CHAPTER 2

LITERATURE REVIEW

The first section of this chapter reviews briefly what FTA is all about and some conclusions from theoretical literatures and theories of free trade. This is followed by some basic theories on AFTA, and an insight to the Malaysian economy.

2.1 FTA AGREEMENTS

FTAs are on the rise in terms of numbers and scope. WTO has identified some 250 RTAs, either between two countries or among several countries, some being in force and some under negotiations. The WTO expects that the number will reach 500 by 2005. Countries engage in FTA for a number of reasons such as increased competition and productivity, efficiency gains and greater variety in consumption goods and services.\(^1\) FTA is a new term introduced in the international economics through GATT. It gained popularity after the unsuccessful 2003 WTO talks in Cancun. Within ASEAN, Thailand and Singapore possess the highest number of FTAs, either being planned or under negotiations.

2.2 TYPES OF TRADE AGREEMENTS

Under the WTO, there are two major types of trade agreements, the Customs Unions (CU) and the Free Trade Areas (FTAs). The difference between FTA and CU is that the former need not have a uniform tariff as against imports from outside countries\(^2\). CU is a complex arrangement, whereby all countries must agree on joint external trade

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\(^1\) See Esperitu, E.B. (2003), *The Manila Times*.

policies. Member countries eliminate tariffs and other trade barriers between themselves but maintain a common external tariff against non-members. The EU is an example of CU. On the contrary, in FTAs, a uniform tariff as against imports from outside countries is not needed. Members eliminate tariff and other tariff between themselves but individual countries maintain own tariff rate against non-members. The North American Free Trade Area (NAFTA) is an example of an FTA.

2.3 WTO AND FTAs

The multilateral trading system under WTO works on a fundamental that reduction in trade barriers should be applied on the Most-Favored Nation (MFN) basis to all WTO members. This means no WTO member should be discriminated against, by another member’s trade regime. However, Article XXIV of the General Agreement on Tariff and Trade (GATT) for trade in goods and General Agreement on Trade and Services (GATS), do permit exceptions to the countries that indulge in FTAs and RTAs.

2.4 LITERATURE REVIEW

One of the central aspects of today’s economic globalization is increasing number of FTAs. Classical economist Adam Smith and David Ricardo were the first advocates of free trade principles. Smith defended free trade in the general interest whereas Ricardo further developed and strengthened the theory of comparative advantage. He took into consideration that productivity levels differ from one country to another, showing that free trade is in the interest of every country, because there is always something that can be traded (Went, 2002).

Many scholars have concluded in their studies that to a great extent, FTA works as an instrument of economic growth. However, others have challenged the above statement.
In the last three decades, open economies have grown much faster than economies with high protection level. Sachs and Warner (1995) noted that economies that followed import substitution policies have experienced economic crisis during the 1980s and 1990s. Today’s economic liberalization is aimed at growth via trade and investment. For example, Grossman and Helpman (1989,1990,1991), Rivera-Batiz and Romer (1991a, 1991b), Romer (1990) and Krugman (1990, ch.11) have concluded that countries open to free trade would have large international market that provides technological spillover effects through investments and higher profits to innovators. They also claimed that a freer trade enhances economies of scale in the research and development (R&D) sector and therefore R&D replication efforts across countries are avoided.

The empirical evidence for the above argument was provided by Coe, Helpman and Hoffmaister (1997) that free trade affects the technological progress, which fosters economic growth. A technological spillover could foster growth since a more liberalized trade incorporates higher investment and thus results in new technology transfer. Levine and Renelt (1992) agree that a positive impact on investment created by trade induces growth.

According to Findlay (1987), free trade arrangement is the “deepest and most beautiful in all economies.” He finds that free trade not only raises welfare of individual countries but the whole world too. Countries will be better off if they exploit the comparative advantage in production they enjoy over at least some other countries. Cobden, the great advocate of free trade in the 19th century, argued that free trade not only enhances trade but also brings closer relations between countries and encourages peace. His claims do justify, as the 19th century was a period of relatively free trade and peace.

The formation of a FTA has its risks. It can exhibit both trade creation and trade diversion. Whether they are welfare reducing or not depends on the relative size of trade
creation versus trade diversion.\textsuperscript{3} The theory of Customs Unions unveiled by Jacob Viner in 1950, which was further elaborated by Lipsey (1970), believed that Regional Trade Arrangements (RTAs) can confer net benefits, if positive 'trade creation' effect outweighs the negative 'trade diversion' effect. His insights also apply to FTAs.

