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**Measures to Enhance Deep Integration between Australia and
Malaysia**

by

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1. Introduction

While the proximate background for the present conference is the decision reached at the Australia-Malaysia Joint Trade Committee in July 2004 to begin parallel scoping studies in the two countries, the ultimate background is the progress that has been made toward bilateral or multi-party Regional Trade Agreements (RTAs) in the Asia-Pacific region and in the world as a whole. What might be agreed between Australia and Malaysia must be viewed in the light of the rapidly evolving trends in regionalism in the Asia-Pacific.

This paper is concerned with “deep integration” features of a possible RTA between Australia and Malaysia. A distinction is made between shallow and deep integration. “Shallow” integration refers to the elimination of the traditional border measures, tariffs and non-tariff measures for goods and other border barriers to trade in services and factors. “Deep” integration refers to the elimination of measures that are beyond-the-border. Lawrence (1996) first made this distinction. This distinction is most helpful but the precise meaning of the measures that pursue “deep” integration needs clarification. This is done in the Section 2. Section 3 looks at the experience in Australia and in Malaysia with incorporating deep integration features in the RTAs to which they are a party. Sections 4 and 5 look at the prospects for deep integration in a Malaysia- Australia Free Trade Agreement in relation to the areas of policy or regulation that might be incorporated, and the modalities that might be used. The last Section draws some conclusions concerning the scope of deep integration measures that are possible within a bilateral agreement, and on the relationship between these bilateral measures on the one hand and similar measures in the agreements with Singapore and with Thailand and the measures that might be possible in an AFTA-CER agreement.

2. What is deep integration?

Economic integration is the process of removing government measures which discriminate against foreign suppliers of goods and providers of services and suppliers of factors. In the regional context, the relevant “foreign” suppliers are those located in the other countries which are members of some regional agreement.

Two or more national economies in a region will be completely integrated if all measures that discriminate against regional suppliers are removed. The concept of complete integration provides a standard by which we can assess the extent of economic integration at any one time in any RTA. In some RTAs it may be the stated objective of present policies.

Two sets of policies are involved in the achievement of a completely integrated market:

- the elimination of *border* barriers to cross-border trade
- the elimination of *beyond-the-border* laws and regulations that inhibit cross-border trade or delivery of services

The first set of measures are the traditional focus of trade negotiations and of the GATT/WTO rules relating to RTAs, that is, the “narrow” integration measures. For goods trade, they encompass all tariff and non-tariff measures applied to good entering a foreign country. Similarly, for services and factor trade, they encompass all border controls; for example, for trade in capital, they include all foreign exchange controls, screening of foreign direct investments and other measures that apply to cross-border investments at the time of entry.

The second set of measures is government laws and regulations that restrict cross-border access to national markets compared to the access of suppliers within national borders, that is, “deep” integration measures.

The restriction of foreign supplies by measures applying beyond the border is usually couched in terms of the principle of National Treatment. National Treatment is the rule that a good or service or factor that crosses the border should receive the same treatment as a like product produced domestically or a like service or a like factor owned by domestic residents with respect to taxes and charges and regulations.

In markets for goods, National Treatment has been a fundamental principle of the GATT/WTO system of international law for more than 50 years. In the WTO (and in many treaties), National Treatment is expressed in terms of treatment which is “no

less favourable” than the treatment accorded national products. It applies to all government measures in the sense of “a law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution or use”. However, national subsidies are one permitted exception and government procurements are a second significant exception. (For a good introduction to the GATT/WTO interpretation of National Treatment, see Jackson, 1997, chapter 8 and also the WTO website.) National Treatment is viewed as a fundamental principle that ensures that treatment of goods after crossing the border shall not be discriminatory. I shall use the term full National Treatment to cover national Treatment as in the WTO plus the areas which are exceptions in the WTO, that is, National Treatment without exceptions.

The WTO Agreement on Trade in Services also enshrines the principle of National Treatment for services, though the interpretation is somewhat different, and countries may list exceptions. National Treatment is a principle applied also to capital flows in many RTAs and Bilateral Investment Treaties but not conventionally to labour markets

Increasingly, it has been realised that even full National Treatment is not enough to remove all measures which inhibit cross-border trade. In goods markets, standards for industrial products, the environment and other areas are not normally discriminatory; they apply equally to goods produced domestically and goods imported. However, in some cases, to meet these standards foreign producers have to modify their products. A simple case is one in which one member uses metric standards for goods sold within its jurisdiction and another uses non-metric, say Imperial, standards. In such cases, there is no question of a violation of National Treatment yet there is a barrier to trade. The same result may apply where there are differences in business laws. The solution to these barriers to trade may be the harmonisation across member countries of the relevant standards or laws. To distinguish this set of measures from the sets of border and beyond-the-border measures that can be addressed by National Treatment, we shall use the term *across-borders* measures. They are a subset of beyond-the-border measures.

