

Victorian Government Submission to the Australia-Malaysia Free Trade Agreement Scoping Study

1.0 Introduction

The Victorian Government welcomes the opportunity to make a submission to the Scoping Study into a possible Free Trade Agreement (FTA) between Australia and Malaysia. We acknowledge the growing importance of Australia's bilateral engagement with Malaysia, particularly for services industries, and look forward to developments in our relationship that are in the best interests of all sectors of the Victorian economy.

Although Victoria currently only has a moderate trading relationship with Malaysia, many areas are continuing to develop and grow, particularly services and some processed food exports. Victoria is committed to achieving a stronger economic and trade relationship with Asia, including building ties with Malaysia. Victoria would benefit from further trade liberalisation in Malaysia provided certain issues are addressed. These issues are outlined in the submission and include:

- effective rules of origin;
- ensuring that sub-national governments are subject to the disciplines of any agreement;
- protection of intellectual property; and
- lowering of tariff and non-tariff barriers impacting on industries such as automotive, education, dairy and aluminium.

Victoria supports the Commonwealth Government commissioning rigorous independent economic modelling of the potential costs and benefits of an FTA with Malaysia. This modelling should consider in detail the potential impacts of an FTA with Malaysia on Australian States and Territories and industry sectors, and should also examine any trade diversion impacts of an FTA. The Government should ensure that the methodology and assumptions underpinning the modelling are transparent and that the results are made available to all stakeholders.

While Malaysia poses significant competitive challenges to Victorian industry, it also represents some important commercial and trade opportunities. Victoria acknowledges that Malaysia is an economy with considerable growth potential. It is one of the richest Asian countries (8th based on GDP per capita) with economic growth expected to surpass the official 6-6.5% target for 2004 after expanding 8% year- on- year in the second quarter of 2004, the highest quarterly growth in four years (Central Bank Negara of Malaysia and *The Economist*).

The recent performance of the Malaysian economy and continuing strength of private sector spending suggests demand for exports such as commodities and services is likely to continue to grow strongly over the coming years. A truly comprehensive FTA between Malaysia and Australia will boost market access for Australian exports into the expanding Malaysian market and provide new commercial opportunities for sectors which have previously been heavily restricted in Malaysia, such as legal services.

An FTA with Malaysia would be strategically advantageous for Australia as it would assist in building stronger relations in the region, especially with the Association of South East Asian Nations (ASEAN). ASEAN is likely to decide if it will pursue an examination of the benefits of an FTA with Australia/New Zealand at its Leaders' meeting on 29 November 2004. This would represent a breakthrough opportunity for Australia to build stronger relations in South East Asia, and has most likely been positively influenced by the Singapore-Australia and Thailand-Australia FTAs, both negotiated recently.

2.0 Victorian and Malaysian Economic Relationship

2.1 Exports

Victoria's exports to Malaysia are modest, representing around 2.5% of total goods exports in 2003/04. Malaysia is Victoria's 13th largest export market, with exports in 2003/04 valued at \$443 million, representing moderate growth of nearly 3% since 1998/99.

Victoria mainly exports commodities to Malaysia, including milk, milk products, medicaments, aluminium and meats, while Malaysia mainly exports labour intensive, value-added manufactured products to Victoria, such as electronics and furniture. Food products such as meat, fruit and nuts, and cheese and curd also present an important component of Victoria's exports to Malaysia. Medicinal and pharmaceutical products are also included in Victoria's top ten exports to Malaysia.

2.2 Imports

Malaysia is Victoria's 10th largest import source, with Malaysian goods and services representing 2.6% of total goods imports to Victoria. Over the past six years Victoria has maintained a balance of trade deficit with Malaysia, with imports consistently approximately twice the value of exports. In 2003/04, Victoria's imports from Malaysia were valued at \$1077 million, \$634 million more than exports.

