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Malaysia's Industrialisation and Trade: Issues, Options and Strategies

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INTRODUCTION

This paper consists of two sections. The first section attempts to review briefly the pattern and strategy of Malaysia's industrialization since independence, emphasizing the trade aspects of the manufacturing sector and the role of international trade in the process of economic development. While it is argued that the export-promotion policy should be aggressively pursued, it is by no means the only one. In view of the fact that the export-oriented strategies can only be effective if external (demand) conditions are favorable and therefore subject to fluctuations, steps have to be taken to supplement these strategies with appropriate government intervention on the supply (internal) side.

While this paper recognizes the role to be played by industrial trade strategies and policies, the focus on Section II will be on the demand side. Therefore, given the need to expand manufactured exports and the access to the major markets of the advanced countries is vital to facilitate the export-oriented industrialization, this section will discuss the global economic problems and constraints, and their implications for Malaysia; the role that Malaysia could play in the current Uruguay Round of Multilateral Trade Negotiations, and the options and strategies that Malaysia could adopt.

GROWTH, STRUCTURAL CHANGE AND PATTERN OF INDUSTRIALIZATION

In the 1960s, Malaysia's Gross Domestic Product (GDP) grew at an average rate of 6.5 percent per annum. Nearly 40 percent of this growth was attributed to the industrial sector (defined to include mining, manufacturing, construction, utilities and transportation) or 17 percent from the manufacturing sector. In the 1970s, Malaysia grew faster at 7.8 percent per annum of which 49 percent of it came from the industrial sector or 25 percent from manufacturing. The economic growth declined to 4.5 percent per annum during the 1980-87 period[1] but the contribution of the industrial sector as well as the manufacturing did not change much. The industrial sector contributed 47 percent and the manufacturing sector 25 percent to this growth. The 25 percent contribution to growth by the manufacturing sector is by no means high by the standards of the Asian Newly Industrialized Countries (NICs), which go beyond 40 percent. It should also be noted that the Malaysian case is quite unique in the sense that it has always been an agro and land-based economy, where the commodity sector is strong.

Figure 1 shows the remarkable structural changes occurring in the Malaysian economy since 1960. The industrial sector gained about 20 percentage points in its share of GDP during the period 1960-1988, almost completely at the expense of agricultural sector (agriculture, livestock, forestry and fishing), while the service sector maintained roughly the same share of around 35-40 percent. The share of the industrial sector overtook the share of agriculture at around 1970 and

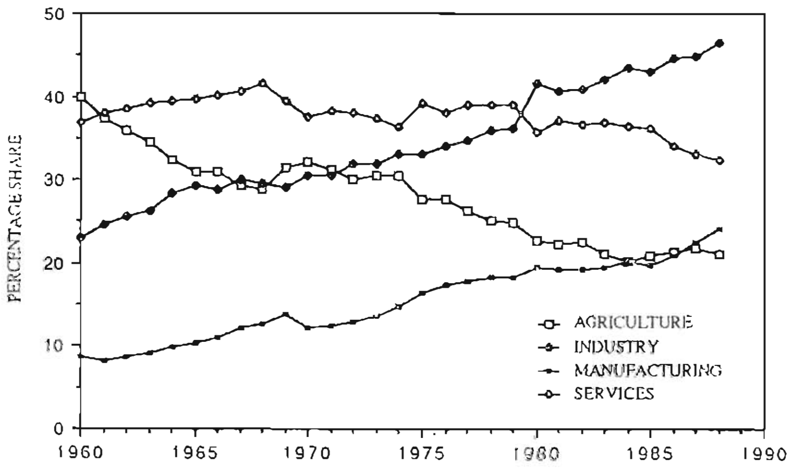

FIGURE 1. Sectoral shares of GDP, 1960-1988

overtook the share of services in 1980. The manufacturing sector, as a sub-component of the industrial sector, has changed more drastically than that of the whole economy. Its share of GDP more than doubled, from less than 10 percent in the first half of the 1960s to over 20 percent in 1987-88, while its contribution to the industrial sector increased from around 35 percent in early 1960s to about 50 percent by 1987-88. The size of the manufacturing sector stated to overtake the agriculture sector by mid-1980s. By then, the agriculture-to-industry transition can be regarded as completed, and the economy has begun to move through the second transitional period from an industrial towards a service economy. This second transitional period is expected to occupy the entire, if not most, of the 1990s, before reaching a stage when the service sector (comprising commercial, personal and public services) will overtake the industrial sector in size.[2] In other words, during the coming decade of the 1990s, the economy is expected to be preoccupied with rapid industrialization, supported by related services sector.

Second important phenomenon , as shown in Figure 2, is the close relationship between growth rates of Gross National Product (GNP) and exports (measured in current values).

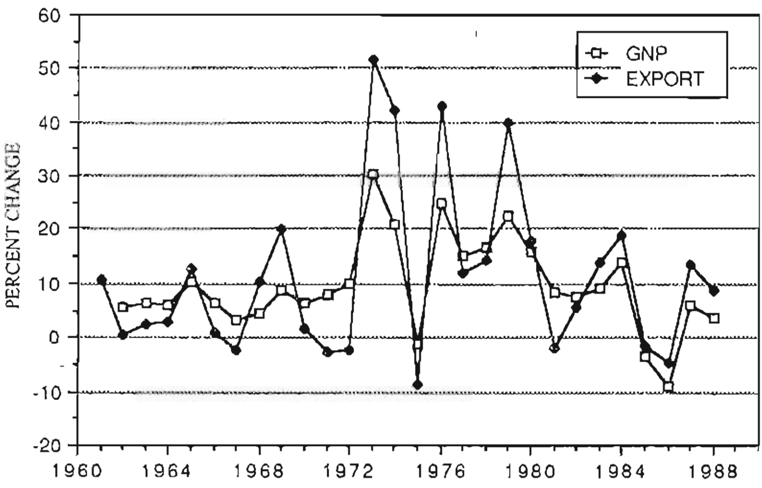

FIGURE 2. Malaysia: Annual growth of GNP and exports

Export expansion seems to be a very significant factor contributing to the country's economic growth. An important point to note here is that the sharp decline in growth rates of both exports and GNP occurred during the periods 1973-75, 1979-82 and 1984-86, which coincide with the periods of world economic recessions. In other words, being an open economy, what happens to the world economy will directly be transmitted into the performance of the Malaysian economy. Nevertheless, as Figure 3 shows, the export-GNP ratio trend for Malaysia has been increasing significantly since the beginning of the 1970s, that is from about 40 percent in the first half on the 1970s to over 60 percent in the second half of the 1980s. If this trend continues, this means that the Malaysian economy is expected to be more open in the future.

