China-ASEAN Free Trade Area

Implications for Sino-Malaysian Economic Relations

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China-ASEAN Free Trade Area: Implications for Sino-Malaysian Economic Relations

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Note: The views expressed in each paper are those of the author or authors of the paper. They do not represent the views of the Asia Research Centre or Copenhagen Business School.

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China-ASEAN Free Trade Area:
Implications for Sino-Malaysian Economic Relations

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ABSTRACT

It is a received opinion that China's emergence as a regional and global power is the most pivotal transformation underway in East Asia. China's enhanced economic standing in Asia has given her new political influence in the region as her trade with the neighbouring states, in particular the member countries of the Association of Southeast Asian Nations (ASEAN) to her south, has been expanding rapidly in recent years. The stunning economic growth of China has created tremendous business opportunities and signed deals has been drawing increasing volume of foreign investment into this Asian giant that was described to have shaken the world – not with her armies, but with her factories. Whether this market is really that huge with potential as has often been presumed and taken for granted is today a topic hotly debated all over the world. With increasing number of foreign companies setting up their businesses in China and the China-ASEAN Free Trade Area – projected to be the world's largest FTA covering 1.7 billion consumers with a combined GDP of US$2 trillion and to be completed within ten years from the setting of its framework agreement in November 2002 – poised to become the core of a broader East Asian economic zone in years to come, this paper attempts to explore the implications, opportunities and challenges arising with the establishment of the ACFTA, the achievement, prospect and challenges with respect to the Early Harvest Program (EHP) and Agreement on Trade in Goods (TIG), potential competition arising from the free flow of goods, impacts on growth, production sharing, possible trade diversion effects and institutional and other factors in market penetration, within the context of both global business linkages and domestic market nexus in the light of the expanding China-Malaysian bilateral trade and China's deepening partnership with ASEAN.

Keywords: *China, ASEAN, Malaysia, CAFTA/ACFTA, trade, investment*

Introduction

China's suggestion for the formation of a China-ASEAN free trade area came at the ASEAN Plus Three Summit in November 2000. During the summit China's Premier Zhu Rongji also proposed the creation of an expert group under the framework of the China-ASEAN Joint Committee of Economic and Trade Co-operation to study the feasibility of the free trade area. After that in August 2001, during a meeting of senior China and ASEAN economic officials in Brunei, China proposed tariff reduction and other measures that were to be phased in over seven years from 2003 to 2009. ASEAN counter-proposed a 10-year phase-in period without specifying a starting date. Then in November 2001, during the ASEAN-China summit, Zhu proposed formally the formation of the China-ASEAN Free Trade Area (CAFTA/ACFTA)[1] within ten years, offering to open China's market in certain key sectors to ASEAN five years before the latter reciprocate. China's proposal was accepted by ASEAN and in November 2002, at the ASEAN-China Summit in Cambodia, China and ASEAN jointly revealed the Framework Agreement on ASEAN-China Comprehensive Economic Co-operation as a legal instrument to govern future ASEAN-China economic cooperation.

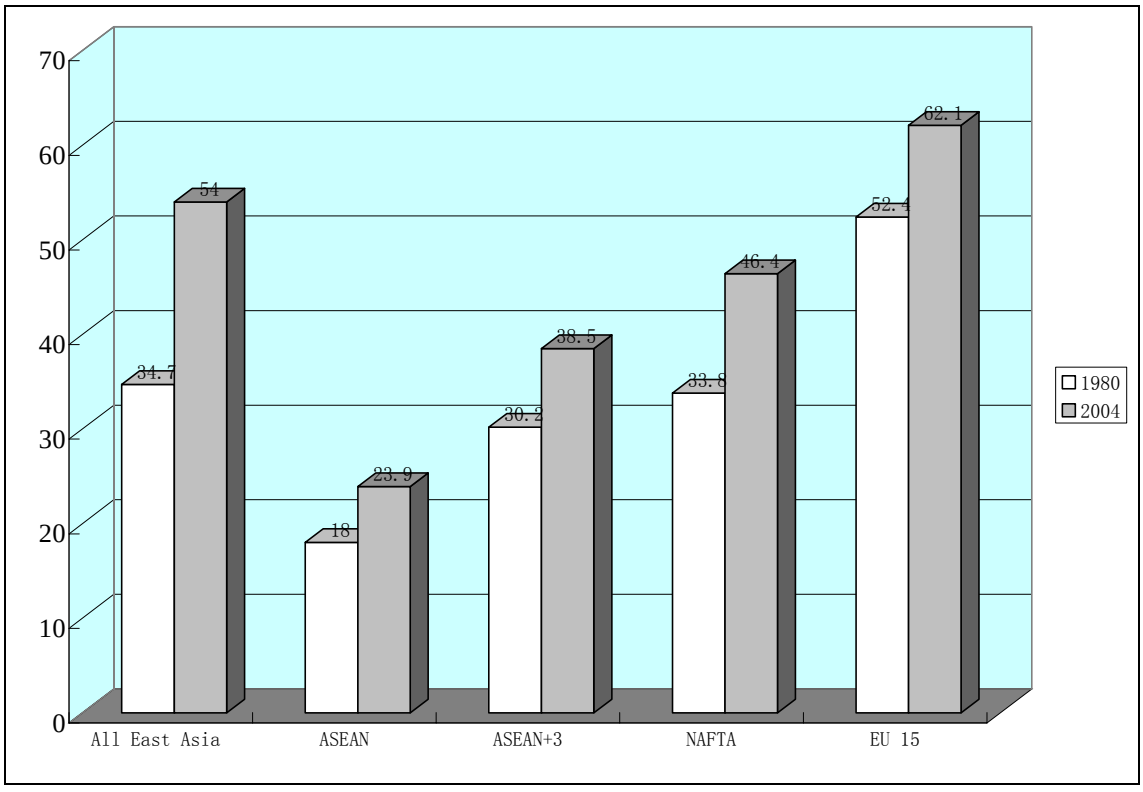
The proliferation of Preferential Trading Agreements (PTAs) has become a major global trend over the past decade. According to WTO data, the organization (and its predecessors, GATT) has been notified of a total of 259 PTAs as at the end of 2002. Among them 176 PTAs are in force. It is estimated that PTA will continue to proliferate and according to the WTO over 300 PTAs will be in effect by 2007.

The slow progress of the multilateral trade talk has been the major push factor for the proliferation of the PTA. With the collapse of the WTO ministerial meetings in Seattle and Cancun, many countries have focused on the PTA as the primary means to intensify trade flows among member

countries. One form of PTA involves the signing of bilateral and regional free trade agreements.

Figure 1 shows the intraregional trade as a share of total trade for East Asia, ASEAN, ASEAN+3, NAFTA and EU15 for the period of 1980 and 2004. From the figure, EU15 leads in preferential trade in 2004; this was followed by East Asia and NAFTA. Intraregional trade in East Asia has progressed significantly compared with EU 15 and NAFTA even without the benefit of an FTA.

Figure 1 Intraregional Trade (as share of total trade)



Source: Philippines Institute for Development Studies, 2005
Note: All East Asia includes ASEAN+3, Hong Kong, Taiwan and China

Like the rest of the world, interest in negotiating trade arrangements has increased in the East Asian region. Recently, the Republic of Korea, China and Japan have linked up with ASEAN, to create the ASEAN plus three grouping through the Chiang Mai Initiative to enhance stability in the Asian

economy. The network of currency swap arrangements between the 10 ASEAN countries and China, Japan and the Republic of Korea established in Chiang Mai in 1999 set the stage for Pan-East Asian financial cooperation. The Chiang Mai Initiative (CMI), consisting of a series of bilateral currency swap agreements, was built on the expanded intra-ASEAN US$1 billion standby swap arrangement, and was hoped to be a first step in a long way to bring about a common East Asian currency in the future (Rujhan, 2006: 13).