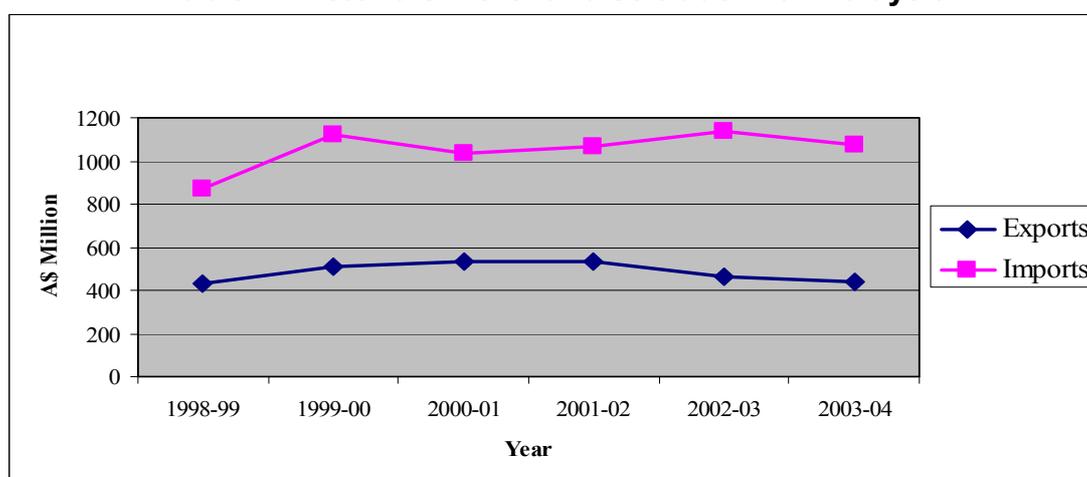
Imports comprised mainly computers, computer parts and petroleum. Other key imports from Malaysia are electronic and telecommunications equipment and furniture.

2.3 Trends

Victoria's trade with Malaysia has remained fairly static in the past six years, as can be seen in Table 1 below. Exports peaked in 2001/02 at \$537 million and have since experienced a slight decline, including a drop of 3.9% in the past year (imports peaked in 2002/03 at \$1140 million and have also declined slightly in the past year). This is in contrast to trade with other Asian countries in 2003/04; Victorian exports to China increased by 17.7% and exports to Indonesia increased by 23.7%. However, the decline in exports to Malaysia is not as dramatic as the decline in exports to Singapore (-25.9%) or Thailand (-26.6%).

This slowdown in export growth may be due, in part, to Victorian exporters focussing on other higher growth markets and perhaps a perception reported by some firms that Malaysia's restrictive industry policies are prohibitive to some investment and that intellectual property laws are not rigorously enforced. Domestic factors may also play a role; for example, the impact of the recent drought. Despite this decline in growth, there are still significant commercial opportunities for some sectors in Malaysia such as business services, which have faced considerable barriers to trade for many years.

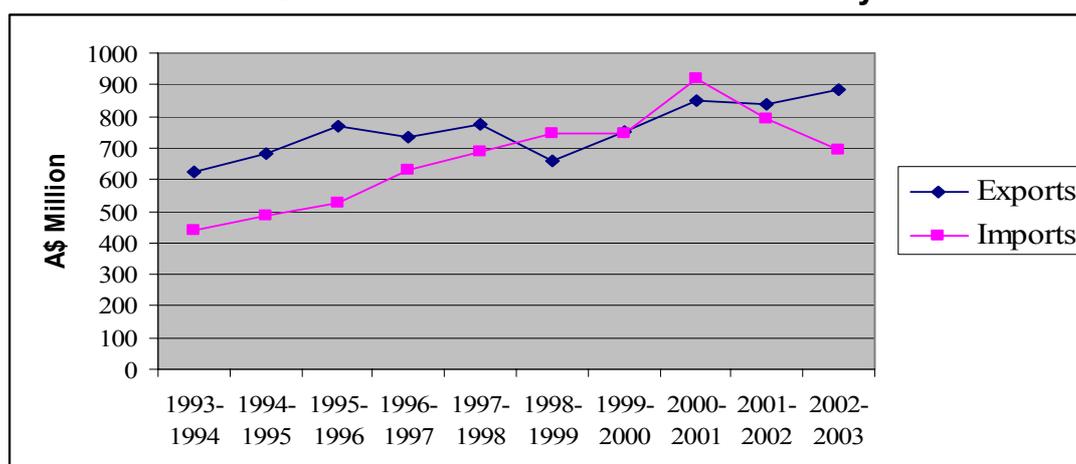
Table 1: Victoria's merchandise trade with Malaysia