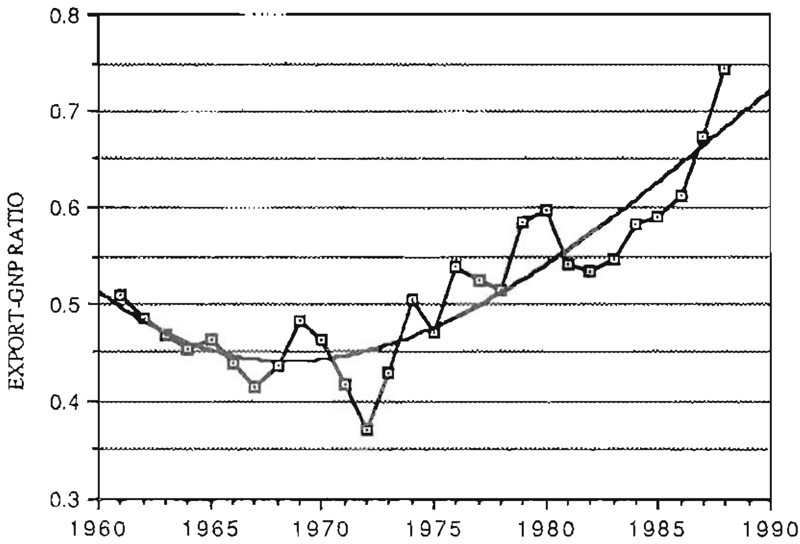

FIGURE 3. Malaysia: Export - GNP ratio, (1961-1988)

Somewhat similar trends also can be seen in terms of the rising contribution of manufactured exports either to total exports (goods and services) or commodity exports. An seen in Figure 4, the ratios of manufactured exports fluctuated around 25 to 30 percent in the 1970s until mid-1980s, but accelerated upwards to around 35-40 percent in 1986-87. Part of this progress was however due to the fall in major commodity prices and/or slow growth of their export volume.

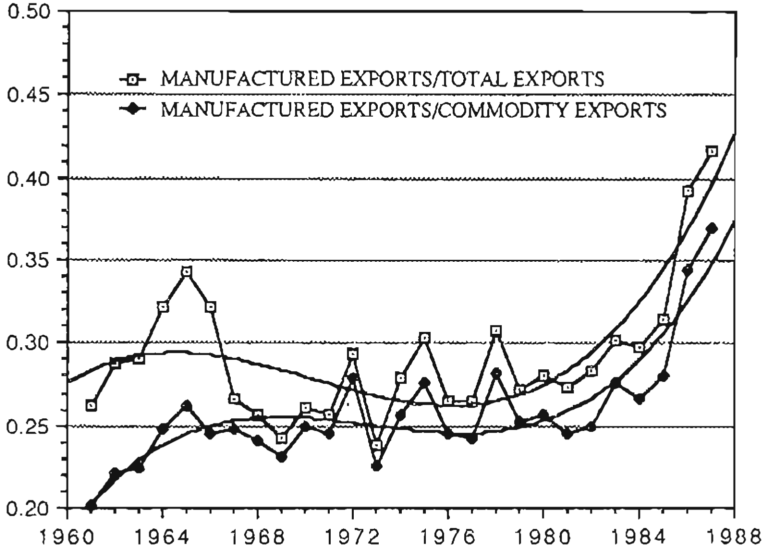

FIGURE 4. Malaysia: Manufactured exports as a ratio of total exports and total commodity exports

The previous analyses indicated that the manufacturing sector started to play a prominent role in the economy from 1970 onwards. Since then there had been a rapid industrial growth accompanied by structural change within the manufacturing sector itself. The data to demonstrate this phenomenon is exhibited in Tables 1 and 2, which show the relative growth of the major manufacturing subsectors and the resulting change in their value-added shares in selected years during the 1970s and 1980s respectively. Evidently, the industrial production indices indicate that the manufacturing sector grew at nearly 11 percent in the 1970s and down to about 6 percent in the 1980-87 period.[3] During this period, food, beverages and tobacco together was the largest sub-sector in the 1970s, accounting for 17.2 percent of 1973 and 15.8 percent in 1978. However, it was superseded by electrical machinery (mainly electronics) in the 1980s. Wood and wood products together with furniture and fixtures ranked second in the 1970s, but went down to the fifth position in the 1980s. The other important subsectors include rubber products, palm oil and palm kernel oil, and textile and wearing apparel. In short, although there was a structural change within the manufacturing sector, degree of concentration remained almost

TABLE 1. Peninsular Malaysia: Industrial production indices and average annual growth

Industry	1968=100 1970	1980	Growth 1970-80	1981=100 1987	Growth 1981-87
Processing of estate-type agricultural products	130.1	439.9	13.0	-	-
Food, beverage & tobacco	119.4	222.2	6.4	140.1	5.8
Textiles & wearings apparel	114.6	357.7	12.1	152.2	7.3
Wood & related industries	125.5	287.3	8.6	105.9	0.9
Rubber products	125.3	203.6	5.0	156.1	7.7
Chemical & products	118.9	250.7	7.7	123.4	3.6
Petroleum refineries	99.5	193.7	6.9	147.5	6.7
Cement & products	118.2	278.5	8.9	81.9	-3.4
Basic metal & metal products	134.5	336.9	9.6	134.8	5.1
Electrical & electronic mach. & appliances	171.5	487.4	11.0	250.6	16.5
Transport equipment	272.5	852.6	12.1	72.8	-5.4
Others	193.9	1705.8	24.3	96.7	-0.6
Manufacturing	129.8	362.6	10.8	141.8	6.0

Source: Treasury Economic Report 1988/89.

unchanged, if not worse. In the 1970s (represented by figures in 1973 and 1978), the top three sub-sectors accounted for about 40 percent of total manufacturing value-added, but in the 1980s (represented by figures in 1983 and 1986) the top three accounted for slightly more than 40 percent. In general, the manufacturing sector of Malaysia is heavily concentrated on agro-based or labor-intensive productions.