Table 1 CMI

<table>
<tr><th>Bilateral Swap Agreement</th><th>Currencies</th><th>Conclusion Date</th><th>Size</th></tr>
<tr><td>Japan-Korea</td><td>USD / Won</td><td>4th July 2001</td><td>US$7 billion</td></tr>
<tr><td>Japan-Thailand</td><td>USD / Baht</td><td>30th July 2001</td><td>US$3 billion</td></tr>
<tr><td>Japan-Philippines</td><td>USD / Peso</td><td>27thAugust 2001</td><td>US$3 billion</td></tr>
<tr><td>Japan-Malaysia</td><td>USD/ Ringgit</td><td>5thOctober 2001</td><td>US$3.5 billion</td></tr>
<tr><td>China-Thailand</td><td>USD / Baht</td><td>6thDecember 2001</td><td>US$2 billion</td></tr>
<tr><td>Japan-China</td><td>Yen/Renminbi</td><td>28thMarch 2002</td><td>US$3billion equivalent</td></tr>
<tr><td>China-Korea</td><td colspan="3" rowspan="6">Under negotiation</td></tr>
<tr><td>Korea-Thailand</td></tr>
<tr><td>Korea-Malaysia</td></tr>
<tr><td>Korea-Philippines</td></tr>
<tr><td>Japan-Singapore</td></tr>
<tr><td>Japan-Indonesia</td></tr>
<tr><td>China-Malaysia</td><td colspan="3" rowspan="2">To be negotiated in the near future</td></tr>
<tr><td>China-Philippines</td></tr>
</table>

Source: Rujhan (2006: 13).

With the changing global trade patterns and proliferation of PTAs, Malaysia's international trade partners are expected to change. In the past, the USA, Japan, and the EU have been the major trading partners of Malaysia. However, with the rapidly growing economies in East Asia,

especially China, there is a strong likelihood that she will become more integrated, through trade and capital flows, with other East Asian countries.

As China is anticipated to sustain relatively high growth rates, Malaysia is well positioned to take advantage of the growth opportunities. To realize this, Malaysia has been actively involved in negotiations with the other ASEAN members to sign an FTA agreement with China not only to promote an increase in intra-regional trade but to enhance market integration as well.

FTA may offer Malaysia substantial potential gains through competition and scale effects. It should be used strategically to serve the growth objective. However, in order to achieve positive outcomes, it needs careful policy design. In particular, it requires Malaysia to consider carefully the implications of the agreement, identify the readiness of the industries for liberalization, identify the market access opportunities in partner countries and ensure effective enforcement mechanisms.

Investment Profile[2]

Historically, Malaysia relies heavily on foreign direct investment (FDI) for her economic expansion and industrial upgrading. Table 21 shows the FDI inflows to Malaysia for the period 2001-2005. The top five sources of foreign investments were USA (RM14,476 million), Germany (RM12,940 million), Japan (RM9,931 million), Singapore (RM8,907 million), and the United Kingdom (RM4,411 million).

FDI to Malaysia continued to increase in 2005 with a total of 562 projects involving foreign investments. Total foreign investments in approved projects increased from 36.05% to RM17,882 million compared with RM13,143 million in 2004. This reflected the fact that Malaysia remains an attractive investment destination in the region. The E&E industry received the

highest amount of FDI with a total of RM11.3 billion or 63% of the total foreign investment approved in 2005. This was followed by investments contracted in scientific and measuring equipment with a total of RM1.4 billion, chemicals and chemical products worth RM596.1 million, plastic products worth RM594.8 million (MIDA, 2005, http://www.mida.gov.my).

The flow of investment between China and Malaysia is actually very limited as compared to other investment partners of Malaysia such as the US, Germany, Japan, Singapore and the United Kingdom. Table 2 shows that China was the 8th largest foreign investor in Malaysia from 2001 to 2005. The amount of investment stood just below the Republic of Korea and surpassed investments from Taiwan and the Netherlands.

Table 2 Top 10 sources of FDI approved projects in Malaysia (RM million)

Country	2001	2002	2003	2004	2005	Total
USA	3412	2668	2182	1059	5155	14476
Germany	2603	5055	170	4724	388	12940
Japan	3366	587	1295	1011	3672	9931
Singapore	2228	1019	1225	1515	2920	8907
United Kingdom	123	168	3870	151	99	4411
United Arab Emirates	-	0.9	3952	-	-	3952.9
Korea, Republic	1703	369	447	325	674	3518
China	2923	55	247	187	40	3452
Taiwan	1140	252	622	415	431	2860
Netherlands	69	607	316	99	1674	2765

Source: Data of 2001 and 2002 are from MIDA, cited from IDE-JETRO and SERI [http://www.seri.com.my/oldsite/occationalpapers/]. Data of 2003 to 2005 are from MITI Report 2006 [http://www.miti.gov.my].

The statistics published by the Malaysian Industrial Development Authority (MIDA) showed that the approved projects from China were 10 as compared to the total 705 approved projects from foreign investors in 2001, with the investments amounting to RM2,923 million, or 15.46% of total foreign

investment in Malaysia. The number of projects approved was 9 with a total amount of RM55 million in 2002; it accounted for only 0.47% of the total foreign investment in Malaysia. Investments from China regained its strength as it grew by more than four-fold to RM247 million; this accounted for 1.58% of the total foreign investment in Malaysia in 2003. The investments from China in 2004 and 2005 were RM187 million and RM40 million respectively, with a share of 1.42% and 0.22% of the total foreign investment in Malaysia.

Table 3 shows the source of FDI from ASEAN members and China to Malaysia. Singapore accounted for the highest amount of investments with RM3, 452 million from 2001 to 2005. Investments from Singapore have recorded an increasing trend since 2002. In 2005, investments from Singapore amounted to RM2,920 million, the highest during the period of 2001-2005. Singapore was the third largest source of foreign investment in 2005. The increasing investments were mainly due to major expansion projects in the E&E industry.

Table 3 Source of FDI to Malaysia, comparison of China vs. ASEAN countries (RM million)

Country	2001	2002	2003	2004	2005	2001-2005
Singapore	2228	1019	1,225	1,515	2,920	**8,907**
China	2923	55	247	187	40	**3,452**
Indonesia	76	12	48	87	52	**275**
Thailand	68	9	264	37	142	**520**
Philippines	-	0.8	34	215	-	**249.8**
Vietnam	-	2.9	-	-	-	**2.9**
Burma	-	1.5	0.3	-	-	**1.8**

Source: Data of 2001 and 2002 are from MIDA, cited from IDE-JETRO and SERI [http://www.seri.com.my/oldsite/occationalpapers/]. Data of 2003 to 2005 are from MITI Report 2006 [http://www.miti.gov.my].

Compared to other ASEAN countries, FDI from China is second only to Singapore and well ahead of the second largest ASEAN source of FDI, namely, Indonesia. A total of 214 projects from China have been approved from 2001 to 2005. Investments from China are involved in the following industries: E&E, chemical and chemical products, wood and wood products, non-metallic mineral products, machinery manufacturing, food manufacturing, and plastic products manufacture.

Just after the East Asian financial crisis, in the year 2000, foreign investments in Malaysia amounted to RM29,663.2 million, constituting 64.7 per cent of total investment. A total of RM22,938.9 million or 77.3 per cent were concentrated in projects of RM100 million and above. Foreign investments were significant both in new projects (RM15,507.2 million) and expansion/diversification projects (RM14,156 million) (see Table 4).

Foreign investments in Malaysia were mainly in the following industries:

- Electrical & Electronics (RM16,480.7 million);
- Paper, printing & publishing (RM3,097.9 million)
- Petroleum products (including petrochemicals) (RM1,918.2 million)
- Natural gas (RM1,444.9 million)
- Food (RM962.5 million)
- Basic metal products (RM836.4 million).

Proposed investments in these six industries accounted for more than 80 per cent of total foreign investment.

Table 4 Applications Received with Foreign Participation by Industry, 1999 and 2000

Industry	2000 (Jan-Dec)		1999 (Jan-Dec)	
	Foreign Investment (RM)	Number	Foreign Investment (RM)	Number
Electrical&electronic products	16,480,701,057	228	2,415,522,694	170
Paper,printing& publishing	3,097,922,315	22	1,207,572,109	16
Petroleum products (incl. Petrochemicals)	1,918,226,770	8	3,161,093,200	10
Natural gas	1,444,946,000	1	-	-
Food manufacturing	962,461,677	55	132,030,280	31
Basic metal products	836,415,575	23	205,275,822	17
Textiles & textile products	803,958,753	24	61,547,697	27
Chemicals &n chemical products	738,527,489	52	287,543,320	34
Rubber products	644,090,448	19	16,913,786	14
Non-metallic mineral products	539,735,070	27	606,190,815	16
Machinery Manufacturing	472,861,605	58	258,481,254	44
Transport equipments	383,823,019	31	206,826,375	24
Fabricated meal products	379,252,836	41	82,709,141	27
Plastic products	347,924,776	26	44,828,505	24
Scientific & Measuring equipments	223,369,697	11	5,050,000	1
Wood & wood products	172,701,682	15	91,610,860	19
Furniture & fixture	108,949,234	17	28,951,034	13
Beverages & tobacco	67,618,720	4	163,216,060	4
Leather & leather products	-	-	15,579,568	4
Miscellaneous	39,713,835	9	48,939,339	8
Total	***29,663,200,558***	***671***	***9,039,881,839***	***503***

Source: Yeoh and Zhao (2005: 15), Table 9. Data from the Malaysian Industrial Development Authority (MIDA).