Harmonisation may involve the adoption of a single set of laws or regulations by all members, thus establishing a single set of standards. Alternatively, it may involve the adoption of minimum standards or the convergence of standards. A third modality is mutual recognition of each others' standards without any substantive changes in each country's standards themselves.

Economic integration is important because it increases the productivity of factors in the regional economy and, therefore, raises real incomes. It also tends to induce a convergence of prices of like products and factors and of incomes in the region. A number of empirical studies have shown these effects in the European Union, which is the most integrated region in the world economy. Empirical studies have shown that integrating economies also has a positive effect on the rate of growth over time though the evidence is mixed (see, for example, the analysis of growth of the EU in Ziltener, 2004).

Sometimes a market in which all suppliers, both from within the nation concerned and from other countries in the region, compete without discrimination is said to be a Single Market. The terminology comes from the EU.

Economists have given a precise definition of a single market. They define a single market as one in which the Law of One Price holds in all tradeable goods, services and factor markets. That is, there is a single price in the region-wide market for every tradeable commodity and factor, expressing all prices in a single currency and adjusting for the real costs of moving commodities or factors between locations. Such an economy is completely integrated.

This concept can be used to provide a test of complete integration and a measure of the degree of (incomplete) integration. Some studies have attempted to test whether the Law of One Price holds in RTA goods markets, chiefly the EU. (This literature is surveyed in Lloyd and Smith, 2004, Section 2.5.1.) There have also been tests of integration in financial markets using the Law of One Price (see, for example, the study by Baele, *et al*, 2004 of the EU financial markets). The difficulty with this approach is to obtain comparable price data for homogeneous commodities. In most

markets, the data does not exist. Instead, one must examine the measures that have been adopted to promote integration of the markets.

3. Australian and Malaysian experience of deep integration in RTAs

As a prelude to what might be feasible in a Malaysia-Australia Free Trade Agreement, it is useful to review how far Australia and Malaysia have gone towards deep integration in RTAs to which they are a party. Table 1 sets out the results for the RTAs of which Australia and Malaysia are members as at February 2005. For Australia this is the 1983 CER Agreement with New Zealand and, more recently, the Singapore-Australia Free Trade Agreement (SAFTA), The Thailand-Australia Free Trade Agreement (TAFTA) and the Australia- US Free Trade Agreement (AUSFTA). For Malaysia, it is ASEAN alone though it is currently negotiating a bilateral agreement with Japan and is a party to ASEAN negotiations for the ASEAN-China, ASEAN-Japan, ASEAN-India and ASEAN-CER negotiations. In addition, the EU has been included in the table because of the precedents it has set; it is the only RTA in the world that approaches the status of a Single Market. It serves as a comparison for how far deep integration has progressed in other RTAs in the Asia-Pacific area.

Following the discussion of the nature of deep integration in the preceding Section, the measures reported in Table 1 distinguish between measures that apply to goods markets, services markets, capital markets and labour markets respectively. Within each set of markets, we also distinguish between measures that apply at borders, “beyond-the-border” and “across-borders” as appropriate. Border measures are not reported here. (Lloyd and MacLaren, 2004, Table 1 report these for 5 of the six RTAs examined.) There is a final category titled “Single market measures” which apply to all markets or to two or more sets of markets. These include monetary unions and fiscal unions as they are a major step by themselves and mark further progress towards a single economy. Within each market category, the choice of features reported in Table 1 is designed to measure key stages in the progress towards complete deep integration in these markets.

We score each box by giving one of three scores – all, some or none. These are denoted by the symbols √, *, and × respectively. If there are very minor exceptions only to a measure, the score will be taken to be “all”. Everything between all and none is “some”. Thus “some” indicates that some steps have been taken by the members towards the implementation of this measure but it is incomplete. In one case, that of monetary union in the EU, the entry is scored “some” because not all of the members have adopted the measure.

These scores are based on the actual progress as at February 2005; where an RTA has a long term goal for some border and beyond-the-border measure, we have endeavoured to assess the level of achievement at the present time. In a number of cases discussions or negotiations on measures are in progress but these cannot be recognised as they have not yet been agreed and/or implemented; for example, there are discussions in ASEAN on mutual recognition of labour standards in service industries.

The scoring is based on an examination of the agreements and related documents for each of the RTAs. In recording the achievements of each RTA, account has been taken of some agreements among the members of an RTA which are not part of or not an amendment to the agreement establishing the RTA. In a few cases, members have reached a separate agreement on particular aspects, either before or after the agreement establishing the RTA. This is especially true of deep integration measures. For example, Australia and New Zealand have an arrangement that allows free movement of persons in the CER area but it predates the CER Agreement and is not part of it. Many pairs of countries which are members of RTAs have double taxation agreements outside the regional trade agreements. In such cases, what matters is the totality of commitments towards integrating the economies of the area. Consequently, all binding agreements have been recognised in compiling the table.