TABLE 2. Value added share of manufacturing sector

Industry	1973	1978	1983	1986
Food, beverage & tobacco	17.2	15.8	16.2	17.0
Palm oil & palm kernel oil	4.0	10.2	8.2	5.6
Textile & wearing apparel	5.2	7.9	5.5	7.0
Leather & footwear	0.1	0.1	0.1	0.2
Wood & wood products, furniture & fixtures	15.6	10.4	5.8	5.7
Paper & paper products, printing & publishing	5.3	4.8	5.1	5.1
Chemical products	7.1	5.7	5.9	6.6
Petroleum refineries	3.8	3.3	2.4	3.5
Rubber products	8.0	9.9	6.5	7.5
Plastic products	1.6	1.8	2.0	2.2
Non-metallic mineral products	4.9	5.1	5.0	6.0
Basic metal industries	5.9	3.1	5.2	3.8
Fabricated metal products	4.9	3.8	4.1	3.0
Machinery	3.3	2.9	3.6	2.3
Electrical machinery	7.3	10.8	18.4	17.6
Transport equipment	3.3	3.0	5.1	3.1
Other	0.8	1.3	1.8	3.8
Total manufacturing (%)	100.0	100.0	100.0	100.0

Source : Manufacturing Surveys (Peninsular Malaysia).
Note : Value added in 1978 constant price.

These industries are also generally the fast growing ones, reflecting Malaysia's comparative advantage in these products.

The external demand has been an important source of manufacturing growth since the 1970s and that the export of manufactures has followed the same trend as manufacturing production are fairly well documented. As shown in Table 3, the contribution of Malaysia's manufactured export to GNP increased significantly from 12 percent in 1970 to 22 percent in 1980 and over 30 percent by the middle of the 1980s. In 1970, the major manufactured exports were (1) chemical and petroleum products (2) food, beverages and tobacco, and (3) wood

TABLE 3. Malaysia : Exports of manufactured goods
($ million)

Industry	1970 Value	1970 %	1975 Value	1975 %	1980 Value	1980 %	1985 Value	1985 %	1981 Value	1981 %
Food, beverages & tobacco	112	18	270	14	475	8	594	5	572	4
Textiles, clothing & footwear	40	7	218	11	806	13	1289	10	1489	10
Wood products	88	14	205	10	467	8	363	3	515	3
Rubber products	17	3	43	2	84	1	113	1	169	1
Chemical & petroleum products	197	32	185	9	361	6	1412	12	1102	8
Non-metalic mineral products	20	3	23	1	61	6	150	1	226	2
Iron and steel & metal manufactures	26	4	49	2	161	3	300	2	548	4
Electrical and electronic machinery & appl.	17	3	304	15	2832	46	6028	50	7579	52
Other machinery & transport equipment	68	11	269	14	407	7	1031	9	834	6
Other manufactures	27	5	412	21	447	7	831	7	1477	10
1) Total Manufactures	612	100	1978	100	6101	100	12111	100	14511	100
2) Total Merchan. Ex.	5163		9231		28013		37576		53878	
3) GNP	11829		22332		53308		72039		81482	
(1) as % of (2)		11.9		21.4		21.8		32.2		26.9
(1) as % of (3)		5.2		8.9		11.4		16.8		17.8

Source : Treasury Economic Reports.

Notes : 1 Estimates for January to July.

2 Includes paper and pulp products, scientific instruments, etc.

products. By 1980, the three major manufactured exports changed to (1) electrical and electronic products, (2) textile, clothing and footwear, and (3) food, beverages and tobacco. By the end of the 1980s, electrical and electronic machinery and appliances accounted for more than 50 percent of manufactured exports, followed by 10 percent of textiles, clothing and footwear, and 8 percent by chemical and petroleum products. Again, there is heavy concentration in the export structure of manufactured goods.

In fact, manufacturing exports have been more concentrated than manufacturing productions. For example, more than 50 percent of Malaysia's manufactured exports consist of electrical and electronic products only, whereas on the production side the top four sub-sectors (electrical machinery; food, heverages and tobacco; rubber products and textiles) account for about 50 percent (see Table 2 and 3). This concentration of exports is probably related to concentrated export markets. Japan, European Economic Community (EEC) and the United States have always been the main export markets for Malaysian manufactured goods. They currently account for more than 55 percent of Malaysia's total exports, while another 20 percent or so go to the other countries of Association of Southeast Asian Nations (ASEAN), particularly Singapore. Nevertheless, Malaysia's import penetration ratios in industrially advanced countries are quite low (Ariff and Hill, 1985). Similarly, imports of manufactured goods mostly come from these same countries. In fact, the imports of manufactured goods are more concentrated as about 80 percent of Malaysia's imports are in manufactured goods of which 60 percent of them come the advanced countries of Japan, EEC and United States.

A study by Kimura (1986) shows that while in 1973 only 16 percent of Malaysia's manufactured products were exported, by 1983 the percentage went up to 25 percent. The highest export-production ratio in 1983 went to electrical machinery (61.2%), followed by textile and wearing apparel (37.6%), machinery (33.2%), and food, beverages and tobacco (32.2%). However, the import-dependency ratio (import/ domestic demand) for the manufacturing sector as a whole, did not change between 1973 and 1983. It remained at around 35-36 percent. Interestingly, products which have high export-production ratio also have high import-dependency ratio. For example, in 1983, the sub-sectors which had high import-dependency ratio of were electrical machinery (60.6%), machinery (78.6%), transport equipment (67%) and textile and wearing apparel (37.9%). Even food, beverages and tobacco had an import dependency ratio of 25.1 percent. This phenomenon may be explained by the fact that the major exporters are large foreign investors or local producers sub-contracted by foreign manufacturers. They produce mainly to meet the demand of export markets rather than the domestic. The creation of economic enclaves by the provision of Free Trade Zones (FTZs) is an important determining factor for this industrialization trend.[4] This phenomenon also indicates that there are rooms for import-substitution strategy.