Foreign investments in new projects were mainly in the following industries: E&E (RM5,373.7 million), paper, printing & publishing (RM3,084.8 million), natural gas (RM1,444.9 million), petroleum products (including petrochemicals) (RM1,012.8 million), textiles & textile products (RM763.7 million) and food (RM703.7 million). Together, these industries involved RM12,383.6 million or 80 per cent of total foreign investment in new projects. Foreign investments in expansion/diversification projects were also concentrated in E&E with RM11,107 million or 78 per cent of the total. The petroleum products (including petrochemicals) industry received a total of RM905.4 million (Yeoh and Zhao, 2005: 15).

The top five sources of foreign investments were the USA (RM9,099.5 million), the Netherlands (RM5,549.8 million), China (RM3,264.2 million), Japan (RM2,797.6 million) and Singapore (RM2,782.4 million). Other major sources of investments were the Federal Republic of Germany (RM1,840.4 million), Taiwan (RM1,111.3 million), the Republic of Korea (RM840.6 million) and the United Kingdom (RM759.2 million) (see Table 5).

Investments from China were in a total of 32 applications, involving investments of RM3,264.2 million. Investments from China were mainly in a new, large-scale pulp and paper mill project involving RM 2,707.8 million.

Investments from Hong Kong totaling RM520.5 million were mainly in food manufacturing (RM124.9 million), non-metallic products (RM132.1 million) and basic metal products (RM72 million). The application received in the basic metal basic industry was to produce copper cathode and cobalt carbonate cake.

The USA, with a total investment of RM 7.5 billion, and Japan, with RM2.9 billion, remained as the top two investors (see Table 6). They were followed by the Netherlands (with investments valued at RM2.2 billion), Singapore (RM1.8 billion), the Federal Republic of Germany (RM1.7 billion) and Taiwan (RM916.1 million). Investments from Taiwan, which had been on the downward trend for the previous two years, recovered in 2000.

Of the total 943 applications received, 527 (56 per cent) were foreign-owned, with investments amounting to RM29.7 billion, 445 (43 per cent) were Malaysian-owned projects involving investments of RM16.1 million, while joint-ventures with equal ownership numbered 11 (1 per cent), with investments of RM 32.7 million (see Table 7).

Table 5 Applications Received with Foreign Participation by Country, 1999 and 2000

Country	2000 (Jan-Dec)		1999 (Jan-Dec)	
	Foreign investment (RM million)	Number	Foreign investment (RM million)	Number
USA	9,099.50	45	2,545.80	39
Netherlands	5,549.80	19	384.3	10
China (incl. Hong Kong)	3,264.20	32	49.3	16
Japan	2,797.60	146	1,297.10	121
Singapore	2,782.40	193	998.7	159
Germany	18,404.40	36	144.5	19
Taiwan	1,111.30	94	345.6	73
Korea, Republic of	840.6	20	17.9	5
United Kingdom	759.2	20	73.1	14
Ireland	369	1	20.1	4
British Virgin Island	192.3	8	5.1	1
Switzerland	110.6	6	789.1	6
Australia	95.5	20	73.3	15
Thailand	64	4	3.4	2
Cayman Island	55.8	2	-	-
Sweden	50.6	4	1.4	3
Canada	46	6	120.9	7
Liechtenstein	30	1	-	-
France	28.2	6	2.2	3
Denmark	26.1	3		-
Syria	20	1	-	-
South Africa	9.2	1	319.2	1
Finland	6.9	1	30	1
India	5.4	2	69.5	6
Vanuatu	4.4	1	-	-
Italy	4	1	73.7	3
Philippines	2.8	1	-	-
Belgium	2.5	1	2.5	1
Norway	2.1	2	20.1	3
Saudi Arabia	2	1	-	-
Indonesia	0.6	1	136	7
Jordan	0.5	1	-	-
Bermuda	-	1	79.3	2
Other	489.9	58	1,437.60	63
Total	***29,663.40***	***	***9,039.70***	***

Source: (Yeoh and Zhao, 2005: 17), Table 10. Data from MIDA.
Note: *** For the number of applications received, figures are not totaled to avoid double counting

Table 6 Approved Projects with Foreign Participation, 1999 and 2000

Country	2000 (Jan-Dec)		1999 (Jan-Dec)	
	Foreign investment (RM million)	Number	Foreign investment (RM million)	Number
USA	7,491.90	48	5,158.90	36
Japan	2,878.60	117	1,006.10	112
Netherlands	2,174.80	14	772.3	10
Singapore	1,778.50	144	902.4	129
Germany	1,655.90	30	187.2	17
Taiwan	916.1	92	267	66
United Kingdom	747.9	17	192.4	13
Korea, Republic of	722.8	14	35.3	6
China (incl. Hong Kong)	379	33	74.4	14
Australia	129.9	14	52.5	16
Ireland	112	2	0.1	2
British Virgin Islands	92	5	-	-
Switzerland	90.8	8	707.6	4
Indonesia	66.3	6	31.6	6
Bermuda	62.5	2	29.8	2
Cayman Island	47.6	1	613	1
Syria	33.6	1	-	-
Sweden	22.1	2	23.5	2
Thailand	16.4	2	0	1
Italy	15.8	2	73.7	3
Denmark	11.7	1	4.2	2
South Africa	9.2	1	319.2	1
Portugal	6.3	1	-	-
Iran	5.6	1	2.5	1
Belgium	5.2	1	2.5	1
India	3.3	2	88.1	9
France	3	2	7.6	3
Saudi Arabia	2.9	1	-	-
Canada	2.3	1	114.6	5
Norway	2.3	1	23.8	3
Sri Lanka	1.7	1	-	-
Jordan	0.7	1	-	-
Other	330.6	57	1,583.60	69
Total	***19,819.30***	***	***12,273.90***	***

Source: (Yeoh and Zhao, 2005: 18), Table 11. Data from MIDA.

Note: *** For the number of applications received, figures are not totaled to avoid double counting

Table 7 Applications Received for Manufacturing Projects by Ownership, 1999 and 2000

	Number		Potential Employment		Total Capital Investment (RM Million)	
Ownership	**2000**	**1999**	**2000**	**1999**	**2000**	**1999**
Wholly Malaysian	272	273	23,517	19,928	3,208.3	1,753.80
Wholly foreign	411	268	59,001	27,620	21,036.9	4,646.40
Malaysian Majority	133	114	16,533	9,610	12,842.6	2,947.10
Foreign Majorith	116	112	14,609	7,947	8,668.6	4,645.60
Joint Venture 50/50	11	9	498	694	118.6	32.7
All	***943***	***776***	***114,158***	***65,799***	***45,875.0***	***14,025.60***

Source: (Yeoh and Zhao, 2005: 19), Table 12. Data from MIDA.

Foreign investments amounted to RM29.7 billion, constituting 64.7 per cent of the total investment. Applications valued each at RM22.9 billion and above. Foreign investments were significant both in new projects (RM15.5 billion) and expansion or diversification projects (RM14.1 billion).

There were total of 38 wholly foreign-owned projects from China during 1991 to 2000. Joint ventures with Malaysian majority totaled 46 projects, those with China majority totaled 26, while only 4 projects were joint ventures with equal Malaysian and China ownership (see Table 8).

Table 8 Number of Manufacturing Projects from China by Ownership

	1991	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	***All***
Wholly Foreign-Owned	-	-	-	1	1	-	4	3	7	20	***38***
JV – Malaysian Majority	2	2	6	6	3	2	6	7	4	10	***46***
JV – Foreign Majority	1	3	3	2	1	2	-	7	3	3	***26***
JV – 50/50	1	-	-	-	2	-	1	1	-	-	***4***

All	***4***	***5***	***9***	***9***	***7***	***4***	***11***	***18***	***14***	***33***	***114***

Source: (Yeoh and Zhao, 2005: 19), Table 13. Data from MIDA.