Using this classification of measures and method of scoring, we can compare the progress towards complete integration of the major RTAs. From Table 1, the EU is clearly the RTA that has progressed the furthest towards complete integration. It has completed the elimination of almost all beyond-the border and all across-border

measures in all four markets, as well as all border measures. The exceptions to beyond-the-border measures are a limited restriction of production subsidies and limited harmonisation of business taxes. With regard to the production subsidies, Article 92 of the original Treaty of Rome forbade “state aids” which distort trade between member states but in practice a number of EU countries give a variety of subsidies to ailing or to high-tech industries (see the discussion on State Aids in the annual reports of the European Commission Directorate-General IV). Despite these and other measures which prevent equal market access in some markets, the EU can be regarded as the only RTA to approach the status of a Single Market. It provides the standard against which progress in other RTAs can be measured.

By comparison with the EU, all other agreements to which Australia and Malaysia are a party have made selective progress beyond the liberalisation of border measures. The items in which progress has been made vary greatly among the RTAs.

CER

In Table 1 CER ranks after the EU in terms of general progress towards the integration of the economies of the member countries.

With regard to goods markets, all border barriers were eliminated by June 1990, only seven years after the agreement came into effect. This includes removal of all non-tariff barriers and all export incentives which distorted regional trade, and a prohibition on the use of anti-dumping action against imports originating in the other member country. With regard to service markets, CER has adopted a negative list approach and the only substantial exception to free trade in services remaining is coastal shipping. There are no border barriers to the movement of labour, both permanent and temporary but, on the other hand, there has been no bilateral liberalisation of capital movements.

With regard to deep integration, CER has also adopted a bold if piecemeal approach. There has been harmonisation of standards for food and food inspection, and pharmaceutical products, conformity assessment and selected areas of business law. In the area of business law, most progress towards harmonisation has been made in the area of competition law. Harmonisation work is proceeding in other areas of

Table 1: Progress Towards Deep Integration in Six RTAsGoods Markets

Beyond-the-border measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
National treatment	✓	*	✓	✓	✓	✗
Prohibition of trade-distorting production subsidies	*	✓	✗	✗	✗	✗

Across-borders measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
Harmonisation of product standards – convergence of product standards	✓	✓	✗	✗	✗	*
– mutual recognition of product standards	✓	✓	*	✗	✗	*

Services Markets

Beyond-the-border measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
National treatment	✓	✓	✓	*	✓	*

Across-border measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
Mutual recognition of labour standards	✓	✓	✗	✗	✗	✗

Table 1 ContinuedCapital Markets

Beyond-the-border measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
National Treatment	✓	✗	✓	*	✓	✓
Prohibition of performance requirements	✓	✓	✗	✗	✓	✗
Prohibition of incentives to foreign investors	✓	✗	✗	✗	✗	✗
Investor protection	✓	✗	✓	✓	✓	✓

Across-border measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
Harmonisation of business laws	✓	*	✗	✗	✗	✗
Taxes – double tax treaty/ bilateral investment treaty	✓	✓	✓	✓	✓	✓
Taxes – harmonisation of taxes on business	*	*	✗	✗	✗	✗

Labour Markets

Across-borders measures	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
Mutual recognition of labour standards	✓	✓	✗	✗	✗	✗

Table 1 Continued

Single Market Measures

	EU	CER	SAFTA	TAFTA	AUSFTA	ASEAN
Regional competition law – convergence of competition laws	✓	✓	✗	✗	✗	✗
– bilateral cooperation agreement(s)	✓	✓	✗	✗	✓	✗
Intellectual property	✓	✗	✓	✓	✓	✓
Monetary union	✓	✗	✗	✗	✗	✗
Fiscal union	*	✗	✗	✗	✗	✗

business law such as electronic transactions law, disclosure regimes and cross-border insolvency. While CER has advanced far towards complete integration in all four market areas, there are some steps to be taken, especially in the capital markets area. CER has no provision relating to investment.

CER has pioneered some modalities; for example, the abolition of production subsidies that distort production in the area and the substitution of competition law remedies for anti-dumping actions. Indeed, if a comparison were made over all free trade areas and customs unions notified to the WTO, CER would still retain its position as the second most advanced agreement in relation to deep integration features. The CER Ministers have described the Agreement as “a model for both countries in their negotiation of newer free trade agreements.” (CER Ministers, 2004).

Australian and New Zealand Prime Ministers and Ministers have in the past described the CER approach in terms such as “pragmatic”. They had avoided the use of terms such as “economic integration” or “a single market”. However, in January 2004 the Australia and New Zealand Prime Ministers announced an intention of creating a “single economic market” (Prime Ministers Howard and Clark, 2004). They have in mind the kind of measures adopted by the EU, though it is doubtful if they have a precise idea of the measures and the extent of integration to be achieved. Table 1 showed that the CER is some distance from complete economic integration or a single market with respect to beyond-the-border and across-borders measures, especially in the capital markets.