Source: Australian Bureau of Statistics

The recent slowdown in the growth of exports is in contrast to growth in trade in services between Australia and Malaysia (note that sub-national data is not available). Imports of services from Malaysia have fallen in recent years, while exports of services from Australia have increased, which can be seen in Table 2 below. These service export increases are primarily related to education and tourism services.

Table 2: Australia's services trade with Malaysia



Source: Australian Bureau of Statistics

3.0 Key issues to be addressed by the Scoping Study

Consultation with stakeholders, including industry associations and individual firms, has revealed a number of important issues which need to be addressed in the Scoping Study. These issues are outlined below.

3.1 Rules of origin

The Scoping Study should consider the most effective way of closing loopholes which may allow other countries to misuse an FTA and use Malaysia as an entry point for their exports into Australia.

It is important to ensure that there is some consistency in the rules of origin system adopted in Australia's FTA agreements. This will help to ease the administrative process associated with an FTA and make it easier for exporters to understand the mutual obligations of both countries in a bilateral agreement.

In summary, Victoria seeks an outcome for the rules of origin system which prevents transshipment and has the lowest possible administration costs, including, for example, uniform rules of origin system for all industries.

3.2 Parties to the agreement

Malaysia has a number of local governments and sub-national provinces which implement and practise their own policies and programs. Victoria believes that sub-national governments should be subject to the disciplines of any FTA, and that such an agreement aim to eliminate any policies that may discriminate against Australian investment or imports into Malaysia.

3.3 Protection of intellectual property

An FTA with Malaysia could provide export opportunities for Australia's knowledge-based industries, such as telecommunications and

pharmaceuticals. Despite a clear legislative framework for the protection of intellectual property, there are widespread concerns from Australian firms about the actual enforcement of Malaysia's intellectual property laws.

As a result, it is important that the Scoping Study assesses Malaysia's current level of intellectual property protection and the extent to which these laws are enforced. The Australian Government and industry need to be satisfied that there is vigorous enforcement of these laws.

3.4 Government procurement

The inclusion of government procurement in an FTA could present significant opportunities for Australian businesses to tender for government work in Malaysia. It would also be useful for the ownership/responsibility of government-owned/quasi government organisations to be clarified for government procurement purposes as well as general trade purposes.

Victoria is keen to ensure that the study identifies the range of policies and practices at the national and sub-national level that effectively give preference to local Malaysian firms at the expense of foreign owned or operated companies.

3.5 Removal of tariff barriers in key Victorian industries exporting to Malaysia

In 2003, Malaysia's simple average tariff on imports of all Australian goods was 9.3%. Despite fairly low overall tariffs, including zero tariffs on a range of products, there are very high tariff rates which affect certain highly significant Victorian exports to Malaysia such as automotive, dairy and aluminium.

In addition, bound tariff rates are often much higher than actual tariff rates. Stakeholder feedback from industry associations and individual firms suggests that this creates an environment of uncertainty for businesses because actual Malaysian tariffs could be increased to these levels at any time.

3.5.1 Dairy and chocolate

In 2003/04, dairy exports to Malaysia were valued at \$171 million and represented almost 40% of all Victorian exports to Malaysia. In Malaysia, there are fairly low or zero tariff rates on most dairy product exports from Australia. However, some processed dairy products face very high tariff rates, such as yogurt which faces tariffs of up to 25%. Given that almost 30% of yogurt exports to Malaysia are from Victoria, elimination of these tariffs would help to drive increased exports from the important dairy processing industry in Victoria.