Table 4 shows the changing import patterns in Malaysia. It is apparent that the export-oriented strategy since 1970 has not decreased the proportion of import demand for investment goods and particularly the intermediate goods for manufacturing; the latter increasing from 21 percent in 1970 to 35 percent in 1988. Even the overall net export of manufactured goods has always been negative (Table 5). Nevertheless, the gap between export and import narrowed down in 1987 compared with 1980, mainly because of improvement in the exports machinery and transport equipment.

THE NEED FOR AN EXPORT-ORIENTED INDUSTRIALIZATION POLICY

It is surprising that in the immediate post-independence period, Malaysia saw industrialization through the import-substitution (IS) strategy as the dynamic path to development. The economy then, was characterized by unstable demand for primary exports (tin and rubber in particular), rapid labor force growth and high unemployment, high levels of imports, excess domestic demand and fragile balance of payment. By the end of 1960s the results of the "industrialization fetish" (MacBean and Balasubramanyam 1978) were already detected at the early period. Despite its contribution to growth, the IS strategy had created distortions in domestic product prices; low value added, poor linkage effects with the rest of the economy, evidence of sub-optimal industries, and inequalities in income and employment. For the most part, this early easy stage of industrialization was oriented towards consumer goods, the production of which is relatively labor-intensive, requires low technical skills, has a ready mass market but increasingly relying on foreign technology and entrepreneurial skills. Locationally, this industrialization was almost invariably concentrated into a few urban centers, notably Kuala Lumpur and Petaling Jaya. Further, the

TABLE 4. Malaysia : Gross imports by economic function

Items	1970		1975		1980		1988	
	$m	%	$m	%	$m	%	$m	%
Consumption goods	1212	28.0	1720	20.0	4325	18.41	10246	23.6
Food	490	11.3	615	7.2	1177	5.0	2344	5.4
Bev. & tobacco	74	1.7	85	1.0			217	0.5
Cons. durables	134	3.1	260	3.0	992	4.2	3386	7.8
Others	514	11.9	760	8.8	2156	9.2	4299	9.9
Investment goods	1152	26.6	2740	31.9	7030	30.0	12677	29.2
Machinery	455	10.5	950	11.1	2578	11.0	3864	8.9
Transport equip.	151	3.5	250	2.9	919	3.9	1433	3.3
Metal products	283	6.5	550	6.4	1767	7.5	2865	6.6
Others	263	6.1	990	11.5	1766	7.5	4515	10.4
Intermediate goods	1572	36.4	3726	43.4	11689	49.9	20057	46.2
For manufacturing	893	20.7	2017	23.5	6670	28.4	15151	34.9
For construction	83	1.9	170	2.0	580	2.5	1129	2.6
For agriculture	158	3.6	330	3.9	899	3.8	1042	2.4
Crude petroleum	215	5.0	665	7.7	1890	8.1	410	0.9
Others	223	5.2	544	6.3	1656	7.1	2325	5.4
Import for re-export	349	9.0	405	4.7	406	1.7	433	1.0
Total	4285	100	8591	100	23665	100	43413	100

Source : Bank Negara Malaysia Annual Reports.

TABLE 5. Malaysia: Exports and imports of manufactured goods
($ million)

Commodity (SITC)	1970 Ex	1970 Im	1975 Ex	1975 Im	1980 Ex	1980 Im	1987 Ex	1987 Im
Cheminals (5)	36.4	312.5	79.4	711.8	171.5	2022.4	726	3316
Manufactured goods (6)	1182.8	770.2	1624.3	1389.4	3690.7	3849.2	3713	4980
Machinery & transport equip (7)	84.1	1197.3	573.0	2744.1	3238.4	9105.3	11697	14356
Misc. manufac. articles (8)	57.8	199.9	529.3	465.3	737.7	975.0	2632	1967
Total manufactures (5+6+7+8)	1361	2480	2806	5341	7838	15952	18768	24619
Export - Import	-1119		-2535		-8114		-5851	

Source : Treasury Economic Report 1988/89
Note : Ex - Export
In - Import

industrialization relied heavily on intermediate manufactured imports and the import of machinery and equipment.

With the introduction of the Investment Incentives Act 1968, a new focus on "export-substitution" was seen to provide as the alternative to IS. This new strategy has generally been referred to as an export-oriented (EO) strategy. The EO strategy is not simply a synonym for a free trade strategy, that is abolishing free trade barriers and distortions (may be caused by the IS strategy) in order to achieve an optimal integration of the country into the world markets, and hence the term "outward-oriented strategy" is also often used. In the Malaysian context, the EO is more appropriately defined as a deliberate government policy with the explicit intention to increase exports, thus going beyond laissez-faire. It involves various incentives and regulations, including tax exemptions and subsidies, double taxation and investments guarantee agreements, regulations on credit and interest rates, exchange control rules, provision and pricing of physical infrastructure (the important ones being the industrial estates and FTZ).

The debate on the role of trade in the process of industrial development or on the relative merits of import-substitution and export-orientation as an alternative means to enforce industrialization in developing countries has a long history. The trade-pessimists often argued that the capacity of developing countries to grow and to import is rather restricted because world demand for their export thus not grow at a rapid pace and the terms of trade constantly moves against them (see, for example, Nurkse 1959; Prebisch 1959, 1983; Singer 1950; Stewart 1976; Lewis 1980). This view was also expressed by the Secretary General of United Nations Council for Trade and Development (UNCTAD) who maintained that the developing countries did not share in three decades of post-war prosperity enjoyed by advanced countries because of "the existence of basic weaknesses in the mechanisms that link the economies of the two groups of countries . . ." (UNCTAD 1977:8-9). The trade pessimists argue that an EO trade policy could be an impediment to growth for several reasons, the important ones being:

1. Because of slow growth in demand for those products in which developing countries have comparative advantage; attempts to increase exports results in lower export prices and a transfer of income to developed countries. The slow demand for exports of developing countries is mainly because of the shift of industrial production in advanced countries from low-technology, material-intensive goods to

high technology, skill-intensive products, increased efficiency in industrial use of material inputs, low income elasticity of demand for many agricultural commodities and simple labor-intensive industries in which the developing countries have comparative advantage. and the rising protection of agriculture and labor intensive industries in advanced countries.

