## AUSTRALIA MALAYSIA FREE TRADE AGREEMENT Session on Traditional Sources of Growth

#### Manufacturing – Trends in Malaysia

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Good morning

Mr Chairman, Professor John McKay, Director Australian APEC Study Centre, Monash University

Mr Leigh Purnell, Executive Director (International)
Australian Industry Group

Ladies and Gentlemen

On behalf of the Federation of Malaysian Manufacturers (FMM), I would like to thank the Australian Government and conference organizers for the opportunity to share our views on trends in the Malaysian manufacturing sector in relation to the prospects to be derived from a Free Trade Agreement between our countries.

2. In preparing for this presentation, the Australian Government's Department of Foreign Affairs and Trade report on "Malaysia: An Economy Transformed" was most helpful, as the publication had provided interesting insights on Malaysia, as viewed from the Australian perspective. Nevertheless, there are a couple of points, which I would like to touch upon, especially in relation to the Malaysian manufacturing sector.

#### **Highly Liberalised Manufacturing Sector**

- 3. One of the key points that I would like to emphasise strenuously is that the Malaysian manufacturing sector operates in a highly liberalized environment. The manufacturing sector is exempted from the Foreign Investment Committee (FIC) Guidelines, the 30% Bumiputera equity and restrictions in market entry have been removed for all sub-sectors. This point was not clearly stated in the publication.
- 4. With effect from June 17, 2003, all new investments and investments in expansion or diversification projects in the manufacturing sector are no longer imposed any equity or export conditions. Existing manufacturing businesses could have their equity and export conditions removed, upon application to and approval from the Malaysian Industrial Development Authority. This particular point has been noted in page 39 of the publication.
- 5. FMM views the liberalization of the manufacturing sector as positive and necessary in helping to hone our competitive strength because Malaysian manufactured products are competing in the global market The Malaysian manufacturing sector has always been the most open sector and takes the lead in the country's liberalization programme.
- 6. In line with our support for liberalization, FMM also supports the removal of market protection policies, including those for the national car projects. Protection distorts the market and competitive strength, and could result in adverse ramifications on the majority of manufacturers in the automotive industry in the export market. We also support the removal of the price control policy and liberalization in all sectors, particularly those providing support services to manufacturers.

7. In this respect, we have been successful to a certain extent in lobbying for the liberalization of the haulage sector, where 62 new haulage licences were issued by the Government in 2003. We support the liberalization of the services sector, particularly in banking and insurance.

#### **Support for Standards Compliance**

- 8. Competing in open markets has also made the Malaysian manufacturing sector an ardent supporter of standards and standards compliance to help level out uneven playing fields in the global as well as domestic markets. However, this aspect had not been given much emphasis in the Australian Government's Department of Foreign Affairs and Trade report on "Malaysia: An Economy Transformed".
- 9. From the Malaysian manufacturing viewpoint, Australia has an extremely stringent regime for quarantine measures, sanitary and phytosanitary measures and labeling requirements. While Malaysia has amended its own labeling laws that are in compliance with CODEX and the Australian Food Standards Code, we understand from our food manufacturers that the phytosanitary measures differ from port to port. We certainly hope that the Australian Food Council would review and standardize these measures. We also note the complaints by Australia that Malaysia has a wide range of non-tariff measures.

### **Challenges to the Malaysian Manufacturing Sector**

10. Taking cognizance that the Malaysian manufacturing sector is a very open economic sector with strong emphasis on standards compliance, I would like to focus on some of the key challenges faced by Malaysia as we move higher up the industrialization process.

#### 11. These challenges are:

a. Maintaining competitiveness, quality and just-in-time delivery in global markets, while competing against sub-standard and under-declared imports in the domestic market. Some manufacturers are already outsourcing production and operation processes to maintain cost competitiveness.

FMM's Quarterly CEO Survey carried out for the third quarter of 2003 revealed that 29.4% of respondents outsourced some of their activities. Contract manufacturing was the main outsourced activity, followed by logistics and information technology services. Other activities outsourced were internal audits, facilities management, R&D and procurement.

We need also to develop cargo consolidation facilities and services, particularly to help local companies export direct. Concurrently, we need aggressive trading houses that could help Malaysian manufacturers, especially SMEs, to venture into new and existing markets by helping to reduce transport costs through cargo volume and ensuring that there is return cargo to Malaysia.

b. Being technology and knowledge-driven is a challenge that Malaysia has been emphasizing since 1995 when we began to focus on promoting high value-add and high-tech products. According to the Malaysian Government's Ministry of Science, Technology and Innovation's 2004 Report on the *National Survey of R&D*, the country began to enter its third stage of competitive development since 1998, as seen from the increasing expenditure on R&D.