A total of 631 projects (79.1 per cent) were approved to be located in the states of Selangor (220), Johor (178), Penang (131), Perak (57) and Kedah (45) (see Table 9). In terms of investment, the state of Sarawak recorded the highest level of RM8,113.9 million, followed by Selangor (RM7,796.8 million), Penang (RM4,442.8 million), Perak (RM3,058.5 million) and Pahang (RM2,830.4 million). The high level of investment in Sarawak was attributed to the natural gas project (RM7,224.7 million) while the bulk of approved investment in the E & E industry were for location in Selangor (RM 2,803.1 million), Penang (RM3,307.1 million) and Perak (RM1,535.6 million). The approved petroleum products (including petrochemicals) projects were concentrated mainly in Pahang (RM2,168.9 million).

Table 9 Approved Projects by State, 1999 – 2000

State	Number		Potential Employment		Total proposed capital investment (RM million)	
	2000	**1999**	**2000**	**1999**	**2000**	**1999**
Federal Territory:						
Kuala Lumpur	16	31	488	1,611	157,177,684	2,777,707,646
Labuan	1	-	103	-	27,000,000	-
Selangor	220	189	15,990	13,094	7,796,811,284	2,572,165,924
Penang	131	95	5,057	14,928	4,442,801,142	4,777,802,063
Perak	57	56	9,240	7,163	3,058,508,950	1,293,182,848
Johor	178	175	18,032	12,268	2,420,209,653	2,311,965,392
Negeri Sembilan	29	33	3,313	2,403	2,172,043,186	379,300,165
Melaka	37	35	4,926	3,124	1,001,738,358	2,871,033,570
Kedah	45	43	10,135	4,576	988,942,614	567,779,333
Perlis	1	-	0	-	-	-
Pahang	25	14	2,362	2,599	2,830,433,047	28,180,088
Kelantan	5	4	253	129	33,300,000	16,600,000
Terengganu	7	16	451	1,563	93,803,258	1,336,439,906
Sabah	14	7	1,241	854	369,320,088	27,310,618
Sarawak	30	27	6,074	1,626	8,113,916,735	261,293,889
Undecided	2	-	282	-	37,000,000	-

Total	***798***	***725***	***87,947***	***65,938***	***33,543,006,026***	***17,020,761,441***

Source: (Yeoh and Zhao, 2005: 20), Table 14. Data from MIDA.

Table 10 Number of Approved Manufacturing Projects from China by State, 1991-2000

	1991	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	***All***
Kuala Lumpur				1	1					1	***3***
Selangor	3	2	6	1	1	1		2	1		***17***
Penang					1	1	2			1	***5***
Perak		1		4	1				1	2	***9***
Johor		2	1				1	1	2	1	***8***
Negeri Sembilan				1							***1***
Melaka			1		2	2		1			***6***
Kedah							1			1	***2***
Pahang			1	1	1			2		1	***6***
Kelantan								1			***1***
Terengganu	1										***1***
Sabah				1			1			1	***3***
Sarawak								2			***2***
All	***4***	***5***	***9***	***9***	***7***	***4***	***5***	***9***	***4***	***8***	***64***

Source: (Yeoh and Zhao, 2005: 21), Table 15. Data from MIDA.

For the number of approved FDI from China during the 1991-2000 period, a total of 68 projects were approved to be located in the states of Selangor (17), Perak (9), Johor (8), Pahang and Melaka (6) (see Table 10). Of the approved manufacturing projects of FDI from China, the highest proportion went to Terengganu (RM379 million), followed by Pahang (RM287 million) and Sarawak (RM135 million) (see Table 11).

Table 11 Approved Manufacturing Projects with Participation from China by Territory/State, 1991-2000

Territory/State	1991	1992	1993	1994	1995
Kuala Lumpur				450,000	1,875,000
Selangor	19,882,200	1,500,000	12,820,800	5,000,000	1,697,500
Penang					2,100,000
Perak		4,500,000		8,350,000	1,125,000
Johor		3,571,840	2,000,000		
Negeri Sembilan				2,220,000	
Melaka			83,300		11,281,350
Kedah					
Pahang			100,000,000	3,185,000	1,085,000
Kelantan	379,652,490				
Terengganu					
Sabah					
Sarawak					
All	***399,534,690***	***9,571,840***	***114,904,100***	***19,205,000***	***19,163,850***

Territory/State	1996	1997	1998	1999	2000	All (1991-2000)
Kuala Lumpur					5,147,940	**7,472,940**
Selangor	1,050,000		6,519,600			**48,470,100**
Penang	7,400,000	665,171			8,941,891	**19,107,062**
Perak				545,000	1,140,000	**15,660,000**
Johor		1,500,000	2,497,500	11,000,000	4,600,000	**25,169,340**
Negeri embilan						**2,220,000**
Melaka	18,234,440		40,000,000			**69,599,090**
Kedah					3,000,000	**3,000,000**
Pahang			174,393,600		8,204,927	**286,868,527**
Kelantan			2,100,000			**2,100,000**
Terengganu						**379,652,490**
Sabah					2,699,900	**2,699,900**
Sarawak			135,400,000			**135,400,000**
All	***26,684,440***	***2,165,171***	***360,910,700***	***11,545,000***	***33,734,658***	***997,419,449***

Source: (Yeoh and Zhao, 2005: 22), Tables 16-17. Data from MIDA.

Table 12 List of China's Companies in the Malaysian Manufacturing Sector (1992-2000)

Name of Company	Industry Classification	Location
Prima Sempurna Sdn. Bhd.	Paper	Kuala Lumpur (K.L.)
Consolidated Farms Sdn. Bhd.	Food	K.L.
Dahol Machinery Sdn. Bhd.	Machinery	K.L.
JCC (Malaysia) Sdn. Bhd.	Fabricated metal products	K.L.
White Heron Pharmaceutical Sdn. Bhd.	Chemicals	K.L.
Lahad Batu Edible Oils Sdn. Bhd.	Food	Sabah
VC Industrial Sdn. Bhd.	Chemicals	K.L.
Lidum (M) Sdn. Bhd.	Transport equipments	Pahang
Hengdali Industries Sdn. Bhd.	Electrical products	Johor
Sportma Intergrated Industrial Sdn. Bhd.	Miscellaneous	Perak
Dynasty Stone Sdn. Bhd.	Non-metallic mineral products	Johor
Weten Asia Sdn. Bhd.	Machinery manufacturing	Perak
Profit Point Manufacturing Sdn. Bhd.	Rubber products	Johor
San Xiang (M) Sdn. Bhd.	Chemicals	Selangor
Morget Industries Sdn. Bhd.	Food	Selangor
Puyuan Heavy Industries (M) Sdn. Bhd.	Machinery manufacturing	K.L.
Fabrik Sutera (M) Sdn. Bhd.	Textiles	K.L.
Vibran Waves Sdn. Bhd.	Basic metal products	Selangor
Qing Dao Resources Sdn. Bhd.	Beverages & tobacco	Sarawak
M & C Herbal Industries Sdn. Bhd.	Chemicals	K.L.
Velox Industries (M) Sdn. Bhd.	Electrical product	Sarawak
Sebangun Saramica Sdn. Bhd.	Wood	Sarawak
Evermore Techonology Sdn. Bhd.	Chemicals	Johor
Incoils Electronics Sdn. Bhd.	Electrical products	Penang
Salutary Insight (M) Sdn. Bhd.	Food	Melaka