2. In the absence of import restrictions, the high income elasticity of demand for imports and the sluggish growth for exports of developing countries have to grow at a slow pace to avoid worsening foreign-exchange crises.

3. Since static comparative advantage of developing countries lies in production of primary products. free trade impedes industrialization.

In contrast to these views, most of the present day economists argue that export growth can make substantial contribution to the economies of the developing countries (see, for example, Balassa 1978, 1983; Bhagwati 1978; Krueger 1980; Little, Scitovsky and Scott 1970; Tyler 1981; World Bank 1987). They generally tend to implicitly or explicitly underplay the role of demand and instead emphasize the importance of trade policy in export performance and industrialization. They contend that liberalization of trade policies enhances export performance by producing a more competitive position in world markets.

These trade-optimists are in favor of export-orientation for several reasons, among which are costs of production are likely to be low because of economies of scale, resource allocation according to comparative advantage, and absence of high tariffs and other restrictions. There would be greater inflow of foreign capital. Liberal trade policies are also supposed to enhance factor productivity and increase efficiency and innovation. Since export-promotion policies generally rely on market forces, economic distortions caused by policy mistakes are therefore less serious. Nevertheless, trade-optimists do believe that economic growth through export promotion may be quite difficult at the beginning, but gradually it would become easier as the process continues. This is in contrast to the import-substitution policy which is easier at the beginning but become progressively more difficult. During the early phase of an export-oriented strategy, the expansion of exports may be slow due to the difficulties in meeting quality and delivery requirement of foreign buyers, but with experience and skills necessary for serving foreign markets, export-expansion should become easier over time.

A recent study by Chow (1987) tends to support the existence of reciprocal causal relationships between the growth of exports of manufactured goods and development of manufacturing industries as experienced by selected NICs during the 1960s and 1970s. His finding is rationalized by the observation that export growth in these countries can expand their limited domestic markets, and contribute to economies of scale necessary for industrial developments. Furthermore, export growth integrates domestic economy with global economies, thereby expanding the dimension of competition to international markets.

However, studies by Kavoussi (1985) and Schmitz (1984), for instance, indicate that although export-oriented trade policies can enhance economic growth, they become effective only when external demand conditions are favorable. The results of the study for the period 1967-77 and using a sample of 62 countries, also suggest that when trade policies are restrictive, export earnings are not likely to grow very rapidly even when external demand conditions are highly favorable. When foreign markets are slack, superior export performance is difficult to achieve even in countries where policies are not biased against exports. A rapid expansion of export earnings requires both favorable external markets and export-oriented industrial policies. An important implication is that the divergence in views between trade-pessimists and trade-optimists is simply because they have ignored the cyclical nature of the global economy and the successive long phases of rapid expansion and slow growth that have characterized international trade. Different phases of the cycles of global economic activity may require different trade policy emphasis.

It is also important for a developing economy like Malaysia to consider not only the demand-side effects of export-promotion strategies, but also the supply side, where national development strategies and policies play a crucial complementary role in the country's industrial development process. Cautioned by Schmitz (1984), the favorable external demand is only part of an alternative interpretation of growth. Amongst the internal (supply) factors, the actual role played by the government is also important. In South Korea, for example, the government followed an "export-subsidy" route rather than the "free-trade" route, with readily available credits at below markets rates. Import restrictions were reduced only selectively and gradually, reflecting the competitive strength of the local producers. Restrictions on direct foreign investments were and are still extensive. At the same time, selected import substitution strategy is also being practiced through non-tariff protections. (Wade 1982; Nam 1989; Yoo 1989). In Taiwan, too, the government has pursued an active, selective interventionist role, including import controls, tax rebates, and "domestic sales subsidizing export sales" (Hamilton 1983; Chou 1985).

To sum up, so as to put the manufacturing sector in proper perspective in the context of Malaysian industrialization and trade growth, the following salient points are worth noting:

1. The Malaysian economic structure is already in the industry-to-service transition period, and this period is expected to occupy the 1990s before reaching the advanced stage when the service sector will overtake the industrial sector in importance.

2. There is a strong correlation between economic growth and trade, and that makes Malaysia vulnerable to changes in the external sector.

3. Export expansion has been an important source of growth forthe Malaysian manufacturing sector since the early 1970s, such that there is a close relationship between the structure of production and that of exports; and a high degree of concentration whether in terms of output, export or export market, makes industrial diversification an important step forward.

4. Malaysia needs an export-oriented industrialization policy, not only based on her successful experience but also supported by empirical evidences from other countries. An important lesson here is that EO trade policies can only enhance industrial growth if external conditions are favorable. Otherwise, steps have to be taken to improve these external conditions, apart from having to supplement with appropriate government intervention in implementing EO trade policies.

In the following section, a discussion will be carried out on more specifically the issues related to external economic conditions and how Malaysia should overcome problems and improve its competitive position in the international bargaining process.

INTERNATIONAL ECONOMIC ENVIRONMENT

The performance of Malaysia's export-oriented industrial strategy, as outlined in the previous section, cannot be entirely attributed to export-oriented policy changes. It also hinges precariously on the continuing expansion of world trade for industrial products as well as the maintenance and strengthening of the multilateral trading system in accordance with the principle of comparative advantage. Any diversion from these trends could seriously undermine the progress of the on-going global economic restructuring exercise in general and Malaysia's industrial development in particular through contraction in trade, investment and technology flows.

In practice, the key factor facilitating export-oriented strategy is access to the major markets of the Organization of Economic Cooperation and Development (OECD) countries. Many export-optimists believe that the penetration of developed country markets is still low. Therefore, there are rooms for further penetration. But some, like Cline (1982) and Kaplinsky (1984), still believe that this may not be so. The existing international environment may make the export-oriented strategies less effective for Malaysia, if Malaysia is not prepared to take appropriate actions.