Trade creation occurs when elimination or reduction of tariff barriers among member countries leads to more trade among them. This enables a country to source a product more cheaply from a partner through trade than to produce it domestically. Viners' static analysis also emphasized trade diversion. It occurs when goods produced by less efficient producers inside an arrangement replace the import of goods produced by a more efficient producer from outside the arrangement. Hence, the source of imports is shifted from a more efficient third country to a less efficient partner. A regional grouping will only make sense if trade creation exceeds trade diversion.

Moreover, member countries of a FTA may be tempted to take advantage of its increased size to improve its terms of trade at the expense of third party countries. According to Yolinda Yok (1999), FTA members will indulge in power games by using their bargaining powers to gain concessions from others. She argues that this would significantly undermine the operation of multilateral trade and investment system.

\textsuperscript{3} Trade creation is larger if trade barriers between members prior to FTA formation are higher and if more countries choose to join the groupings. In addition, countries that are geographically closer will have higher trade creation due to the lower transportation costs. Countries that venture into economically competitive interaction are more likely to create trade. This implies that trade creation is larger between two integrating competitive industrialized economies rather than between an agricultural nation and an industrial nation. Trade diversion is likely if FTAs external trade barriers are lower and if the trade outside the FTA arrangement is smaller prior to the formation. See Trade, Regionalization, and Tariffs: The Correlates of Openness in The American Long Run, in Kerremans, B. and Switky, B. (eds), The Political Importance of Regional Trading Blocs, Ashgate Publishing, pp.55-69.
Therefore, there is a danger of countries reverting to the practice of unilateralism and protectionism.

Several scholars have investigated that FTAs are more likely to create net gains. Siddique (2003) incorporated both static\(^4\) and dynamic gains\(^5\) of free trade in his argument. He claims that FTA raises efficiency of domestic industries. Larger market size increases cross-border investment opportunities and encourages easier technological transfer. He also noted that FTA has the potential to benefit a country from the transfer of both physical and managerial technology. The transfer of physical technology embodied in new machines raises the productivity of industries while superior managerial technology transfer enables industries to harness the maximum potential of physical technology. With all these, there will be a reduction in illiteracy, morbidity, and infant mortality. There will also be an increase in health standards and nutrition, longevity and the general quality in life.

He also concludes that there is a possibility of some sector losing out as the main static advantage of free trade occurs due to the replacement of costly domestic production by cheaper imports. Thus, uncompetitive domestic industries have to close down or reduce production, causing income loss to those associated with these industries.

\(^4\) Trade creation and trade diversion are static effects, referring to a one-time change in the allocative efficiency. See Tran, V. T. (2002), AFTA in the Dynamic Perspective of Asian Trade, Japan Center for Economic Research (JCER) Discussion Paper No.77, p.3.

\(^5\) Dynamic effect refers to long-term implications for economic development of partner countries. These include higher economies of scale, higher competition, efficient production facilities, and high foreign direct investment (FDI) flows. See Trade, Regionalization, and Tariffs: The Correlates of Openness in The American Long Run, in Kerremans, B. and Switky, B. (eds), The Political Importance of Regional Trading Blocs, Ashgate Publishing, pp.61-62.
Esperitu, E. B. (2003) agrees with Siddique. He believes that freer trade area expands market, creates more jobs, increases income, and efficient use of each countries resources. He claims that countries in similar stages of development should form groupings, reap benefits of trade and specialization on a regional level, and by negotiating collectively with other trade blocs, wield some power of their own. He further argues that FTA provides freedom of labor and capital movements among themselves in order to equalize opportunities regionally.

In their empirical literature survey on the impact of RTAs, Robinson and Thierfelder (1999) used Multi-Country CGE Models, which differ in terms of country and commodity coverage, policy detail and assumed market structure. In spite of these differences, their surveys concluded that RTAs, in aggregate, create larger trade and increases welfare measured in real GDP for member countries.

For many, AFTA is an ambitious project. It marks the culmination of ASEAN leaders’ efforts to achieve regional cohesion. Even during the financial turmoil that swept much of the region in 1997, the leaders believed that the only way to generate trade and investment whilst restoring financial stability is through deep economic integration that is through AFTA. Several economists have addressed the impact of AFTA in the ASEAN region.