Philips and JVC Video (Malaysia) Sdn. Bhd.	Machinery manufacturing	K.L.
Jiangnan Escalator (M) Sdn. Bhd.	Escalators	Penang
Good Time Media Sdn. Bhd	Particleboaru	Melaka
Kunmah Electric Motor Sdn. Bhd.	Electrical product	Selangor
Statwise Industry Sdn. Bhd.	Itaconic acid	Selangor
Adhesive Technologies (M) Sdn. Bhd.	Hot melt adhesive	Selangor
Fong Mei Sdn. Bhd.	Food	Melaka
Beijing Tong Ren Tang (M) Sdn. Bhd.	Chemicals	K.L.
High-Tech Activated Carbon Sdn. Bhd.	Activated carbon	K.L.
Sparkling Ceramics Sdn. Bhd.	Ceramic table ware	Penang
Shenjia Machine Industrial Sdn. Bhd.	Machinery manufacturing	Perak
Soon Hang Rayon Industrial Sdn. Bhd.	Textiles	Perak
Kayumas Panel Sdn. Bhd.	Wood	K.L.
Teraju Industrial (M) Sdn. Bhd.	Chemicals	K.L.
Chuan Shen Rubber Products Sdn. Bhd.	Rubber products	Pahang
Soon Bao Corporation (M) Sdn. Bhd.	Fabricated metal products	Perak
MEC Metallurgical Equipment Sdn. Bhd	Electrical products	K.L.
Modern Optimum Sdn. Bhd.	Electrical products	K.L.
Newtronics (M) Sdn. Bhd.	Electrical products	K.L.
Pharmaceutical Sanjui Factory (M) Sdn. Bhd.	Chemicals	Perak
Shuang Xing Industries (M) Sdn. Bhd.	Chemicals	K.L.
SINO-MAL Agriculture Sdn. Bhd.	Chemicals	K.L.
United Dragons Corporation Sdn. Bhd.	Rubber products	Melaka
Perindustrian Dimensi Sdn. Bhd.	Non-metallic mineral products	Selangor
Greatpac Marketing Sdn. Bhd.	Electrical products	K.L.
Advance Gears Development Sdn. Bhd.	Transport equipments	Johor
Sunking Metal Works Corporation Sdn. Bhd.	Transport equipments	Selangor
Jiangsu-Bornew Industries Sdn. Bhd.	Scientific & measuring equipments	K.L.
B. L. Medical Industrial Sdn. Bhd.	Chemicals	Johor
Kampong Lanjut Tin Dredging Sdn. Bhd.	Basic metal products	Selangor
Kemajuan Teknologisumal Sdn. Bhd.	Machinery	K.L.
Video Plus Electronic (M) Sdn. Bhd.	Electrical products	K.L.

Midoly Sdn. Bhd.	Electrical products	K.L.
Selangor China Contaliner Corp. Sdn. Bhd.	Freight containers (80% export)	Selangor
Terengganu Anshan Iron & Steel . Sdn. Bhd.	Iron & steel (100% export)	Terengganu
Namland Engineering Sdn. Bhd.	Hydraulic cylinders, valves, pumps	K.L.
Tegas Mewah Sdn. Bhd.	Windmill generators (80% export)	Selangor
Citec Denco. Sdn. Bhd.	Air conditioners	Selangor
Season Samponents (M) Sdn. Bhd.	Battery Chargers	K.L.
Sri Rampaian Sdn. Bhd.	Beverages & tobacco	Kelantan
Malgant Mfg. Sdn. Bhd.	Beverages & tobacco	Kedah
Comagro Industries (M) Sdn. Bhd.	Food	K.L.
Kian Joo Can Factory Bhd.	Paper, printing	Selangor
Maestro Swiss Chocolate Sdn. Bhd.	Food	K. L.
Abadi Mewah Plywood Sdn. Bhd.	Wood products	Sabah
Public Package (NT) Sdn. Bhd.	Plastic products	Penang
Hevea OSB Sdn. Bhd.	Wood products	Johor
Honaik Sdn. Bhd.	Chemical	K.L.
Grandfast Sdn. Bhd.	Wood products	Sarawak
H & Y Electronics Sdn. Bhd.	Electrical products	Penang
Great Wall Nutrition Technologies Sdn. Bhd.	Food	Johor
Butterfish Sdn. Bhd.	Food	Penang
South Pacific Chemical Industries Sdn. Bhd.	Chemicals	Selangor
Oronmas Sdn. Bhd.	Beverages & tobacco	K.L.
Takehara Chemical (M) Sdn. Bhd.	Chemicals	Perak
Hevea Medical Sdn. Bhd.	Wood products	Johor
Todaili Electronics (M) Sdn. Bhd.	Electrical products	Kedah
DSG (Malaysia) Sdn. Bhd.	Paper, Printing	Selangor
Mace Garment (M) Sdn. Bhd.	Beverages & tobacco	Johor
Sharp Roxy Corporation (M) Sdn. Bhd.	Machinery manufacturing	Kedah
Conplamas (Malaysia) Sdn. Bhd.	Transport equipments	Penang
Lung Lee Metal (M) Sdn. Bhd.	Basic metal products	Selangor
Hui Hong Engineering Sdn. Bhd.	Machinery manufacturing	Melaka
BI Technologies Corporation Sdn. Bhd.	Electrical products	Pahang
Digital Data Technologies Sdn. Bhd.	Scientific products	K.L.
Mega Printing & Packaging Sdn. Bhd.	Paper, printing	Melaka
Team Concepts Industries (M) Sdn. Bhd.	Electrical products	Kedah
Wai Fatt Precision Engineering Sdn. Bhd.	Machinery manufacturing	Johor
Karbon Teknik Kita Sdn. Bhd.	Chemicals	Sabah
Sharp Roxy Appliance Corporation (M) Sdn. Bhd.	Machinery manufacturing	Selangor
Rephouse (M) Sdn. Bhd.	Rubber products	Selangor
KKB Engineering Berhad	Machinery manufacturing	Sarawak
Varitronic EC (M) Sdn. Bhd.	Electrical products	Penang
Toscana Furniture (M) Sdn. Bhd.	Wood products	Johor
Ridon Wood Products Sdn. Bhd.	Wood products	Sabah
United MS Cables Mfg. Sdn. Bhd.	Electrical products	Selangor
Diaper Technology Industries Sdn. Bhd.	Paper, printing	Johor
Kilang Papan Seribu Daya Berhad	Wood products	K.L.
Win Muar Sdn. Bhd.	Paper, printing	Johor
Yupiteru (Malaysia) Sdn. Bhd.	Machinery manufacturing	Penang
Malke Industry Sdn. Bhd.	Food	K.L.
Warrior Rubber Prods (M) Sdn. Bhd.	Rubber products	K.L.
Hwayen Button Industries Sdn. Bhd.	Miscellaneous	K.L.
Profit Point MFRG. Sdn. Bhd.	Rubber products	Johor

UNIKA Rubber Products Sdn. Bhd.	Rubber products	Johor
PMCC Special Steel Sdn. Bhd.	Fabricated metal products	K.L.

Source: (Yeoh and Zhao, 2005: 23-27), Table 18. Data from MIDA.

ACFTA May Attract More Investments from China

Promoting investment is a prominent objective of ACFTA. Theoretically, economic integration is seen as a potential tool to stimulate investment within the region and attract investment outside the region. The logic is that with larger markets, more competition and improved policy credibility will increase the incentives for investment and by that means raise incomes for the member countries.

For Malaysia, investment is a key component in economic development and has become one of the main aspects to be considered for her participation in ACFTA. As a small open economy with restricted source of investment in her domestic market, Malaysia has to rely on FDI to promote economic development and enhance her competitiveness. Malaysia's participation in ACFTA will only be beneficial if it creates greater incentives for investment.

China is among the countries from which Malaysia hopes to attract more investment. With the implementation of the "open door" policy, Chinese companies have become stronger and more competitive and their overseas investments have increased fairly rapidly. ASEAN will be a priority market for Chinese companies' overseas investments in the future, due to the geographical closeness and similarity in culture, especially after the establishment of the FTA between the two sides. Malaysia as a member of ASEAN has an advantage with its provision of conducive and cost-competitive environment for foreign investors. Malaysia's investment rules have been liberalized to allow foreign companies to own 100% of a company, and that

manufacturing companies no longer have to comply with equity to export conditions. Other relaxations include expatriate employment policies for manufacturing and related services sectors.

Besides, China is actively enforcing its "go global" strategy by encouraging its local enterprises to go beyond her border and venture in bilateral investment activities. Hence, many Chinese companies will come out from China to source for new investments. When ACFTA becomes a reality in 2010, ASEAN will be seen as an attractive region, since market risks and uncertainty are minimized through the FTA. On top of that, Malaysia has an edge over many other ASEAN countries with its natural resources and political stability. Besides, it offers developed infrastructure and established industrial experience.

ACFTA May Further Promotes Bilateral Trade between Malaysia and China

China has been Malaysia's important trading partner in recent years. Moreover, trade flows between them exhibited increasing trend from year to year. Trade between them is expected to further expand in the future with the opening of their markets. This optimistic forecast is the result of China's dynamic growth and her commitments to WTO in economic restructuring.

If the principles of ACFTA agreements are fully applied, the regional framework abolishing trade barriers will facilitate trade flows among member countries and also encourage more economic cooperation, thereby lowering trade friction among the countries concerned and finally, result in an increase of trade among member nations.

Malaysia will benefit from ACFTA if there is net trade creation. Theoretically, trade creation will most likely be greater after the FTA comes into effect. Countries that trade heavily with each other stand to gain the most from the elimination of tariffs and non-tariff barriers. With China increasing her

share in Malaysia's total trade, it is likely that Malaysia will gain from the trade integration of China and ASEAN.