The world trading system is at the crossroads. Despite repeated declarations made by governments of the developed countries to resist protectionist pressures and to roll back protection, new measures have been introduced to limit imports to the detriment of many developing economies. In this context, it is alarming to note that the economic recession which beset the world economy during most of the 1980s has plunged the international trading system into complete disarray and indiscipline. Although the global economy in general has shown some sign of recovery in recent years, the threat on the world trading system in terms of protectionism in still looming large and in certain aspects in gaining momentum. In terms of tariff barriers to imports, it is conceded that the average nominal tariff rates in major industrial nations have unambiguously and significantly been reduced as a result of a series of tariff reduction exercises agreed upon, namely during the Kennedy and Tokyo Rounds of multilateral trade negotiations (MTN) under the auspices of General Agreement on Tariffs and Trade (GATT) (Ariff and Hill 1985). Nevertheless, they tend to be relatively high for labor-intensive manufactures such as textiles, clothing and footwear, travel goods and wood products which are important manufactured exports of many developing countries. Some of the tariff rates discriminates between imports from developed and developing countries, such as between soft and hardwood, and between some temperate and tropical fruits and commodities.

In addition, the prevalence of tariff escalations still persists due to the uneven reductions of tariff on products different levels of processing. A study on the tariff systems of the major industrialized countries shows that quite a large proportion of the processing chains register tariff increases as one moves from the primary to the process stages of production (Balassa and Michalopoulos 1986). Such tariff escalations reflect higher effective rates of protection for more highly processed items. This in turn restricts the market for such products exported by the developing countries and hence may stifle their effort to industrialize through further processing of their primary commodities.

In addition to tariff barriers, imports are also restricted through the use of non-tariff barriers (NTBs) which have increased in forms and severity. In fact, the NTBs constitute the single most important obstacle against export expansion. The NTBs include quantitative import restrictions, quotas and ceilings, voluntary export restraints (VERs), orderly marketing arrangements (OMAs), preferential procurement policies, state and sole agency trading arrangements. What makes the NTBs more difficult to handle in international trade is that they are less visible and more volatile than tariff barriers. Other trade measures which would not normally be considered as NTBs but which could in practice be applied in ways that could have the same effects include anti-dumping and countervailing duties, price investigations and surveillance and automatic import authorizations.

Although the effects of the NTBs imposed by the developed countries on their trade as a whole are relatively small, but the share of their restricted import is larger in their trade with the developing countries than with the developed countries. It is even more alarming to note that on the whole that the share of exporting manufactured goods. In other words, the manufactured imports from developing countries are subject to restrictions to a greater extent than the manufactured goods traded among the developed countries.

The upsurge in the occurrence of the NTBs in the industrialized countries is partly a direct consequence of increasing preference for bilateral solution to bilateral trade disputes which have been increasing lately. Ineffectiveness of certain crucial rules and procedure of the GATT, particularly with regards to its dispute settlement mechanism which allegedly has' no teeth' and lacked the legal power to ensure its dispute penal's decision binding over disputing countries concern, have led to increasing recourse to bilateral agreements, the majority of which contravened the GATT's rule and procedure. It is of major concern to the developing countries in the sense that, if this trend continues, it may erode the confidence in the GATT system and trigger off trade wars among the major participants. The danger is that the developing countries may get caught in the crossfire.

An indication that the world economy is heading towards and preparation for a major crisis is the preponderance of initiatives to form economic blocks among the major industrialized nations. The move towards total economic integration among the EEC countries and their closer alignment with the European Free Trade Area (EFTA) and the socialist block are still clouded with uncertainties and speculations as to their ultimate motives in relation to the need for liberalized world trading system. To match the EEC moves, the United States has recently signed an agreement to form the US-Canada Free Trade Area (FTA) and launched its Carribean Basin Initiatives. In addition, the US International Trade Commission (ITC) has released a report summarizing the views on the pros and cons of entering into an FTA with Japan. Similar studies are being made with respect to other Pacific Rim nations, including Taiwan, South Korea, members of ASEAN and other countries of the Asia-Pacific Region. Not to be left behind, New Zealand and Australia too have entered into an agreement for Cover Economic Relation. What is particularly distressing is that these initiatives are taking place at the time when the need for a more liberalized global trading system is more crucial than ever and when an increasing number of developing countries have begun to liberalize their trade regimes to reinforce their outward-oriented industrialization strategies.

IMPLICATIONS FOR MALAYSIA

It is important to stress that while Malaysian export do face protectionism in the developed countries, the specter of protectionism is less scary than the Newly Industrialized Economics (NIEs) like South Korea, Taiwan, Hong Kong and Singapore. The main explanation for this, lies in the fact that Malaysia is a small producer and exporter of manufactured goods, quite unlike the Asian NIEs. Therefore, Malaysia is unlikely to be perceived as a major threat to the local industries of the developed countries. At least, Malaysia is yet to feel the full impact of protectionist barriers in the developed countries. One may also argue that in the absence of protectionist barriers, the Malaysian exports would have performed better.

Perhaps, in a near future, as Malaysia's industrialization process reaches its advanced stage as envisaged by the Industrial Master Plan (IMP), the developed countries' perspectives and opinions on the

Malaysian economy are expected to change towards a more hostile posture as exemplified by the experience of the Asian NIEs in the 1980s. By then, what have been considered as non-consequential now may no longer hold and that protectionism can threaten Malaysia's economic position.

The recent US move to review the GSP status of Malaysia which arose from the allegation that the Malaysian government had violated the workers' right to form active labor movements in the country had become a major concern to the government and this experience should be viewed as an signal for Malaysia that its GSP status is always being threatened. In the past, Malaysia was only concerned with problems of the exclusion of products of its major exports from the United States GSP; the early exhaustion of GSP quotas and ceilings; the erosion of the United States GSP margin of preferences and the US stringent position of the rules of origin. Recently, Malaysia has also become increasingly concerned with the new United States (US) GSP scheme elements, such as the conditionality and linkage of non-trade issues with GSP, which will impose undue encumbrances on the beneficiaries from utilizing the scheme.

The US is also one of the large users of VERs, OMAs as well as anti-dumping (AD) and countervailing duties (CVDs). In as far as AD and CVD actions are concerned, these were taken against Malaysia's exports of carbon steel wire rods, carbon steel pipes and rods, and certain textile products and apparel, the exports of which have increased substantially to the US in recent years. In addition, Malaysia was also being investigated regarding the exports of other items such as thermostatically controlled appliance, plugs and photo albums. Although the number of AD and CVD investigations has been small, the trend does not augur well for Malaysia's export drive.