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6 The Computable General Equilibrium (CGE) framework is suitable for quantifying the cost and benefits of RIAs. They evaluate the impacts of policy choices by integrating economies and their partner countries. CGE models have made two distinct contributions. Firstly, they provide quantitative estimate of the effects of actual or proposed RIAs. Secondly, the models help us to understand the theoretical interactions of key variables. The sensitivity of the CGE models’ results towards key parameter values allows for a better policy formulation as proper information about the impacts of RIAs are obtained (See Baldwin and Venables, 1995).
Two recent studies by DeRosa (1995) and Lewis and Robinson (1996) investigated the effects of AFTA for the ASEAN-5 using CGE models and found AFTA to be trade creating for these members. According to them, except in Singapore and to a lesser extent in Malaysia, the AFTA plan was found to yield only small improvement to economic welfare in ASEAN countries. These two highest income ASEAN countries benefit from the diversion of trade in other ASEAN countries, and end up supplying the largest proportion of the increased intra-regional demand for manufactures (DeRosa, 1995). Both DeRosa and Lewis' studies reported that alternative scenarios in which trade regimes of ASEAN countries are liberalized on a MFN basis rather than a preferential basis, yields larger gains in trade, investment and the economy as a whole.

Adams (1995) studied the real income effect posed by AFTA by measuring the macroeconomic effects of AFTA. He concludes that ASEAN will benefit from it, as the real income will rise in each ASEAN countries with improvements ranging from 0.6 percent (Indonesia) to 1.6 percent (Malaysia). He also concludes that the trade volume will rise in ASEAN. The World Bank (1993) used its own baseline projections of GDP, trade, and capital flows until the year 2000 to simulate the effects AFTA and reported that if AFTA were to be non-discriminatory (that is, if AFTA cuts were extended to other trading partners as well), real income in ASEAN will grow by 4.2 percent, and exports and imports will expand by 3.7 percent and 5.4 percent, respectively.

After assessing the trade regimes of the four new members of ASEAN, namely Cambodia, Lao PDR, Myanmar and Vietnam (CLMV), Fukase, E. and Martin, W. (2001) used a set of CGE models to quantify whether AFTA is trade creating or trade diverting and also to determine the effects of tariff reductions under AFTA for CLMV and their ASEAN partners. The static welfare benefit from their simulation results of AFTA and MFN liberalization for CLMV, showed that economic impacts of AFTA are positive,
although relatively small. They found that the benefits increase if the new members' commitments are on a non-discriminatory basis. Their conclusion is consistent with the findings of DeRosa (1995) and Lewis and Robinson's (1996).

Since an important objective of AFTA is to promote intra-regional trade, much of the concern that threatens the realization of AFTA is pertaining to the contributions to the expected growth in intra-industry trade following liberalization. Although, free trade is beneficial in the long run, there are significant adjustment costs in the short run to medium run (Menon, J., 1996). Therefore, a number of studies to examine the changing pattern of intra-industry trade in then region were done by Kwan (1994), Imada (1990) and Ariff (1991) based on the Grubel and Lloyd (1975) index of intra-industry trade, which measures the share of intra-industry trade in total trade at any point in time.

According to En Abdul Razak Haji Ramli, Senior Deputy Director (Trade Policy) of Ministry of International Trade and Industry Malaysia, in his speech a the Federation of Malaysian Manufactures (FMM) Seminar held in Kuala Lumpur, Malaysia in 1993, AFTA will stimulate intra and extra-ASEAN investment through networking and complementation of industrial activities as well as improvement of the overall trade and investment prospects in ASEAN. He noted that under AFTA, intra-ASEAN imports are expected to rise by 40 percent to 70 percent, except for Singapore, which will experience a marginal increase due to the already low tariffs in operation. He claimed that Malaysia is poised to figure prominently in the AFTA trade matrix over other ASEAN countries. The study of Imada et. al indicates that 50 percent intra-ASEAN tariff preference would result

Intra-industry or "two-way" trade involves simultaneous import and export of a product, e.g. exports of Proton Sagas and imports of BMW. Inter-industry refers to international exchange of different products, e.g. exports of food and imports of machinery (See Menon, J. (1996), Adjusting towards AFTA: The Dynamics of Trade in ASEAN, Institute of Southeast Asian Studies, p.5).
in net welfare gain for ASEAN member countries. He also points that intra-ASEAN imports and exports will rise sharply and trade increases will be fairly distributed. Although, the sharp increase in imports is partly due to the diversion of imports from non-ASEAN sources, this trade diversion effect is less than trade creation. Meanwhile, the rise in exports would not be at the expense of exports to the rest of the world. Therefore, AFTA will principally be trade creating rather than trade diverting.