The Survey, carried out once in two years, indicated that in 2002, Malaysia's expenditure on R&D increased at a faster pace than its economic growth when it surpassed the RM2 billion mark to reach RM2.5 billion, rising by 47.1% or RM0.8 billion compared to the RM1.7 billion recorded in year 2000. Economic growth in 2002 was 4.1%.

c. Having technical and marketing skills is yet another challenge for the Malaysian manufacturing sector, which is also highlighted in the Australian Government's publication. Malaysia needs engineering and technical skills, especially at the middle management level, who can design, innovate and adapt technology.

Currently, skills set in most firms are mainly at senior management level. Companies tend to hire external experts and consultants for their technical needs. This is not a sustainable strategy in the longer term since the level of expenditure for such expertise would continue to increase.

External expertise is also not sustainable in the longer term in an environment where multinational customers demand that their original equipment manufacturers are technically competent to contribute towards product and process development activities.

We would also need marketing expertise to move firmly into valuepioneering and create demand for Malaysian products. Malaysian businesses need international competency in maximizing benefits from Free Trade Agreements; d. Expanding ICT adoption and literacy to bridge the digital gap in the face of rapidly evolving new technologies like nanotechnology, grid computing, RFID, WiFi, etc is a challenge that the Malaysian manufacturing sector has to catch up on.

The OECD's December 2004 Information Technology Outlook report had warned that laggard users risk new digital divides, especially when we have yet to "master" the adoption of ICT in all business processes, which until today, is mainly used for information.

#### Joint Path for Growth in an Australia-Malaysia FTA

- 12. Having noted the above key challenges, the most important question is the directions or objectives that the Malaysian manufacturing sector hopes to achieve from Free Trade Agreements with Australia and other developed nations. As emphasised earlier, the Malaysian manufacturing sector is very open and operates in a highly liberalized environment. We have also proven to be successful manufacturers of quality products, as seen from the fact that Malaysia ranked 17<sup>th</sup> as an exporting nation and our manufactured products, which made up over 80% of Malaysia's total exports, are well accepted in major industrialized markets like the US, European Union and Japan.
- 13. Hence, the first primary objective that we wish to achieve from a Free Trade Agreement is equally open and wider market access for Malaysian manufactured products through the reduction of tariffs as well as the removal of non-tariff barriers. We are able to assure our Free Trade partners that Malaysian products meet the quality and standards requirements of our customers, including those in the industrialized nations and in high-tech products.

- 14. The second primary objective that the Malaysian manufacturing sector would seek from a Free Trade Agreement is assistance and support to strengthen our competitive and innovative capabilities. In this respect, we need assistance and support, particularly in the upgrading of manufacturing support factors, such as those highlighted earlier as key challenges to the Malaysian manufacturing sector's advancement into the higher-tech, higher value-added and more sophisticated global manufacturing environment.
- 15. In this respect, we are seeking support and assistance to move into higher levels of industrialization and to be able to work alongside developed nations as full partners in joint ventures in the world economy and at the micro firm level where we work alongside multinationals as equals. The Malaysian manufacturing sector is confident of accomplishing this objective.

#### **Development and Strengthening of Support Factors**

- 16. Hence, the Malaysian manufacturing sector hopes to gain, other than a more liberalized trade environment for our products, the following assistance from a Free Trade Agreement with Australia, or any developed country for that matter, to upgrade and strengthen support factors, critical to our onward progress to become a fully developed and competitive nation:
- a. Harmonisation of standards between the two countries to remove non-tariff barriers the harmonization of standards should preferably be an extension of the ASEAN standards harmonization efforts;
- b. Collaboration to secure markets, whether for products or services in third countries that could leverage on Malaysian and Australian niche strengths;

- c. Expansion of existing educational ties to include post graduate and lifelong education programmes, such as those modeled after Japan's The Association for Overseas Technical Scholarship (AOTS) programme;
- d. Expansion of R&D collaboration, which began with Curtin Sarawak
  Campus receiving funding from the Malaysian Government's
  Intensification of Research in Priority Areas grants, into other areas of
  technologies; and
- e. Collaboration to electronically connect businesses to facilitate cross border exchange of products, specifically processed food, between food suppliers and hypermarkets of both countries.

#### Harmonisation of Standards

- 17. The Free Trade Agreement should acknowledge prior and on-going standards harmonization efforts at the Malaysian as well as ASEAN level. The extended harmonization with common ASEAN standards would ensure that all imports into Malaysia conform to the same standards.
- 18. Harmonization to common regional standards would simplify standards requirements in trade in goods and services across borders between all countries concerned, without additional testing and certification costs. In this instance, the harmonization would be a proactive effort since an ASEAN CER [Australia and New Zealand] Free Trade Agreement is also being negotiated.