Malaysia has offered 590 products under the Early Harvest Programme (EHP) that was implemented on 1st January, 2004, which includes unprocessed agricultural products and some specific products including coffee, cocoa and cocoa products, animal and vegetable fats, mineral fuel, soap and stearic acid, articles of rubber and glass envelopes for cathode-ray tube.

In 2004, Malaysian exporters benefited by exporting these products to China. A total of 2,046 Form E (Preferential Certificates of Origin under ACFTA) were issued for exports to China. Total amount of exports under EHP was RM514.1 million. Meanwhile, no imports from China were recorded under the EHP in 2004. Malaysia's exports under EHP had further increased to RM540.3 million in 2005. (MITI, 2006:189-190, http://www.miti.gov.my/ekpweb/static.websearch) The Agreement on Trade in Goods (TIG) came into force on 20th July 2005. Malaysia's exports under the agreement are encouraging with a total of 1,381 Form E being issued by Malaysia for exports to the Chinese market. The value of exports under this agreement totaled RM756.5 million. In terms of imports from China, total value of RM3.7 million was recorded in 2005. (MITI, 2006: 189-190)

Table 13 shows Malaysia's main exports under ACFTA in 2005. These include chemical products (47.3%), palm oil (15.2%), stearic acid (10.4%), rubber products (8.1%) and detergent and soaps (7.4%).

Table 13 Malaysia's Main Exports under ACFTA, 2005

Product Category	RM million	Share to Malaysia's Total Export Under ACFTA (%)
TOTAL	1296.8	100
Chemical products	613.1	47.3
Palm oil	196.7	15.2
Stearic acid	134.5	10.4
Rubber products	105.3	8.1

Detergent and soaps	95.9	7.4
Cocoa products	74.9	5.8
Fish and crustaceans	19.1	1.5
Mangosteen, watermelon and papaya	18.9	1.5
Cathode-ray tubes for television	13.2	1.0

Source: MITI, 2006, *http://www.miti.gov.my/ekpweb/static.websearch*

It can be seen that commitments made by the Chinese government by lowering the level of China's market admittance of many unprocessed agricultural products and other specific products are actually in accord with Malaysia's exports, which has led to the growth of Malaysian exports.

ACFTA May Promote Economic Efficiency and Productivity

Free trade with a larger, dynamic partner like China should result in improved efficiency and productivity for Malaysian firms. Reduced tariff and especially non-tariff barriers should lead to lower transaction costs and enable products to flow freely within the region. This will ensure production specialization and enable firms to realize economics of scale as resources have been efficiently utilized in the suitable sectors. The minimizing of these transaction costs should also result in cheaper prices for consumers and larger profits for firms.

FTA may increase the intensity of competition, which will induce firms to eliminate internal inefficiencies and raise productivity level. Besides, productivity may also increase as firms learn from each other through cooperation. These learning processes typically include work methods, plan layouts, incentive programs and management techniques.

Other Forms of Economic Cooperation Inspired by ACFTA

Malaysia also hopes to reap positive benefits from the services sector in the Chinese market. These include construction buildings, tourism, financial services, education services and the halal food market.

Opportunity in Tourism

Malaysia has opportunities to boost its tourism industry by attracting more Chinese tourists. This is based on the strong economic forecast in China that will lead to substantial increase in demand for various services especially recreational activities. Malaysia is an attractive destination for Chinese tourists since it offers tropical scenery, tasty fruit and a thriving rain forest with a long history. Besides this existing attractiveness, Malaysia has advanced communication and road infrastructure to allow easier access to existing local attractions.

The China National Tourism Administration reports an astounding 29 million Chinese nationals travelled abroad in 2004, and the number has increased substantially in 2005 with further travel concessions in place and new availability of outbound travel products. In recognition of China's potential as a big tourist country since a portion of the Chinese population is getting rich, the Malaysian government has adopted various measures to attract Chinese tourists to our country. For example, The Ministry of Tourism has intensified its tourism promotion by setting up tourism offices in Beijing and Shanghai; simplifying visa formalities; opening more chartered flights and staging promotion exhibitions in a few major cities in China.

In order to attract more tourists, the Malaysian Ministry of Tourism has also participated in exhibitions in cities in central and western China. In addition, the ministry also stations immigration officers fluent in Mandarin at the nation's main gateway, the Kuala Lumpur International Airport, to ensure

that tourists from China will not face any problem when entering the country. The booming of the tourism industry is expected to bring services-related FDI into restaurants, tourism facilities, wholesale and retail-trade. It will become another source of income for Malaysia. This is in line with the current government intention to accelerate the domestic private sector and stimulate the services sector to spearhead economic growth.

Opportunity in Education Service

As the wealth effect kicks in, a growing number of Chinese students will seek foreign education. China's education market is estimated to be worth US$54 billion, and likely to grow at 20% annually (Shen, 2005). The joint educational venture has become an important form of China's educational cooperation with the world, and it has developed very rapidly in recent years. Currently, there are 657 joint educational ventures in China, as compared to only 70 in 1995.

Several Malaysian education providers have entered Chinese market to capture the growing demand for tertiary and technical education in China. For example, the Kuala Lumpur Infrastructure University College (KLIUC) recently signed a Memorandum of Understanding with Tongji University, Tianjin Engineering and Technical Institute, and Tianjin University to provide joint technical twinning degrees in engineering and scientific fields. Besides, another higher learning institution, Inti International College, has been providing management education in Beijing for a decade since 1993. (IDE-JETRO and SERI, 2004:15) As in 2005, Malaysia is hosting about 10,000 Chinese students. The Ministry of Higher Education has launching a media blitz to promote Malaysia's educational facilities to attract more Chinese students to study in Malaysia. In addition, Malaysia and China have agreed to work together on a mutual accreditation program for tertiary students of both countries. Now, the Ministry of Higher Education is shifting its focus to mid-west China and plan to reach out to more students in this region.[3] In addition,

twinning programs with foreign university in the United Kingdom, the US and Australia could enable Chinese students to obtain foreign degrees in Malaysia at a lower cost. Thus, education services providers can exploit this great opportunity to export its education services to China by having Chinese workers and students studying in Malaysia, or to set up training centres in China.

Opportunity in Halal Food Sector

With the formation of ACFTA, Malaysia has the potential and capability to be a halal food production base in the region as Malaysia has established its reputation as an authority in halal certification. With the expertise that has been accumulated over the years, it is possible for Malaysia to take the lead in defining, coordinating and marketing the wide range of halal products in the region. In addition, Malaysia could serve as a local point for halal product trade intelligence by being the premier destination for halal trade exhibitions and commerce. By using Malaysia as a potential hub, halal producers may be able to easily penetrate the traditional halal food markets such as Southeast Asia and the Middle East as well as other potential markets, which include North Africa, the European Union, and China.

There is an opportunity in the halal food sector, as China has an estimated 150 to 200 million Muslim population. Recently, BIZ Link Global Sdn. Bhd, a Bumiputra halal product manufacturer has ventured into the Chinese market as it offers immense opportunities for halal products. The company signed a Memorandum of Understanding in Shanghai to export halal food products to two companies, Shanghai Henyi Trading Co Ltd. and Shanghai JD Trading Co Ltd. (MIDA, 2006a, *http://www.mida.gov.my*). However, there are a lot more that needs to be done in order for Malaysia to achieve her goal of becoming a region halal food hub. Countries such as Thailand and the Philippines have established halal food programs of their

own to serve the global halal market, which will be in direct competition with Malaysia's own plans.

Opportunities in Other Sectors

Besides, while the manufacturing sector remains a main source of growth for Malaysia, it is imperative that Malaysia broadens its economic base. Based on this consideration, Malaysia has increased its focus on the services sector as it attempts to develop the sector as another source of income. The International Management firm AT Kearney in a recent report described Malaysia as a rising alternative to India and China for offshore services.[4]

Malaysia hopes to target China for its services. Many business service providers as in the fields of information technology, legal services and engineering consultancy services are looking forward to a more liberal environment conducive for the investment in the services sectors when ACFTA is established. In addition, there are considerable opportunities to further pursue benefit for both countries in other sectors such as construction, healthcare and education services.

With China's economic restructuring, the construction of infrastructure, residential and office buildings will certainly offer many opportunities for Malaysian construction companies. Opportunities exist in areas such as ports, roads, highways, telecommunications and transportation sectors as well as oil and gas exploration. In addition, China's "Develop the West" Strategy will create opportunities for construction and infrastructure opportunities in China's western regions. Indeed, some Malaysian companies have ventured into contract biddings. The Lions Group, for example, has been involved in property development, including hotel building and retail property development in China (IDE-JETRO and SERI, 2004).