Nevertheless, some trade diversion is not favorable to the extra-ASEAN in the short term. In the long run, however, as AFTA stimulates ASEAN economies, demand will increase. Thus, AFTA is expected to strengthen the extra-ASEAN linkages of each member countries.

2.5 THE MALAYSIAN ECONOMY

Malaysia has today become an export driven economy spurred on by high technology, knowledge-based and capital intensive industries. The structural transformation of Malaysia over the last 40 years is due to the decisive steps to move from a country dependent on agriculture and primary commodities in the sixties to a manufacturing based nation.

Malaysia’s GDP grew at an average rate of 5.1 percent in the 1960s and 7.8 percent in the 1970s due to the government’s decision to concentrate more on manufacturing sector. However, the global recession in 1985-1986 caused Malaysia’s economy to grow at a lower average rate of 5.9 percent. From 1991-1996, the economic growth was rapid at an average rate of 8.7 percent per annum due to the recovery of the world economy. This growth momentum was disrupted by the East Asian financial crisis that caused currency crisis and stock market shocks in several Asia Pacific Region. Malaysia’s GDP
experienced severe contraction in 1998 when the GDP registered a negative growth rate of 7.4 percent owing to a large drop in private domestic demand caused by a sharp decline in investment and consumption. As a consequence, the unemployment rate rose, inflation doubled and the ringgit fell.

Nevertheless, Malaysia bounced back towards economic recovery within two years with the government’s decision to adopt sound financial and economic policies such as pegging the ringgit and using selective exchange control regimes. The fact that Malaysia’s economic growth was achieved within an environment of relatively low inflation is even more impressive. These efforts by the government generated an average growth rate of 7.2 percent from 1999-2000, better than expected at an average of 4.7 percent per annum during the period. The GDP grew by 6.1 percent in 1999 and by 8.3 percent in 2000. This indicates further proof of the Malaysian economy’s resilience during the financial crisis. The rebound of economy can also be attributed to rising private consumption, a revival in domestic investment, and strong export growth since Malaysia’s trading partners kept their markets open throughout the crisis. Therefore, the unemployment rate declined to 3.1 percent in 2000 and inflation slowed from 2.8 percent in 1999 to 1.6 percent in 2000.

In 2001, Malaysia’s GDP growth rate was only 0.4 percent. Recovery of the Malaysian economy gained momentum in 2002 amidst a more challenging external environment. Real economic growth turned positive in the first quarter and strengthened to 5.6 percent in the fourth quarter. For the year as a whole, real gross domestic product (GDP) expanded by 4.2 percent compared to 0.4 percent in 2001.
2.51 THE MALAYSIAN ECONOMY IN 2003

The Malaysian economy demonstrated greater resilience in the face of uncertainties to expand by 5.2 percent, rapidly than previous forecast. For the year as a whole, real GDP expanded by 5.2 percent (2002: 4.1%), exceeding the official forecast of 4.5 percent (Graph 2.2 and Graph 2.3). Inflation remained low and stable in 2003. The overall inflation rate, as measured by the annual change in Consumer Price Index (CPI), was slightly lower at 1.2 percent, compared to 1.8 percent in 2002. As for the core inflation, that is inflation due to demand pressures, was lower at 0.6 percent. In 2003, the accommodative monetary framework continued to operate under a pegged exchange rate system, reinforcing other policies towards stronger growth in output. The ringgit remained fixed at RM3.80 = US$1 since September 1998.
Graph 2.2
Real GDP

Source: BNM Annual Report 2003

Graph 2.3
GNP Growth and Nominal GNP per Capita

Source: BNM Annual Report 2003
The manufacturing sector grew by 8.2 percent for both export and domestic oriented industries. The agricultural sector enjoyed growth of 5.5 percent since higher production and high prices of palm oil and rubber particularly, drove growth.

Exports of primary commodities rose 30.4 percent due to higher prices and improving external demand. The services sector, however, experienced significant drop in the first half of 2003, most notably because of the impact of Severe Acute Respiratory Syndrome (SARS). Even then, growth in this sector still remained resilient in the second half due to strong loan growth, increased use of new services in the telecommunications segment and sustained volume of international trade. The sector expanded by 4.1 percent for the year as a whole.

GDP growth in 2003 was private sector driven. Private expenditure contributed 2.5 percentage points of the 5.2 percent growth rate. A significant development in 2003 has been the turnaround in private investment, which increased by 1.1 percent after two years of contraction. In the second half, capital spending also experienced an increase as a result of low interest rate environment, stronger corporate balance sheets and cash flow positions, and high capacity utilization, especially in the manufacturing sector.