#### Collaboration in Third Countries

- 19. Australia and Malaysia may wish to consider establishing an Australia Malaysia Third Country Investment Fund, modeled along a similar facility available for Singaporean and Malaysian businessmen. The Fund would encourage Malaysian-Australian collaboration in projects in third countries to boost trade and investments as well as to strengthen business ties.
- 20. For instance, Australia could make use of Malaysian ties with Islamic countries and comparatively lower product costs, while Australia could provide its niche expertise and probably, venture capital. Malaysia has relative strength in terms of construction projects overseas. These projects should bring in Malaysian manufacturers using Made-in-Malaysia building materials and Australian modular building expertise.
- 21. Concurrently, joint collaboration on a third country's project would facilitate the flow of technical and professional expertise through mobility of labour between Malaysia and Australia. Mobility of labour would help Malaysia to upgrade its capacity in the appropriate technical skills and help Australia to further expand some of its services exports.
- 22. Of greater importance, international sourcing of knowledge is an integral strategy to complement technology transfers and technology acquired through FDIs. Hence, the Free Trade Agreement should facilitate the sourcing of knowledge and expertise between Malaysia and Australia.

# Expansion of Education Ties to Include Post-Graduate and Lifelong Education

- 23. Further to the mobility of labour, the Free Trade Agreement should also seek to expand education ties between our countries to include post graduate and lifelong education. In this respect, Malaysia has found her experience with Japan's The Association of Overseas Scholarship (AOTS) programme very useful in providing working adults with continuing education in technical skills and exposure to a different as well as positive work culture and environment.
- 24. Such a scholarship programme would help Malaysians to further familiarize themselves with Australian expertise and work processes in Information Technology, biotechnology, and so forth, in the same manner that Malaysians acquire machinery and engineering, quality management skills and work culture from the Japanese.

#### Expansion of R&D Collaboration

- 25. The Free Trade Agreement should encourage further expansion in R&D collaboration. We note that in August 2003, Curtin University of Technology's Sarawak Campus became the first international university in Malaysia to access the Intensification of Research in Priority Areas grants from the Government.
- 26. We understand that Curtin Sarawak conducts research in Soft Soil Centre, sustainable energy and communications, parallel computing and GIS applications, palm oil research, geopolymer concrete research, systems approach to aviation safety, entrepreneurship, cultural approaches to teaching and learning, and media studies.

27. Access to Government grant was awarded even without the need for a Free Trade Agreement arrangement. Obviously, under a Free Trade Agreement, the scope for collaboration would be even greater, including facilitating trade in research collaboration in Australian projects and conversely, to allow Malaysians to access research grants from the Australian Government. Collaboration would assist in capacity building, knowledge sharing and joint intellectual property ownership and development for both countries.

#### Electronic Connection to Promote Cross Border Exchange of Goods

- 28. We would also like to further expand our adoption of ICT, particularly in carrying out electronic commerce between business-to-business in the domestic market as well as across borders, whether for supplies or finished products.
- 29. More specifically, FMM is working on a project to link electronically Malaysian food suppliers to hypermarkets. This project could be eventually expanded to facilitate electronic connections with Australian food suppliers and hypermarkets. The electronic connection would be in line with the demands of a global supply chain for just-in-time inventory management as well as sourcing of supplies between the two countries in processed food.
- 30. At policy level, the electronic connection would facilitate the harmonization of RFID and product coding standards between the two countries. Such collaboration on harmonization of standards is also being carried out between ASEAN and Japan.

#### **Conclusion**

- 31. Of paramount importance in the Free Trade Agreement is of course the further opening of markets for each other's products and services. Nevertheless, the above proposals are some areas for collaboration and mutual benefit that could be considered as part of the proposed package between Malaysia and Australia. Malaysia has much to offer, particularly in opportunities in new sectors of growth.
- 32. In this respect, the agro-based sector is targeted to be Malaysia's third engine of growth. Opportunities, whether in terms of upstream activities in breeding, cultivation and harvesting, or downstream in processing, packaging and distribution abound for the manufacturing and relevant services sector. A Free Trade Agreement with Malaysia would help to ensure that Australia jointly participates in and reaps mutual economic benefits from these opportunities.
- 33. More importantly, we hope that a Free Trade Agreement between our countries would help us work more strongly alongside each other as well as help each other to work more strongly alongside other developed nations and in the global manufacturing environment.

Thank you.