In 2003, around 60% of the Australian confectionery workforce was located in Victoria, with the three biggest confectionery manufacturers, Mars Confectionery, Cadbury Schweppes and Nestlé having production facilities in Victoria.

There is high demand for confectionery, particularly chocolate, in Malaysia, so this has the potential to be a lucrative export market for Victoria and Australia. Tariffs on cocoa beans and products entering Malaysia are high; there is a 15% tariff on chocolate blocks and bars and a 30% tariff on chocolate and other food products containing cocoa. There is also a 10% sales tax on these items in Malaysia. Tariffs on cocoa paste, cocoa butter and cocoa powder are between 25 – 30%.

Elimination of these tariff barriers would greatly improve opportunities for Victorian and Australian chocolate exports to Malaysia and would increase access to a burgeoning market.

3.5.2 Aluminium

Aluminium was the third largest Australian export to Malaysia in 2003/04, with exports worth \$188 million. Alcoa, whose aluminium smelting operations are located in Victoria, is Australia's leading aluminium producer and directly employs around 1800 people in Victoria, including regional Victoria. Alcoa exports aluminium to many of the fastest growing economies in Asia, including Malaysia, and supplies 13% of total world demand for alumina.

As Victoria's second largest export to Malaysia, it is vital that high aluminium tariff barriers are eliminated as part of any FTA with Malaysia (30% tariffs on imports of aluminium from non-ASEAN countries). An FTA which achieves this is likely to stimulate increased exports of aluminium from Victoria to Malaysia.

3.5.3 Automotive

Both high import tariffs and non-tariff barriers currently hamper the efforts of Australian automotive producers trying to compete in the Malaysian market. Malaysia currently has tariffs of up to 200% on motor vehicles and automotive component imports. Victoria is the largest manufacturer of automotive vehicles and parts in Australia, comprising 57% of national automobile production and 54% of total national automotive exports. Exports are impeded by these high tariff barriers and the discriminatory and anti-competitive automotive industry development policies practised in Malaysia.

The Scoping Study needs to analyse the benefits of eliminating the range of tariff and import quota restrictions on automotive imports. Malaysia offers a significant potential market for Victorian automotive exports; however, this will not be fulfilled without a commitment by Malaysia to liberalise and reform the domestic motor vehicle industry.

The Study therefore needs to address the prohibitive industry development policies practised by the Malaysian Government, which serve to severely restrict foreign ownership and support the local industry at the expense of foreign motor vehicle exporters. Other sectors where non-tariff barriers restrict Australian exports to Malaysia will be addressed in the next section.

3.6 Removal of non-tariff barriers in key Victorian industries exporting to Malaysia

Victoria is very keen to ensure that issues relating to non-tariff barriers to trade are addressed as part of the Scoping Study into a possible FTA with Malaysia. The following areas face such barriers which in some cases serve to impede exports and investment to a greater extent than tariff and import quota restrictions.