The strategy the two countries have adopted to achieve a single (economic) market is to progressively adopt measures in each of the market areas. Before the announcement of the goal of a single market, they had initiated a number of working parties and groups to consider further beyond-the-border harmonisation in therapeutical goods and some areas of business law. In July 2004, they sent a reference to the Australian Productivity Commission to explore options for the harmonisation of all laws in the areas of competition and consumer protection law. The options include the option of a single law and a single competition authority. The

governments had also established a Working Group on Court Proceedings and Regulatory Enforcement under the Attorney General's Department. Thus, after the announcement of the goal of a single market, business law has been singled out as the area which offers promising possibilities of integration, largely based on earlier harmonisation of laws in this area.

The joint meetings of the Australian Treasurer and the New Zealand Minister of Finance and of the Prime Ministers in February 2005 announced a number of new deep integration measures. These were a commitment to establish a joint trans-Tasman Council on Banking Supervision, the endorsement of the recommendations of the Productivity Commission (2004) concerning trans-Tasman competition and consumer protection regimes and the adoption of a "goal of establishing a joint regime" in this area, the pending completion of a mutual recognition regime for securities offerings and progress towards the alignment of accounting standards in the Trans-Tasman Accounting Standards Advisory Group. The last may involve the creation of a single jointly-administered standards body, as in the areas of food and therapeutical standards. The Ministers also decided to investigate the possibility of adding an investment component to the CER Agreement.

Presumably other areas will follow at a later date. With this approach, the end achievement is uncertain.

Australian "New Age" agreements

The three "New Age" agreements – SAFTA, TAFTA and AUSFTA - are broadly similar in their pattern of progress though they differ in detail. All three go well beyond a traditional free trade area agreement restricted to lowering border barriers to trade in goods. All three contain measures relating to all four market areas and also contain some beyond-the-border measures. However, they do not contain any across-borders measures apart from double tax agreements concluded outside the framework of the RTAs and, in the case of SAFTA, an agreement on mutual recognition of conformity assessment for product, sanitary and phytosanitary standards that builds on an earlier agreement. Although all three have been put forward as New Age agreements, the measures they incorporate are in fact a long way from complete

integration and much less than those in the CER. There is no evidence that these later agreements were influenced by CER precedents.

SAFTA has progressed further towards a single market than the other two and is, therefore, the most liberal of the three. This reflects the general willingness of both parties to have a very open agreement and also the lack of conflict between the interests of the two economies. (See Sen, 2004 for a Singapore perspective on the agreement.) On the other hand, AUSFTA has progressed further than SAFTA in a few respects. For example, it provides for the elimination of performance requirements and there is a bilateral cooperation agreement between the competition authorities of the two countries. Both of these are areas of special concern to the US Government.

By comparison with both SAFTA and AUSFTA, TAFTA is less liberalising in the goods, services and capital market areas. It contains a number of chapters which relate to different measures but make no progress beyond WTO commitments: for example, this applies to agricultural export subsidies and anti-dumping actions in the area of goods trade. It also contains provisions for further liberalisation in areas already covered (such as market access for services) and for future negotiations in areas not already covered (such as possible mutual recognition of labour standards for service providers and possible cooperation between the competition authorities of the two countries.) It contains little in the area of capital markets and nothing in the area of labour markets beyond the NAFTA-style provisions relating to the temporary movement of business-related natural persons.

ASEAN

It is worth exploring deep integration features of ASEAN in some depth as this agreement, to which Malaysia is a party, will have a major bearing on Malaysian willingness and ability to adopt deep integration measures in a MAFTA.

The major vehicle for liberalising trade in goods is the 1992 ASEAN Free Trade Area, AFTA. This established a Common Effective Preferential Tariff (CEPT)

Scheme. Article 5 also provided for “...further measures on border and non-border areas of cooperation to supplement and complement the liberalisation of trade”.

Trade in services was not covered until the introduction of the ASEAN Framework Agreement on Services (AFAS) of 1995. This provides for preferential intra-ASEAN trade in services by means of the members making commitments which are inscribed on a schedule. AFAS states the goal of the agreement as “... to eliminate substantially restrictions to trade in services among members...within a reasonable time-frame.” Seven priority areas were nominated. This is the positive lists approach. There is provision for subsequent negotiations. The Agreement also provides for the mutual recognition of education achievements, licensing and certification of service suppliers.

Cooperation in the area of investment began with the 1998 Framework Agreement on ASEAN Investment Area (AIA). With regard to intra-area investment, the objective set out in Article 3 is

“... to progressively reduce or eliminate investment regulations and conditions which may impede investment flows and the operation of investment projects in ASEAN, and to ensure that the realisation of the above objective would contribute towards free flow of investments by 2020”.