The public sector continued to play a vital role in sustaining domestic demand. Public consumption increased by 7.9 percent due to higher spending on supplies and services. On the other hand, real public investment growth moderated to 3.6 percent. As a result, real aggregate domestic demand (excluding change in stocks) increased more rapidly by 4.8 percent (Graph 2.4).
Graph 2.4
Real GDP and Aggregate Domestic Demand

Source: BNM Annual Report 2003

In 2003, export of goods in the trade account accelerated by 11.5 percent (2002: 7%), which led to the external sector’s contribution to growth (2 percentage points; 2002: -4.3 percentage points). The trade surplus rose to RM81.1 billion (2002: RM54.6 billion) because the pick-up in the investment activities, higher commodity prices and sustained consumer demand, spurred the growth in exports. Meanwhile, import growth moderated to 4.8 percent (2002: 8.1%) as exports of primary commodities had a low import content, unlike manufactured exports. Malaysia experienced a current account surplus increase to RM 50.8 billion, equivalent to 13.7 percent of GNP (2002: 9.1% of GNP). This is because large trade surplus, coupled with a smaller income account deficit, brought by the repatriation of earnings from overseas investments by Malaysian firms. The financial account in the balance of payments remained stable, recording a deficit of RM12.1 billion (2002: - RM11.9 billion).
Malaysia's external debt position remained stable in 2003, standing at RM187.2 billion or 50.7 percent of GNP (2002: RM185.6 billion or 55.3% of GNP) despite a RM4.1 billion revaluation adjustment that resulted mainly from appreciation of the euro and yen. The debt service ratio improved from 6.7 percent in 2002 to 6.1 percent in 2003.

2.52 PROSPECT FOR THE MALAYSIAN ECONOMY IN 2004

The Malaysian economy recorded high performance in the last three years even though there were uncertainties arising from international terrorism, war in Iraq, unprecedented volatility in global economy, the outbreak of SARS and Bird Flu. Through continuous fiscal stimulus and accommodative monetary policies, the government will be able to sustain growth along with the expansion in domestic demand. Malaysia registered GDP rates of 4.2 percent and 5.2 percent in 2002 and 2003, respectively. There is a brighter prospect for growth in 2004 owing to the fact that global economic growth is at 4.1 percent. Thus, the economy is expected to strengthen further in 2004, building on the strong growth momentum in the second half of 2003. Real GDP is expected to expand by 6-6.5 percent (2003: 5.2%). This will mainly be private sector driven while positive impact of pro-growth fiscal and monetasy measures is expected to robust consumer spending and private investment activities. Malaysia is also expected to benefit from the expansion of intra-regional trade, in line with the growth in Asia, stronger than the global average.

The Malaysian economy grew by 8 percent in the second quarter of 2004 from first quarter, surpassing expectations. The manufacturing and services sectors continue to register strong growth, 12 percent and 7.4 percent, respectively. The agricultural sector grew 3.2 percent year-on-year in the first half of 2004. Export growth was broad based, including electronics, chemical products and commodities. Import growth reflected sustained production growth, higher domestic demand and investment activities. The
private consumption is currently growing at 9.3 percent and is expected to remain strong in 2004, while private investment is projected to grow by 14.8 percent in 2004. Inflation remained low at 1.2 percent in the second quarter of 2004. Domestic interest rates are expected to remain low as the market expects the currency peg to hold in the short term. Malaysia's BOP is likely to gain a positive figure. For 2004, the overall BOP is expected to record a stronger surplus of RM42.34 billion (RM39.06 billion in 2003). Supported by growing optimism externally, the current account of the BOP is expected to record a significant surplus of RM61.69 billion in 2005 from an estimated RM57.97 billion, or 14.1 percent of the GNP this year (2003: RM50.85 billion; 13.7%).

2.6 MALAYSIA'S APPROACH TO FTAs

The World Trade Organization (WTO) allows formation of FTA if duties are eliminated on substantially all trade. The diverse nature of FTAs or EPA (Economic Partnership Agreements), which includes merchandise trade, services, investment, economic cooperation and trade facilitation, is used as an important trade policy tool in order to stimulate and accelerate economic growth. It is also a major exception to the fundamental principle of Most-Favored Nation (MFN) treatment under WTO.