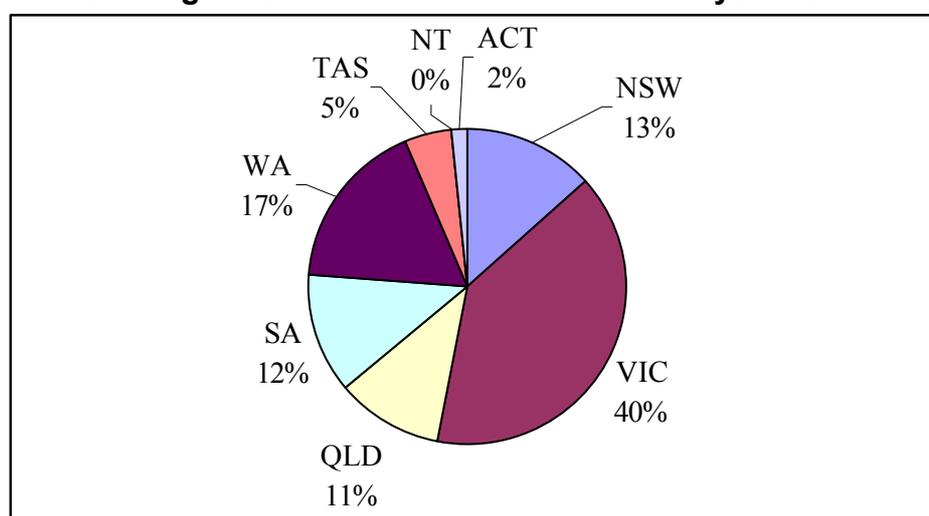
3.6.1 Education

i) Malaysian students in Victoria

Malaysia is a key export market for Victoria's education sector. In 2004, Malaysian students represented the third-largest population of international students in all education sectors in Victoria (6,882), behind China (14,819) and India (7,589) and comprising more than 10% of all international students in Victoria. Nationally, Malaysia is the second-largest source country for overseas students studying onshore in Australia (behind China) and more than 40% of Malaysian students in Australia study in Victoria.

Malaysia is one of four major off-shore campus markets for Australia and is the largest market for off-campus (distance/online) education. Of five foreign branch campuses in Malaysia, three are Australian and two of these are Victorian (Monash University and Swinburne University).

Table 3: Higher education enrolments of Malaysian students



Source: AEI Market Indicator Data 2004, Extracted: August 2004

However, growth in the export of education services in South East Asian countries, including Malaysia, has slowed recently. In 2003/04 the number of Malaysian students commencing studies in Australia decreased by 10.5%. In contrast, Chinese and Indian student numbers rose in 2003/04.

Although the Productivity Commission found in its October 2003 paper *Restrictions on Trade in Education Services: Some Basic Indexes* that

Malaysia has relatively few direct restrictions affecting trade in education services, there remain some barriers which should be addressed in the negotiation of an FTA with Malaysia.

The primary barrier to education exports to Malaysia is lack of recognition of many Australian tertiary and professional qualifications. There is also a lack of consistency and transparency in the process of recognising a degree from an Australian university or TAFE.

These issues combine to create a disincentive for Malaysian students to come to Australia to study. The streamlining of the Malaysian qualification recognition bodies' (LAN and JPA) procedures for approving and recognising courses offered by Australian education institutions would make the process more transparent and less onerous. The recognition of Australian honours degrees and off-campus (distance education and on-line learning) degrees also needs to be resolved. This may stimulate increased exports of post-graduate education services.

ii) Barriers to establishing a branch campus in Malaysia

There are also a number of important barriers to the establishment of branch campuses in Malaysia. These include restrictions on:

- the number of foreign education service providers;
- foreign direct investment in education activities;
- domestic student enrolments in international schools;
- land requirements; and
- joint venture or partnership (franchising) requirements.

Australian universities would benefit if these impediments were addressed in the Scoping Study and formed part of any negotiation of an FTA with Malaysia.

3.6.2 Business services

It is important that the Scoping Study considers the range of restrictions and in some cases direct prohibition of foreign operations of business services in Malaysia. For example, foreign legal firms are restricted from entering into joint venture arrangements with local law firms and foreign lawyers are not allowed to practise Malaysian law or operate as foreign legal consultants.

These restrictions are aimed at protecting the local industry and operate as a significant barrier to exports and commercial growth of the business services sector in Australia. Exports of legal services from Australia have grown significantly over the last decade. In 1991/92 Australia's exports of legal services to Malaysia were \$93 million, generating a net surplus of \$57 million. By 2001/02 exports of legal services had increased to \$346 million, with a net surplus of \$231 million (statistics for Victoria are not available).