Many Malaysian companies are keen to undertake management wastewater treatment plants, water supply work and city gas distribution projects on a build, own and transfer basis. For example, Salcon Berhad, one of the leading water and wastewater service providers in the region, has won a 30-year contract through its wholly-owned subsidiary, Salcon Zhejiang (HK) Private Limited to operate and manage the supply of treated water in Haining, Zhejiang province, China. (MIDA, 2006b, *http://www.mida.gov.my*). China's successful bid for the 2008 Olympic Games and the 2010 Asian Games has also reinforced the optimism for prosperous development in that sector. Malaysian companies could bid on projects involving architectural design of sport and related facilities, infrastructure and construction that meet the requirements of modern sports facilities.

China-Malaysia cooperation in energy and other natural resources is growing to the benefit of both countries. In October 2006, Malaysian state energy firm Petronas won a 25-year contract to operate and manage the supply of some three million tons of natural gas annually to Shanghai, China. The signing of a natural gas supply between the two nations is worth a reported US$25 billion.

Challenges of ACFTA to Malaysia

There are uncertainties that influence the trade effects of ACFTA on Malaysia. For instance, Malaysia will encounter a certain amount of other challenges such as competition in the substitutes between Malaysia and other ASEAN members in the Chinese market. Malaysian producers also face increasing competition from China, both at home and in third country markets, particularly on a wide range of labour- and technology-intensive manufacturing sectors. Besides, there is a possibility of trade diversion effect from the ASEAN market towards China as its attention is diverted to the Chinese market.

Challenges in Labour-Intensive Sectors

Malaysia's comparative advantage for the manufacture and export of labour-intensive products has eroded. In the past, labour-intensive, low-wage industries were instrumental in attracting investments and generating the growth of exports. However, China and the other emerging market economies, with ample supply of low-cost labour, have become more competitive and have attracted FDI. China's exports in labour-intensive sectors appeared strong as well. Relying on its cost advantage in labour-intensive sectors, China was able to erode the market share of the ASEAN countries.

Table 14 shows total labour force in China and ASEAN-5 for 1980 and 2002. Although annual growth rate in China was the lowest among the reference economies, the labour force in China is undeniably huge compared to ASEAN-5. Hence, China will have a definite advantage in the labour-intensive sector.

Table 14 Total Labour Force of ASEAN-5 and China

Country	**Total (millions)**		**Average annual growth rate**
	1980	**2002**	**1980-2002**
Indonesia	58.6	104.2	2.6
Malaysia	5.3	10.3	3
Philippines	18.7	34.2	2.7
Singapore	1.1	2	2.8
Thailand	24.4	37.5	2
China	538.7	769.3	1.6

Source: The World Bank, *World Bank Development Indicators 2004*, cited in Aziz and Abu Bakar, (2005: 18), Table 7.

Malaysia also faces challenges from China in terms of labour costs. Monthly wages of unskilled production workers for some companies in the

eastern seaboard cities of China could be 20-70 per cent lower, as compared to Malaysia. Some companies in Malaysia, such as Motorola, Sony Electronics, Acer Technology, Philips Semiconductor, have relocated some of their operations to China to take advantage of the lower labour costs (UNDP, 2006: 73).

Removal of trade barriers will benefit manufactures with lower production costs. In the context of ACFTA, Malaysian firms are concerned about the hollowing-out of low-cost, assembly-line and labor-intensive industries from Malaysia as such industries shift production bases to China to take advantage of the lower costs of production. Hence, ACFTA could present a negative impact on Malaysia's manufacturing sector, particularly electronics and textiles unless Malaysia quickly move up the value-chain and invest more in research, development and product design.

Competition at Home and in Third-Country Markets

As mentioned above, China has better cost competitiveness in the labour-intensive sector. The formation of ACFTA and the removal of trade barriers will enable the competitive exporter with cheaper products to access the region’s markets easily. Hence, Malaysian manufacturers will face greater competition in the domestic market as well as in third country markets of ASEAN. The products involved many lines of textile and clothing, plus consumer electronics, footwear, toys and plastic products.

In particular, garment producers in Malaysia have faced negative impacts from home-market penetration and third-market displacement by China in recent years. Malaysia’s Associated Chinese Chamber of Commerce and Industry reported that out of over 4,000 small and medium enterprises involved in this sector, some 3,000 have closed down.

In addition, China has developed competitiveness in a wide range of other manufactures, including machinery and electrical appliances, optical instruments, clocks and watches, metal products and several chemicals. In fact, these manufactured goods accounted for about 70% of all ASEAN's imports from China (Wattanapruttipaisam, 2003). Hence, Malaysia's industries are seriously challenged by improved productivity and quality and lower costs to meet the price competition from China.

Difficulty in the Implementation of Rules of Origin

The rules of origin for ACFTA require that at least 40% of the product content originates from any party. However, the implementation and determination process is complicated as production processes have gone through tremendous internalization. Moreover, if inputs sourced from various countries are used in production, then the measurement of content will become more complicated. On the other hand, some of the ASEAN members and China are involved in more than one PTAs. This can create overlapping sets of trade rules and regulations that make sourcing products to different markets complicated and often more costly.

Overall Implications for the Malaysian Economy

Table 15 Bilateral Exports at World Prices (US $ million)

From	**Indonesia**	**Malaysia**	**Philippines**	**Singapore**	**Thailand**	**Vietnam**
Indonesia	–	1,762.40	1,137.60	3,996.80	1,935.90	426.10
Malaysia	1,255.70	–	2,336.70	17,638.20	5,173.30	349.00
Philippines	399.70	639.60	–	1,332.70	2,945.70	131.70
Singapore	2,884.60	18,746.70	5,015.80	–	7,381.80	3,728.40
Thailand	1,200.90	2,940.60	1,475.20	6,300.80	–	1,041.60
Vietnam	200.70	874.30	436.10	470.70	121.40	–
USA	3,826.30	9,321.70	5,520.70	19,014.00	9,014.10	220.70
Japan	9,615.70	15,655.80	6,526.60	26,887.20	18,768.30	709.40
China	2,654.20	2,530.50	1,998.60	8,302.00	3,116.10	676.40
Rest of the	26,994.60	27,530.60	14,971.50	48,351.00	35,027.50	2,199.90

World						

From	**USA**	**Japan**	**China**	**Rest of the World**
Indonesia	7,555.00	13,613.10	3,432.60	20,398.80
Malaysia	17,240.70	11,330.20	5,349.80	27,045.70
Philippines	8,168.00	4,624.00	1,537.00	8,867.30
Singapore	20,997.70	12,353.00	11,625.10	43,064.20
Thailand	12,211.70	13,396.60	4,677.90	25,490.60
Vietnam	264.50	1,809.70	475.3	2,710.10
USA	–	85,810.80	27,512.80	557,112.40
Japan	132,276.30	–	50,601.70	222,544.60
China	64,444.80	47,163.40	–	123,339.10
Rest of the World	584,918.70	224,874.70	132,498.80	2,720,745.80

Source: ASEAN-China Expert Group

Table 16 Change in Exports with FTA (US$ million)

From	**Indonesia**	**Malaysia**	**Philippines**	**Singapore**	**Thailand**	**Vietnam**
Indonesia	0.00	-69.00	-117.05	-106.35	-141.49	-40.05
Malaysia	-45.49	0.00	-245.11	-312.71	-219.41	-20.97
Philippines	-2.82	16.57	0.00	46.89	-24.97	-3.00
Singapore	-47.27	-392.6	-329.26	0.00	-233.84	-430.61
Thailand	-29.13	-65.56	-118.87	-101.24	0.00	-52.49
Vietnam	-10.53	-31.02	-18.62	-15.08	-5.69	0.00
USA	8.29	11.17	-152.88	208.02	-75.46	-1.19
Japan	-16.76	-1.68	-266.16	325.30	-342.10	-23.38
China	1,371.60	1,456.34	3,057.17	643.94	3,140.16	944.81
Rest of the World	-13.82	119.73	-543.70	417.50	-365.92	-89.28

From	**USA**	**Japan**	**China**	**Rest of the World**	**Total**
Indonesia	-209.99	-313.66	2656.09	-547.45	1,111.05
Malaysia	-416.56	-246.27	3207.28	-688.07	1,012.60
Philippines	413.49	39.16	330.8	104.46	920.57
Singapore	-321.22	-200.07	3,639.18	-745.43	938.89
Thailand	-252.78	-271.3	2,907.76	-525.48	1,490.90
Vietnam	-12.07	-19.01	267.04	-59.24	95.79
USA	0.00	123.37	-501.03	100	-279.69
Japan	393.97	0.00	-823.79	472.14	-282.44
China	-813.34	-511.53	-889.91	-1,557.07	6,842.16
Rest of the World	482.25	467.77	-2,679.26	844.00	-1,360.75

Source: ASEAN-China Expert Group

Table 15 shows the bilateral exports at world prices and Table 16 shows the change in exports with the FTA. The results show that ACFTA will benefit Malaysia through increasing market access to China's huge market. Malaysia's exports to China will increase by US$3,207.28 million or by 59.95%, while imports from China will increase by 57.55% of by US$1,456.34 million. The reduction in tariffs results in both countries trading more heavily with each other. Malaysia is one of the biggest gainers among the ASEAN members in terms of exports to China.