The Agreement provided for open access and national treatment for all “ASEAN investors” in manufacturing and manufacturing services, and other privileges (minimum 30 per cent corporate investment allowance, duty free imports of capital goods). Exceptions were listed on a Temporary Exclusion List, a Sensitive List and a General Exceptions List, following the modality of CEPT. Provision of intra-area preferences is unusual in RTAs. However, national treatment and privileges are to be extended to all non-ASEAN investors by 2020.

The Agreement contains other objectives relating to increasing the flow of investments into ASEAN from non-ASEAN sources as well as ASEAN sources and promoting ASEAN as the most attractive investment area. This is another unusual feature of the AIA by comparison with investment provisions in other RTAs.

There are no general provisions relating to the freedom of movement of labour within the ASEAN area. The Hanoi Plan of Action set out a programme to promote human resource development in the area. This included a plan to establish networks of professional accreditation bodies to promote regional mobility and mutual recognition of technical and professional credentials and skills standards, beginning in 1999. The ASEAN Labour Ministers meet annually. In May 2000 they adopted an ASEAN Labour Ministers Vision and Mission Statement. The focus is on regional cooperation in human resource development.

Thus, the emphasis in ASEAN to date has been on border measures, with few deep integration measures being adopted. In the first three decades of ASEAN there was no mention of economic integration. However, attention is switching to these measures.

The landmark ASEAN Vision 2020 statement, made in 1997, declared that “we commit ourselves to moving towards closer cohesion and economic integration”. It announced a number of measures to pursue this new goal. The First Plan of Action, the Hanoi Plan of Action, the following year reaffirmed the goal of “closer economic integration”. Significantly, it expanded on this goal by declaring an intention

“To create a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, [our underlining] equitable economic development and reduced poverty and socio-economic disparities”.

The 2003 Declaration of ASEAN Concord II went further. In the section on the ASEAN Economic Community, it reiterated the “end-goal of economic integration as outlined in the ASEAN Vision”. It then declared

“The ASEAN Economic Community shall establish ASEAN as a single market and production base.”

The Tenth ASEAN Summit in Vientiane in November 2004 reaffirmed the ASEAN Concord II Declaration. The Vientiane Action Programme (VAP) replaces the Hanoi Plan of Action. It is to be implemented over the six years 2004-2010. Despite a focus in the VAP on deepening economic integration of member economies and the

adoption of a new goal of a single market since the Hanoi Plan of Action, VAP contains no major new initiatives with respect to deep integration. The main vehicles are the ASEAN Framework Agreement for the Integration of Priority Sectors and the Road Map for the Integration of ASEAN, both of which existed before the Summit. There are 11 priority sectors at present but more may be added. The overall strategy for deepening integration is to remove barriers to the free flow of goods, services and skilled labour and freer flow of capital by 2010 “to the extent feasible and agreeable to all member countries” (ASEAN, 2004, Section 2).

Thus, ASEAN, like CER, has now progressed to the most far-reaching goal, that of a single market but the ASEAN commitment is less comprehensive in terms of both sectors and measures.

To date, as shown in Table 1, ASEAN is further from the goal of a single market than CER. The progress in removing border measures that discriminate against producers in other ASEAN member countries has been substantial but there are still barriers in all four market areas (See Lloyd and Smith, 2005, Section 6.4.1 for further discussion.)

With regard to *beyond-the-border* measures, progress in the harmonisation of standards and other laws and regulations affecting goods trade has been limited. Under the provision in CEPT regarding non-border areas of cooperation to complement trade liberalisation, harmonisation of standards is progressing slowly. In addition, ASEAN adopted in 1998 the Framework Agreement on Mutual Recognition Arrangements. Under this scheme, the sectoral MRA for Electrical and Electronic Equipment is in operation and the MRA for Cosmetics has been signed. MRAs are being developed for the Pharmaceuticals, Prepared Foods, Telecommunications, Equipment and Automotive sectors. The progress in the beyond-the-border measures affecting services trade to the individual national commitments are listed in their national schedules.

4. Prospects for deep integration in a MAFTA – areas of policy

In order to see where progress concerning deep integration may be beneficial to Australia and to Malaysia, we need to observe broad features of trade between the two

countries. (Further information on trade patterns can be found in DFTA, 2005, chapter 5 and, for flows into and out of Australia, in relevant ABS sources.)

In relation to bilateral goods trade, Australia is a large net *importer* of goods. Thus, we in Australia would gain from removing beyond-the-border regulations and laws in Australia that inhibit our imports of goods from Malaysia. The principal imports are IT products (computers, integrated circuits and telecommunications equipment) and crude petroleum. This indicates that we should look at standards that affect these areas. Our exports are overwhelmingly primary products, agricultural products and minerals, mostly subject to little processing. There will be gains to Australian (and also one should add to the Malaysian consumers and users of these products) if access to Malaysian markets is improved by the removal of Malaysian beyond-the-border standards, regulations and laws that inhibit this trade.