The quota system under the Multi-Fibre Agreement (MFA), an orderly marketing arrangement, is yet another cause for concern in Malaysia-US economic relations. Successive renewals of the MFA, the latest being MFA IV (1986-1991), have become more restrictive to cover not only agreements on cotton, wool and man-made fibres, but also include silk and other vegetable fibres such as ramie and linen. Although Malaysia has generally not complained about the US MFA quota system (at is guarantees market access for her textile and apparel exports to the US, which accounts for some 40 percent of its total exports in the product group), the system may eventually frustrate the medium-and long-term efforts to rationalize and upgrade its domestic textile industry as envisaged by the IMP.

Against the US protectionist trend, it is natural for Malaysia to be wary of her future prospect despite the presidential vetoes of a number of protectionist bills last year, especially when both the House of Representatives are now being controlled by the pro-protectionist Democratic Party. The suggestion that the passage of the 1988 Omnibus Trade and Competitiveness Act in the Congress in August 1988 has dampened the protectionist trend is not entirely true. Closer scrutiny of the Act reveals that it could be detrimental to free trade because of the presence of a number of provisions for protectionist measure in it. The Act gives the president the power to retaliate against countries deemed to indulge in unfair trade practices. It stresses reciprocity, seeking from foreign government *quid-pro-quo* market access for American products. This principle itself contradicts the GATT rules and procedures which confers special and differential treatment to the developing countries. In fact, Malaysia and other ASEAN countries have already expressed their concern over the possible negative effects of the Act on them.

With regard to Malaysia-Japan trade relations, in almost the same vein as that of Malaysia-US, issues of the 1980s are expected to remain unresolved until the 1990s. On the issues of tariff escalation, effective rates of protection on manufactured products of major interest to Malaysia (such as cocoa products, paper and board, textile and clothing, leather products and vegetable oils) are still substantially higher than their nominal rates would indicate.

As in the case of US, the NTBs constitute the most important obstacle to increasing exports to Japan. Major Japanese NTBs include import quota system, stringent health and sanitary regulations, industrial and agricultural standard specifications, domestic content requirements, complex and lengthy customs procedures,and Japan's complicated impregnatable domestic distributionand marketing channels. With respect to the tariff and quota system, Malaysia is concerned with the inclusion of more products which are of its major export interest into the list of products which are subject to quota restrictions. This includes a more restrictive import quota on wood and wood products (particularly veneer sheets, sheets for plywood, plywood, particle board and laminated wood), some items of textiles and clothing (such as batik, woven fabrics and garments), leather and leather goods (mainly footwear), iron and steel products (rods, tubes and pipes) and toys.

Japan's industrial and agricultural standards (JIS and JAS) are also another set of NTBs which have made it extremely difficult for most

Malaysian manufacturers to gain acceptance by the Japanese customers because of the stringent rules on standard and certification to test data submitted by an approved foreign testing organization for the JIS trademark. There have been instances where Malaysia's products, already complying with the international standards, have been rejected on the basis of alleged non-compliance with Japanese standards.

Needless to say, recent development of the EEC economic block has raised a certain degree of apprehension and anxiety on the part of Malaysia due to the continuous threat to its industrial export expansion strategy.

THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (MTN)

Under the auspices of GATT, the present round of Multilateral Trade Negotiations MTN was launched at Punta del Este, Uruguay in late 1986. This event has been considered significant and crucial in so far as it affects the world's trading system in the 1990s in general and Malaysia's export-oriented industrial development in particular. For the first time Malaysia is taking the MTN seriously and is gearing itself to actively participate in the negotiation process. Malaysia's new found interest in the MTN is motivated partly by an outright fear of what might happen to the world economy in the absence of trade talks and partly by the realization that its trade interest might not be addressed in the trade negotiation if left entirely to the major participants. Malaysia has a high stake in the Uruguay Round as its long-term goal of transferring the economy from the status of a primary producer to a modern industrial nation hinges precariously on the results of the trade talks. The message is loud and clear. Malaysia is prepared to participate actively in the MTN as evidenced by its preparedness to exchange concessions and offer in a number of issues, some of which are old and some are new.

The old issues refer to left-over issues from the Tokyo Round related to trade in agriculture, tropical and natural resource-based and manufactured products as well as those related the functioning of GATT, such as its safeguard and dispute settlement mechanism, controversies surrounding its selectivity, transparency, conditionality, reciprocity and special and differential treatments for the less developed countries (LDCs) provisions and exceptions in the MTN. The new issues are mainly those sponsored and spearheaded by the major industrial countries and equally opposed by some "hard core" large developing countries. These include trade in services and high-techs, trade related investment measures (TRIMs) and trade related aspects of intellectual property rights (TRIPs). Despite the diversity of issues and their strong linkages, it is not difficult to identify issues of utmost priority to Malaysia which need to be addressed amicably in the present MTN.

The following discussion will cover briefly some of these issues with emphasis on what Malaysia's objectives, stance and options would be in the MTN in so far as they affect Malaysia's export oriented industrial development strategy. Issues related to trade in agricultural and tropical products, though important to Malaysia's overall industrial strategy, are beyond the scope of this paper.

TRADE IN MANUFACTURES

TARIFF AND NON-TARIFF BARRIERS

Malaysia is already gearing itself towards the next phase of industrialization which is based crucially on its success to create a "niche" for itself in the world market for traditional manufactures as well as for certain high value-added and technologyproducts in which Malaysia has the potential comparative advantage. However, the timing seems to coincide with the growing intensity and diversity of protectionism as well as the rapid deterioration of the multilateral trading system.

Protectionist forces are most vicious in the realm of manufactures. Tariffs in general may have become less important as a protectionist forces are most vicious in the realm of manufactures. Tariffs in general may have become less important as a protectionist device. However, tariffs on some products of export interest to Malaysia, such as textiles, footwear, wood products and electrical goods, are still significant. For instance, the highest US tariff are on footwear, while the highest for EEC and Japan are on woven textiles and furniture respectively. Electronic components are imported duty free in industrial countries while consumer electronics and electrical appliance do encounter high tariff barriers as they are considered as "sensitive" items. On the other hand, it is the NTBs which pose the greater threat to Malaysia's manufactured exports.