Australian business services exports have a high growth potential in countries such as Malaysia, which have had a highly protected industry for many years. Australian expertise is greatly valued in South East Asian countries, as shown by demand for legal services in Singapore, Thailand, Hong Kong and mainland China, and it is likely that if these restrictions were lifted in Malaysia, increased commercial opportunities would arise for Australian firms.

Other issues relating to legal sector trade, for example cross-border movement of Australian lawyers and judicial and other dispute resolution services, were raised in consultation with the Law Institute of Victoria (LIV), who will most likely address these issues in more detail in their submission.

3.6.3 Meat

The meat industry is Victoria's second largest food sector. Over 10,000 people are employed within the Victorian industry, which represents approximately 22% of the national meat industry workforce. During 2002/03, exports of Victorian meat products exceeded \$1,200 million, of which \$17 million was to Malaysia. Edible offal of bovine animals was the most valuable meat product exported to Malaysia in 2003, valued at \$4 million. There are generally zero tariffs on meat products entering Malaysia. However, the Study needs to address some non-tariff issues, such as the harmonisation of halal accreditation standards, to further enhance the ability of Victorian meat companies to export to Malaysia.

Religious affiliation affects patterns of food consumption in Malaysia. For example, Muslims do not eat pork and only eat meat that has been certified halal, while Hindus and some Buddhists do not eat beef. The Australian meat industry has adopted many acceptable practices to allow products to be certified as halal. However, these processes are not always consistent between Australia and Malaysia. Australian meat exporters would benefit from a standardisation of these regulations between Malaysia and Australia. It is important that the Scoping Study considers the benefits to halal exports in particular, of standardising these regulations to ensure that all halal food products accredited in Australia have the opportunity to be exported to Malaysia.

3.7 Removal of non-tariff barriers affecting all Victorian industries operating in Malaysia

3.7.1 Investment

In 2003 Malaysia announced new rules on foreign equity ownership that allow foreign investors 100% ownership in manufacturing firms. The new rules also streamlined the approval process for manufacturing licenses. This is welcomed by Victoria as it allows foreign manufacturers to compete in the domestic market. However, it is important to encourage further loosening of investment regulations in Malaysia, such as the requirement that all foreign manufacturing activity and some services such as telecommunications be

licensed regardless of the nature of the business. Increased investment by Australian firms in Malaysia is likely to lead to increased trade and benefits to Australian industry and as such the Scoping Study should thoroughly examine restrictions on inward investment into Malaysia.

3.7.2 Standards and technical regulations

Feedback from industry has highlighted that in some cases there are no clear guidelines on Malaysia's standards and technical regulations, including labelling requirements. Presently, Malaysia and Australia's standards conflict with respect to labelling certain food products, such as some dairy goods.

Victoria is keen to ensure that the Scoping Study analyses whether real opportunities exist to harmonise some of Australia and Malaysia's standards and technical regulations and make these more transparent for industry under an FTA.

4.0 Conclusion

Victoria supports the examination of the benefits of an FTA with Malaysia, and therefore welcomes the current DFAT Scoping Study. There are some commercial opportunities for Victorian exporters and investors from increasing market access to this important regional market and engendering a culture of deregulation and loosening of trade and investment restrictions in Malaysia.

As outlined above, growth in trade between Victoria and Malaysia has been fairly static over the last five years. Some important Victorian sectors, such as legal services and telecommunications, have not been able to adequately explore the potential for commercial expansion in Malaysia because of prohibitive import restrictions and industry development policies.

The Scoping Study needs to address such practices and policies, as well as the overt tariff barriers. The elimination of both tariff and non-tariff barriers to trade is likely to stimulate trade between the two countries and provide commercial opportunities for currently prohibited activities, such as the increased export of motor vehicles and business services to Malaysia.

Further detail on the issues raised in this submission and stakeholder feedback is available on request. The Victorian Government looks forward to further communications and cooperation with DFAT on completion of the Scoping Study.