However, the FTA will create trade diversion effects for Malaysia. According to the simulation results, Malaysia's exports to ASEAN members, USA and Japan will decline significantly. Malaysia's exports to Singapore dropped by 1.77% or by US$312.71 million. Exports to Thailand and the Philippines show a similar trend and are reduced by US$219.41 million and US$245.11 million respectively. Exports to Indonesia dropped by US$45.59 million or by 3.63%. Vietnamese imports from Malaysia were also reduced, by US$20.97 million or by 6.01%. Malaysia's imports from ASEAN members show a decreasing trend except for the Philippines.

With the formation of ACFTA, an individual country will source her demands from the cheaper producer in China. Meanwhile, the reduction in trade barriers will encourage more exports to flow into China's huge market. This will change the trade flows of member countries as the shifts in demand and supply will be more inclined towards China. However, the reduction of exports in ASEAN members is offset by the increasing exports to China and the rest of the world. The overall effect is net trade gain of US$1,012.60 million for Malaysia.

Table 17 Sectoral Impacts of Exports and Imports with China (US$ million)

Sector	Exports	Imports
1 Food	-4.86	163.54
2 Vegetable oil	505.54	1.64

3 Other Agriculture products	145.65	11.47
4 Extractive	25.72	1.90
5 Tex apparel	465.62	307.61
6 Chemicals	186.37	105.69
7 Motor Vehicle	618.62	45.67
8 Electronic & machine	495.07	361.36
9 Other Manufactures	773.63	453.95
10 Services	-4.07	3.50
Total	**3,207.28**	**1,456.34**

Source: ASEAN-China Expert Group, 2002, *http: //www.aseansec.org*

Table 18 Impact on Real GDP to Malaysia

Real GDP (US$ million)	Absolute increase (US$ million)	Percentage increase
98, 032.3	1,133.5	1.17%

Source: As Table 17.

According to the GTAP[5] results of sectoral impact shown in Table 17, we see that ACFTA creates both positive and negative impacts on productive sectors in Malaysia. On the negative side, due to lower production costs in China, exports of Malaysia's food to China are reduced by US$4.86 million. Services export is another sector that will have a negative impact. Exports in this sector to China are estimated to drop by US$4.07 million.

On the positive side, exports of other manufactured products to China are likely to increase by US$773.63 million. The producers of motor vehicles will be the second biggest gainer after the reduction of trade barriers, with a total exports increase by US$618.62 million. This is followed by exports of vegetable oils, which is benefited from reduction in China's import tariff, causing the total exports to increase to US$505.54 million. The export of vegetable oils will continue to benefit Malaysia with the increasing demand from China. Electronic and machinery is a major commodity traded with China, this sector continues to benefit Malaysia with a positive growth of

US$495.07 million. Textile will benefit from the tariff cut in China's tariff rate with exports increasing to US$465.62 million. There are also gains for sectors like chemicals, other agricultural products and extractives. Because of China's need in these sectors, it is expected that Malaysia's complementarities could play an important role in these bilateral exchanges.

China, as the "factory of the world" and the source of cheap components, parts, and finished goods such as shoes, textiles and apparel and electronic equipment, is an important sourcing market for Malaysia. Malaysia will gain from China with her access to cheaper imports from China. From Table 17, it can be identified that three sectors increasing imports largely from China are manufacturing sector, electronics and machinery, and textiles and apparel. These sectors are expected to increase imports by US$453.95 million, US$361.36 million and US$307.61 million respectively. The shifts in demand towards cheaper products have caused increasing imports from China. It is expected that China's products will not only substitute higher cost products outside the region, but also domestic products.

Concluding Remarks

One of the major concerns is the inefficient domestic sectors that require gradual pace of liberalization to avoid serious structural adjustment problems. These less competitive industries would suffer from adjustment costs if entry into the FTA proceeds as scheduled. Hence, Malaysia's policy towards ACFTA should contain special provisions to address the needs of these industries. Such provisions can take the form of different levels of obligation or phasing requirements.

Malaysian manufacturers are facing increasing competition in labour-intensive and lower-end manufactured products from the lower-wage and resource-rich member countries of ACFTA such as China, Indonesia and

Vietnam. A key challenge therefore is how Malaysia can raise its level of competitiveness. In order to increase her share of exports, it is vital that the nation raises its productivity level and at the same time, improve its competitiveness through the enhancement of technological and knowledge capability. These will involve restructuring and upgrading the industrial structure, moving up the value chain into new areas of competitive advantage and developing new products and services. Besides, it does require the country to adopt efficient practices and good governance.

Malaysia needs to promote new growth areas to diversify its manufacturing base and to counter competition from China in labour-intensive sectors. New growth sectors include information and communication technology, nanotechnology, medical devices and advanced materials.

The development of human capital will be the key driver of growth in the knowledge-intensive industries and will determine the competitive position of the nation. Thus, under the 9th Malaysian plan, investments in human capital will be given high emphasis so as to sustain economic resilience and growth and drive a knowledge-based economy. In addition, lifelong learning program has been implemented to encourage skills upgrading among all segments of society, and education and training delivery system will be expanded, particularly in the vocational and technical fields (UNDP, 2006: 74).

In response to challenges in China's market, enterprises operating in China must amend their strategies to accommodate China's unique market, and give serious thought to the issue of localizing their company in China. They must pay attention to the fact that there is a difference between the line of thinking of Chinese consumers and home country's consumers. In addition, enterprises must realize that communication in China is has a very complex channel, therefore they must make creative adjustments to their global strategies in China in drawing up overall operating strategy.

To succeed in China, firms need to think long-term, carefully cultivate and nurture relationships, choose the right strategy and have clear objectives. A careful and thorough understanding of China's legal system is also vital for firms to operate in China.

The collaboration from private sectors is crucial to match this economic liberalization effort. The private sectors need to be proactively involved and synergize on potentials offered through the various economic initiatives in ACFTA. However, this essentially requires them to understand the issues involved. Hence, it is crucial to create the awareness for these groups to realize the areas where business opportunities can be expanded. Meanwhile, all enterprises must be able to respond to the changing market conditions and competition. Entering into FTA means facing the pressure of competition from multinational corporations of other member countries. For enterprises to continue to grow, they must foster innovation and change to increase their competitive capacity.

In conclusion, engaging in ACFTA can help Malaysia to increase competitive capacity, raise efficiency, pave the way to new markets and hence promote trade and investment. The question then is how Malaysia should use regional cooperation, particularly the ACFTA, as a channel to capitalize on the opportunities and manage the challenges arising from the competition. This requires both public and private sectors to understand the issue involved and develop policies that will maximize the benefits and minimize the costs.

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[1] China calls this China-ASEAN Free Trade Area (CAFTA); ASEAN calls this ASEAN-China Free Trade Area (ACFTA). To avoid confusion with another CAFTA (Central American Free Trade Agreement), the acronym "ACFTA" is used in this paper.

[2] Due to space limitation, this section discusses only China's FDI flows to Malaysia. For a discussion of Malaysian investment in China, see Yeoh and Ooi (2007).

[3] The Star, "KL and Beijing Discuss Accreditation System", 24 July 2006, newsdesk@thestar.cpm.my

[4] Asia Times, "Malaysia Focuses On Services", 18 May 2005, http://www.atimes.com

[5] GTAP of ACFTA by ASEAN-China Expert Group. The GTAP model is a multi-region and multi-sector model. It contains 45 countries and 50 production sectors.

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