In looking at the gains from deep integration in goods markets, one should consider potential trade patterns rather than actual trade patterns. It is possible that above-average levels of restrictions in some industries may depress actual trade and create larger potential trade gains. However, it seems that the pattern of goods trade between Australia and Malaysia has not been substantially distorted by border and beyond-the-border restrictions with the possible exception of automobiles and automobile components and parts.

In relation to bilateral services trade, Australia is, in contrast to goods trade, a large net *exporter* of services. Australian exports of services are dominated by the exports of education services and business and tourist travel, all of which involve the movement of people. The number of Malaysians who visit Australia each year for tourist purposes is greater than the number of Australians who visit Malaysia. In GATS terminology, these services exports are provided predominantly by Modes 2, Consumption Abroad. Therefore, they are affected by laws and regulations which inhibit the movement across borders of people. These are immigration laws and regulations.

In relation to capital flows, Malaysian investment in Australia has been larger than Australian investment in Malaysia since 1999. This applies to both direct investments

and to portfolio and other investments, and Malaysian investments in Australia have been growing rapidly whereas Australian investments in Malaysia have been declining. The principal areas of investment in Australia are energy, agribusiness, manufacturing, real estate, restaurants, travel agents and the gaming industry. The fall in Australian investments in Malaysia is probably due in part to the concerns over investments returns since the 1997 Asian financial crisis as inward foreign investment from all sources has slumped since the crisis.

Malaysian restrictions on inward foreign investments are higher than those for goods trade. (APEC, 2003 gives a survey of the Malaysian investment regime that is comprehensive if a little dated.) All foreign acquisitions of a Malaysian corporation require approval and this usually requires a Malaysian partner and, in the case of new listings on the Bursa Malaysia and acquisitions of domestic companies, the Malaysian Government requires 30 per cent bumiputra equity participation. There are other requirements of companies registering and operating in Malaysia (see DFAT, 2005, chapter 4 and APEC, 2003).

The Malaysian economy is subject to a much higher degree of direction and regulation than the Australian economy. As with the Governments of Australia and the States, the Government of Malaysia has been privatising a number of previously government-owned enterprises. There are, however, still a large number of government-owned and government-linked companies in a wide range of industries (see DFAT, 2005, Table 1.1). Foreign-invested enterprises are subject to numerous direct controls on their output and input decisions. These include company registration, local employment, contracts, borrowings and exchange controls.

The important consideration in the present context is not whether the degree of regulation of business activities is higher in Malaysia but whether there is more or less discrimination against foreign-invested enterprises. In Malaysia, the direct controls on their output and input decisions in areas listed above are different than those imposed on like domestic Malaysian enterprises.

These Malaysian restrictions on Australian direct investments in Malaysia are a mixture of border and beyond-the-border measures. There are major border

restrictions in the foreign investment approval process operated by MITI and foreign exchange transactions of foreign-invested (and domestic corporations) corporations require the approval of Bank Negara Malaysia. Companies seeking foreign investment approval must also apply for company registration with the Companies Commission of Malaysia, large manufacturing companies must obtain a manufacturing license from MITI, companies involved in technology transfer must be approved by MITI and projects with environmental risks must be approved by the Department of the Environment. Thus, in Malaysia areas such as environmental regulations and employment and labour training, which are usually regarded as beyond-the-border measures, are tied to the right of establishment.

The Malaysian foreign investment regime has been designed since the 1990s to encourage foreign investment in particular sectors, chiefly capital- and technology-intensive industries, especially IT and multimedia activities, and, more recently, in manufacturing service industries. There are particular restrictions on foreign equity participation in activities such as extraction and harvesting of timber, capture fisheries and oil and gas upstream industries. For services, these restrictions may have affected the pattern of Australian exports of services to Malaysia. For example, Malaysia totally excludes Australian law firms and lawyers, and architecture and engineering firms have difficulty exporting their services to Malaysia. The Australian Government has expressed concern about barriers applying to exports of services from the education, legal, architecture, accounting, engineering, telecommunications and insurance and banking service industries (DFAT, 2005, p. 106).

On the other hand, Malaysia has a number of incentives through their income and indirect tax law and the provisions for free zones which discriminate in favour of foreign investors over domestic Malaysian investors, but they are heavily hedged with restrictions as to the activities and the location of the activities.

It is important to note that Australian exports of goods and services to Malaysia are closely related to both outward and inward direct investments with Malaysia. Many direct investments into Australia are in the industries that produce goods or services we export to Malaysia. Thus, the facilitation of inward investments from Malaysia facilitates Australian exports of goods to Malaysia. Exports of Australian services by

Mode 3, Commercial Presence, require outward investment (and vice versa of course for service imports and inward investments). Mode 3 is the dominant mode of delivery for services such as financial and legal services.

