systems. The crisis started with the crash of the housing market in the United States, which spread into a global financial crisis (https://www.rba.gov.au/).

Government-linked Companies (GLCs) are companies with primary commercial objectives and in which the Government of Malaysia has direct controlling stake. This definition was used for the purposes of the GLCT (http://www.pcg.gov.my).

Inter-American Development Bank (IDB) is a development financing institution for Latin America and the Caribbean, established in 1959. The Bank aims to achieve development in a sustainable and climate-friendly manner, in addition to providing financial assistance and technical support for the region (https://www.iadb.org).

International Investment Agreements (IIAs) are divided into bilateral investment treaties and treaties with investment provisions. IIAs are agreements that promote and protect investments made by investors of both countries in each other's territory (http://investmentpolicyhub.unctad.org/IIA).

International Labour Organization (ILO) is a tripartite agency of the United Nations that brings together governments, employers and workers of 187 Members. It was established in 1910 and aims to set labour standards, develop policies and devise programmes promoting decent work (https://www.ilo.org).

Investor-State Dispute Settlement (ISDS) is a mechanism included in many investment and trade agreements to settle disputes. A foreign investor can bring the Host State to international arbitration for breaches in IIA obligations.

Mercosur *(Mercado Comun del Sur)* (Common Market of the South) is a common market consisting of Argentina, Brazil, Paraguay, and Uruguay, established in 1991. Venezuela and Bolivia joined the bloc in 2006 and 2015, respectively. Member States agreed to remove custom duties, implement common external tariffs and adopt common trade policies (http://www.mercosur.int/).

National Development Policy (NDP) Malaysia 1991 – 2000. The NDP succeeded the New Economic Policy (NEP) in 1991. Its aims were the eradication of poverty, rapid development of an active *Bumiputera* commercial and industrial community, and greater involvement of the private sector as an engine for growth (Wan Khatina Nawawi *et al*. 2010, 298).

New Economic Policy (NEP) was launched in 1971 in Malaysia. Its objectives were eradication of poverty regardless of race and restructuring of society to abolish the identification of race by economic activity. The main goal of the policy was national unity (Wan Khatina Nawawi *et al.* 2010, 298).

Organisation for Economic Co-operation and Development (OECD) was established in 1961 and includes 26 Members. The organisation aims to promote policies which enhance the economic and social well-being of people around the globe (https://www.oecd.org/about/).

Regional Comprehensive Economic Partnership (RCEP) is an ASEAN-driven proposal for a regional free trade area. The deal includes ASEAN Member States and countries that have PTAs with ASEAN—Australia, China, India, Japan, Republic of Korea and New Zealand (https://dfat.gov.au/).

'**Singapore issues**' refer to four issues—trade and investment, trade and competition policy, transparency in government procurement and trade facilitation—introduced to the WTO agenda at the December 1996 Ministerial Conference in Singapore (https://www.wto.org).

Spaghetti bowl effect was a term first used by Jagdish Bhagwati in his 1995 book *US Trade Policy: The Infatuation with Free Trade Agreements*, to describe the complexity of preferential trading arrangements. It refers to the creation of miniature trade regimes that link countries in several ways due to different trade agreements. If these trading relationships are illustrated on a world map, it has been suggested that it would resemble a spaghetti bowl (Panezi 2016).

State-owned enterprise (SOE) refers to any corporate entity recognised as an enterprise by national law—including joint stock companies, limited liability companies and partnerships limited by shares—and in which the state exercises ownership. SOEs also include statutory corporations—corporations established through specific legislation—if their purpose and activities are economic in nature (OECD 2015).

Trade in Services Agreement (TISA) is a services trade agreement negotiated by 23 WTO Members. The negotiations started in 2013 to further liberalise services trade via the development of new and enhanced disciplines, and improvement of market access. The Agreement builds on WTO's General Agreement on Trade in Services. Parties involved in the negotiations are Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, the European Union, Hong Kong (China), Iceland, Israel, Japan, Liechtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Peru, South Korea, Switzerland, Turkey, and the United States (http://www.international.gc.ca/).

Translantic Trade and Investment Partnership (TTIP) is a trade and investment deal currently negotiated between the European Union and United States which began in July 2013. The deal aims to increase market access, help reduce red tape faced by exporting firms and set new rules to make export, import and investment activities easier and fairer (http://ec.europa.eu/).

Trans-Pacific Partnership Agreement (TPPA) is a preferential trade agreement that was intended to liberalise trade and investment between 12 countries, namely Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. The Agreement was signed in February 2016. However, the United States withdrew from the Agreement in January 2017 (http://www.miti.gov.my).

Uruguay Round is the eighth round of multilateral trade negotiations, first launched in 1986 and concluded in 1994. The negotiations include 123 nations and covered almost all trade (https://www.wto.org).

World Intellectual Property Organization (WIPO) is the international forum for intellectual property services, policy, information and cooperation. It was established in 1967, includes 191 Members and is a self-funding organisation of the United Nations. It aims to develop an intellectual property system that is balanced, effective and enables innovation and creativity (http://www.wipo.int/).

World Trade Organization (WTO) was established in 1995 as the successor to GATT. It deals with the rules of trade between nations at a global level. It has 164 Members, where 117 are developing nations (https://www.wto.org/).

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