The WTO agreements play a pivotal role in the Malaysian trade and trade-related policy formulation. These include regional arrangements such as the South East Asian Nations (ASEAN) and Asia Pacific Economic Cooperation (APEC) forum, and various bilateral agreements, including areas not covered by WTO agreements. Malaysia coordinates its policies on WTO matters with other ASEAN members and also ensures that its participation in RTAs is consistent with the main principles underlying the WTO agreements. Basically, Malaysia aims to seek negotiation arrangements that will provide balanced benefits amongst member countries and flexibility in addressing problem areas.
Malaysia remains its priority to pursue trade liberalization through "equitable rule based on a multilateral trading system" under the WTO. Undoubtedly, FTAs complement the WTO through deeper liberalization measures. This is why as a trading nation and an open economy, Malaysia has chosen to pursue bilateral and regional trading arrangements to capture every opportunity available and to gain market access in the WTO. Currently, the FTAs or EPAs Malaysia pursues with selected countries does not only include trade and investment facilities but also cooperation in non-trade areas including science and technology, education, agriculture, transport and information and communication technology.

2.7 MALAYSIA'S INVOLVEMENT IN FTAs

2.71 REGIONAL FTAs

i) ASEAN-CHINA

Signed on 4th November 2002, in Phnom Penh, Cambodia, it is a framework agreement on Comprehensive Economic Cooperation (CEP) between ASEAN and China. It entered into force on 1st July 2003 and includes early harvest package covering Chapter 1-8 (agricultural products of the Customs Harmonized system). It also contains guidelines for FTA negotiation in goods, services and investment.

ii) ASEAN-JAPAN

This framework for Comprehensive Economic Partnership (CEP) between ASEAN and Japan was signed on the 8th October 2003, in Bali, Indonesia. Programmes included in this framework are trade and investment facilitation and liberalization, and cooperation in other areas such as science and technology, human resource development (HRD), Small
and Medium Enterprises (SMEs), energy, Information and Communication Technology (ICT), transportation and logistics, tourism and hospitality. The FTA negotiations are carried out in two-track process; a common set of rules of origin is used to gauge bilateral FTAs between Japan and selected ASEAN countries and region-wide CEP to be implemented by 2012.

iii) ASEAN-INDIA

Signed on 8th October 2003, in Bali, Indonesia, the main elements of agreement are negotiations to establish FTA in goods, services and investment, and identification of areas for cooperation aimed at capacity building. It also contains an early harvest package on goods and trade facilitation measures.

iv) TRANS REGIONAL EU-ASEAN TRADE INITIATIVE (TREATI)

In order to enhance economic partnership between ASEAN and EU, on the 4th April 2003, ASEAN and EU ministers agreed to establish TREATI. The main areas of cooperation include tourism, customs, sanitary and phytosanitary (SPS) measures, technical barriers to trade; and trade and investment facilitation and promotion. The implementation of TREATI acts as a benchmark for future cooperation between the two regions.

2.72 BILATERAL FTAs

i) MALAYSIA-JAPAN

The objective of this bilateral cooperation is to realize a FTA in 10 years. The preparation for this agreement began in February 2003 and formal negotiations only commenced on the 11th December 2003, which is targeted to be concluded by end of 2004.
This FTA covers components such as industrial and agricultural goods, services, trade, investment, rules of origin, SMEs standards and conformance, dispute settlements and customs procedures. Other areas of cooperation include education, HRD, R&D, ICT, science and technology.

ii) MALAYSIA-US TIFA (TRADE AND INVESTMENT FRAMEWORK AGREEMENT)

This agreement was signed in 10th May 2004. According to Minister of International Trade and Investment Datuk Seri Rafidah Aziz, TIFA could be a precursor to free trade relations. TIFA will deal with various aspects of bilateral trade ranging from intellectual property, biotechnology and communications technology to wider participation in trade and investment by mid-and-small-sized companies.8 Initiation of consultations in areas such as WTO and APEC coordination and participation of SMEs in trade and investment is also included in TIFA. This agreement will benefit American companies that have set up operations and base in Malaysia as the bulk of Malaysia’s exports to the USA are products from these companies. Malaysia is America’s 10th largest trading partner and the USA is the largest destination for Malaysian products, absorbing nearly one-fifth of its US$100 billion (RM380 billion) in exports in 2003.

Other proposals for establishment of regional plus FTAs are ASEAN-Closer Economic relations (ASEAN-CER), ASEAN-Korea and the US-proposed ASEAN-US Initiative (AUI) FTA, which is only for interested members in ASEAN. Other RTAs where Malaysia is a member include Organization of Islamic Conference (OIC) and Trade Preferential System (TPS-OIC) and D8 Preferential Tariff Agreement (D8-PTA).

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