Moreover, in the case of some service industries, there is competition between Australian exports of services by means of Mode 2 delivery, Consumption Abroad, or by Mode 3, Commercial Presence. For example, export of tertiary education services can be done by bringing Malaysian students to enrol in Australian institutions or by an Australian tertiary institution establishing an offshore campus in Malaysia (as Monash University has done). The latter Mode 3 delivery requires Australian investments in Malaysia. Consequently, deep integration measures that remove barriers to direct investments may either boost or reduce exports of goods and services.

Deep integration should, in addition to removing barriers to individual export and import and investment flows, establish neutrality between selling goods into the Malaysian markets by means of exports or by foreign investment to service Malaysian markets and between providing exports of services by alternative modes, and *vice versa* for Malaysian exports of goods and services.

By contrast, in Australia, the regulation of foreign-owned enterprises is concentrated in border controls on FDI inflows. Beyond-the border regulations and laws do not discriminate between domestic and foreign-invested enterprises, with a few industry-specific exceptions; for example, banking and financial services and broadcasting services.

In relation to labour movements, although both Australia and Malaysia have a substantial stock of residents who are immigrants, there is no real prospect that a bilateral treaty will contain provisions relating to the permanent movement of people between them.

Australia has liberal provisions for the inflow of persons seeking temporary work in Australia. There is both a Business Visitor (short stay) visa programme, that allows stays in Australia up to three months, and a Business Visitor (long stay) visa programme, that allows stays in Australia up to four years. Two of the three groups

covered by the long stay visas are tied to foreign invested-enterprises; visas for personnel (executives, manager and specialists) working for companies operating in Australia, and personnel from offshore companies seeking to establish a branch or joint venture or to fulfil a contract awarded to an offshore company. The third category is persons coming under a labour or skills agreement. Australia has a Professional Development scheme for foreigner undertaking training for professional development. It also has a scheme for Working Holiday Makers that allows employment in Australia for up to 12 months for young people. It has reciprocal agreements with 19 countries currently but not including Malaysia. Numerically this is by far the most important of the schemes permitting temporary employment. Students and some other categories of visas allow limited work.

Malaysia has categories of visit passes for foreign citizens seeking residence in Malaysia for business reasons. In order to attract FDI and promote technology transfer and inflow of foreign talents and skills, particularly in the manufacturing and manufacturing-related services sectors, Malaysia has liberalised the policy on the employment of expatriate in these sectors. The regulations on the inflow of temporary labour other than those employed in foreign-invested enterprises are strict.

There is already a bilateral double taxation agreement between Australia and Malaysia. It might be worthwhile examining the text of the present agreement to see if it is inadequate in any respect.

There is no prospect of a provision relating to competition policy law, as in CER, for the simple reason that Malaysia does not yet have a comprehensive competition law.

A chapter relating to intellectual property might be included, as in the three New Age Agreements that Australia has joined, though this is not a big issue for either Australia or Malaysia.

There is no prospect of a monetary or a fiscal union. Neither Australia nor Malaysia has any experience in this area in its previous bilaterals and any thought of these far-reaching deep integration measures is premature.

5. Prospects for deep integration in MAFTA – modalities and proposals

There are multiple modalities for the removal of beyond-the-border measures that discriminate against foreign suppliers of goods or services and the movement of capital and labour across borders. One of the difficulties in negotiating beyond-the-border measures in a bilateral agreement is the different views of the two countries with respect to beyond-the-border modalities and the different experiences they have had in previous bilaterals negotiated with other countries. We saw in Section 3 above that Australia and Malaysia have had rather different experiences in their prior bilaterals with regard to deep integration. Another difficulty is the Australian precedents set in SAFTA and TAFTA and the desirability of avoiding differential treatment among the ASEAN countries with whom we have individual bilaterals.

With respect to trade in goods, the important modality is National Treatment. There should be National Treatment clauses in a MAFTA in relation to goods trade, as there is in SAFTA, TAFTA and AUSFTA. This would follow Article III of GATT 1994 but it would reinforce the principle of no discrimination in goods trade by means of beyond-the-border treatment.

A MAFTA might contain a CER-type prohibition on production subsidies which distort trade since subsidies are outside the usual definition of National Treatment in the WTO and in RTAs. Although I am not aware of any evidence that domestic subsidy schemes distort Australian-Malaysian goods trade, such a provision would prevent this happening. This feature would be novel for Malaysia.

With respect to trade in services, there should be a National Treatment clause, as in the recent SAFTA and AUSFTA agreements. These clauses should contain as few exceptions and limitations as possible and definitely fewer than those currently listed in the WTO GATS schedules by both Australia and Malaysia. They could duplicate the lists in the Annex to SAFTA or TAFTA, otherwise there would be differential treatment between Malaysia and the other two ASEAN countries with whom we have bilateral agreements.

There seems little scope for across-border measures by means of harmonisation of standards applied to categories of goods and services either by means of the establishment of single standards (as in the CER agreements applying to foods and food inspection, pharmaceuticals, and accounting) or mutual recognition for goods or labour or securities (as in CER again). (Harmonisation of conformity assessment may be an exception.) The attraction of mutual recognition for trade in goods is that it is a simple device that can be applied immediately to all goods standards, as in the EU and in the CER Trans-Tasman Mutual Recognition Agreement (TTMRA).

There are several obstacles to initiatives relating to the harmonisation of standards. One is the wide differences in standards between Australia and Malaysia in many areas. A second is the lack of experience in Malaysia in this area. A third difficulty is the possible duplication with efforts that might emerge in the AFTA-CER negotiations (see below). If there is a mutual recognition provision, the scheme should follow that of the TTMRA. It would be undesirable, in my view, to adopt a sectoral approach to mutual recognition for goods, as ASEAN has adopted under the 1998 Framework Agreement on Mutual Recognition Arrangements.

A MAFTA should contain, in my view, provision for liberalising trade in investment along the lines of the investment chapters in SAFTA and TAFTA. Both of these provisions are essentially border measures but they could contain some beyond-the-border measures. The investment provisions should contain investor protection measures and investor dispute settlement provisions, both state-to state and investor-to-state, along the lines of those in AUSFTA.

With respect to foreign investment, the Malaysia regulatory framework that applies to foreign investment is a part of the one regulatory framework that applies to both foreign and domestic investors. There is no specific foreign investment law in Malaysia. However, there are many provisions which apply to foreign investors differentially. The granting of National Treatment would eliminate these discriminatory provisions. Exceptions or limitations should be kept to a minimum and should be less than those in Australia's recent bilateral agreements. As with National Treatment for services, the investment chapter could duplicate the list in the Annexes to SAFTA or the very similar list in the Annex to TAFTA, otherwise there

would again be differential treatment between Singapore and Thailand on the one hand and Malaysia on the other.

A provision outlawing investment incentives would be beneficial economically, I have no doubt, to the countries which presently have such schemes, principally in this case Malaysia. Such schemes distort both the source and the industry pattern of FDI and discriminate against domestic investors. However, this might be regarded as a radical initiative. No previous RTA, to my knowledge, has such a provision. The ASEAN Investment Area has not taken this step within ASEAN. It would be a major step for Malaysia.

A MAFTA should contain, in my view, provision for the temporary movement of people covering categories of business-related people movement, as in chapter 11 of SAFTA and in the TAFTA Schedule of Commitments. They could duplicate the categories of workers in SAFTA or the very similar categories in the TAFTA Schedule to avoid again differential treatment between the ASEAN countries with whom we have bilaterals. The agreement should also contain a provision for Working Holiday visa, either as part of the RTA or as an extension of the separate Australian network of reciprocal schemes.

A MAFTA should have a chapter on intellectual property, duplicating that in TAFTA or the very similar provisions in SAFTA. These cover the observance of international obligations by both parties and cooperation on enforcement of these obligations.

6. Conclusions

There is no difficulty in principle with deep integration between the Malaysian and Australian economies. Deep integration measures eliminate beyond-the-border discrimination and supplement the removal of traditional border discrimination. In practice, however, there are some difficulties due to the different patterns of beyond-the-border discrimination in the two countries and in their experiences with RTAs with other third countries.

The principal scope lies in National Treatment for services trade and investment, the temporary movement of business-related persons and intellectual property. There is

little scope for across-border harmonisation of standards or for more ambitious steps such as harmonisation of competition laws, or fiscal or monetary unions. Thus the scope of deep integration in a MAFTA will be considerably less than that in CER, which is made possible by the great similarities in the regulatory systems and laws of these two neighbouring countries. It is, nevertheless, worth pursuing.

In looking at the modalities and the details of the measures that may be adopted, one problem is that of avoiding differential treatment between Malaysia on the one hand and Singapore and Thailand on the other. In the areas of services trade, investment, the movement of business-related persons and intellectual property, this could be avoided by duplicating the relevant provisions of SAFTA or TAFTA. Where the provisions of these two agreements differ, the provisions of the more liberal of the two should generally be adopted.

A related problem arises with the negotiations on an AFTA-CER agreement that have now begun. It is not at all clear why Australia and Malaysia are considering a bilateral agreement when negotiations for an agreement that includes these bilateral relations as a part of a much broader set of relations among 12 (10 + 2) countries have already begun. If these negotiations result in a far-reaching agreement containing both narrow and deep integration measures, as I hope they do, a bilateral MAFTA will be redundant.

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