In the above context, it is of utmost priority for Malaysia to seek a commitment on "standstill" and "roleback" of all tariffs and NTBS starting with the request for a substantial reduction in tariff. While acknowledging the difficulty to dismantle the NTBs, Malaysia would like for a start to have them at least converted into tariff (tariffication of the NTBs) which will gradually be reduced phases through GATT discipline and scrutiny.

THE MULTIFIBRE ARRANGEMENTS

The basic issue which Malaysia should address is whether to stick to the present Multifibre Arrangements (MFA) IV or to press for negotiation in textile trade long before the expiry of the MFA IV period with the aim of the eventual return of the textile trade to the GATT rule. Needless to say, Malaysia did gain in terms of market access provided by the quotas allocated by the MFA signitories. Without prior allocation of quotas, Malaysia's textile exporters would find it difficult to compete with the more efficient exporters. However, there is number of qualifications that need to be taken into account.

First, the MFA has become restrictive by trying to include all conceivable fibres in an attempt to control trade in all textile products. The bilateral agreements signed under the present MFA IV are very detailed. This would make diversification into uncontrolled goods extremely difficult.

Second, even though the existing quotas have not been fully utilised, this situation may be the reverse in the near future considering that the industry's export has been projected to double up to M$3.5 million by 1995. The annual quota expansion of 1 - 2 percent provided for in the MFA agreements might be insufficient compared with the average annual rate of growth of the Malaysia's textile exports.

If the textile trade were to be brought under the GATT rules and principles, there would be substantial redistribution away from the developed countries. Similarly, there would be a redistribution of production and export among developing countries in favour of those with low cost of production and better marketing skills. Herein lies the dilemma for small exporters like Malaysia. Malaysia will find it difficult to compete with the countries like Taiwan and South Korea which have lower production cost and better marketing skills. On the other hand, if Malaysia were to push strongly for the textile trade to be fully liberalised and placed under the GATT's rule and principles, then it has to compete with NIEs for the share in production and export of the products. Under the present condition, to overtake the advanced textile manufacturers like Hong Kong, Korea and Taiwan is a formidable task. Even low wage countries like Sri Lanka, China, Bangladesh and Pakistan are fast catching up with Malaysia and can provide stiff competition in the near future.

Under such circumstances, Malaysia's textile exports are still still in dire need for a more generous MFA, at least until such time when the development strategies envisaged for this industry have been successfully implemented. Hence, in the present round of MTN, Malaysia is expected to adopt a low profile stance in the textile negotiation group, giving support inly to the long-term objective for a liberalised trade in textile.

THE GENERALIZED SYSTEM OF PREFERENCES

A major form of special and differentiated treatment accorded to the (LDCs), beside the MFA, has been the Generalized System of Preferences (GSP) of the industrialized nations. In as far as Malaysia is concerned, there is no doubt that the GSP has partly contributed to the growth in Malaysia's exports. An estimate of the net trade expansion effect of the GSP showed an increasing trend in the late 1970s and a declining one in the early 1980s. Similarly, the country's benefit in terms of tariffs saved on its exports to the GSP-giving countries has been very marginal. Against this, it is interesting to note that the GSP has become problematic and uncertain, and has managed to divert Malaysia's attention from a more pressing problem faced by manufactured exports. All this goes to show that while the GSP has been some what beneficial to Malaysia, it cannot be relied upon heavily for future growth in our exports. Perhaps in the long run, export growth would be achieved more from generous MFN tariff reduction with minimal quantitative restriction than from the GSP facility. Even at present, for certain products, Malaysia would be better off if the GSP were replaced by generous MFN tariff reduction, free from other form of restrictions as these products are fairly competitive even without the GSP treatment. This would be the stance to be taken by Malaysian in the present round. In any case, Malaysia's GSP days seem numbered. That the Asian NIEs have been recently graduated out of the US-GSP, suggests that Malaysia will have to follow suit sooner or later.

SAFEGUARD

Issues on safeguard related to Article XIX of GATT which permits import restrictions if imports cause or threaten "serious injury to domestic producers". Safeguard measures are supposed to be applied on a MTN basis and temporary in nature, but in practice, they proved to be otherwise. Selective application of safeguard actions may result in smaller trading nations with limited leverage, including Malaysia, being at the unfavorable position. The accomplishment of comprehensive agreement on a new safeguard code under the surveillance and security of GATT is important to Malaysia because Malaysia is attaining comparative advantage in many industries, such as steel, textile, clothing,. footwear and some electrical appliances. At the same time, many developed countries may increasingly resort to safeguard actions to protect their domestic "sunset" industries.

DISPUTE SETTLEMENT MECHANISM

The dispute settlement procedures of GATT have been proven difficult in handling conflicts between contracting parties. The dispute panel has 'no teeth' and putting the panel's recommendation into effect depends on the willingness of countries to implement them as it is not a court of justice.

Malaysia has not been directly associated with these issues thus far as most bilateral disputes are resolved bilaterally. Nevertheless, it cannot be construed that Malaysia is viewing these issues lightly. On the contrary, Malaysia has been and should continue to be sensitive and concerned with the outcome of the negotiations in this area based on several counts.

First, indiscriminate and increasing preference for the use of VERs and other grey-area measures by developed countries to take advantage of the present ineffectiveness of the GATT safeguard and dispute settlement codes, has directly and indirectly affected Malaysia's merchandise trade in general and its exports of tropical products and manufactures in particular. The need to curb the use of these non-GATT practice is more crucial to Malaysia now than it was before.

Second, improved and stronger principles, rules and procedures may provide the avenue through which most of these grey-area measures could be subjected to the GATT principles.

Finally, stronger safeguard and dispute settlement codes would help alleviate the fear, justified or otherwise, on Malaysia's part to participate more actively in issues that require Malaysia to liberalize its trade and more importantly on the "new" issues in TRIMs and services.

TRADE-RELATED INVESTMENT MEASURES

Briefly, the United States (the main sponsor of Trade-related Investment Measures (TRIMs)) argues that some of the elements of the industrial policies of many countries tend to restrict the international flow of investments which effectively distort production and trade patterns, thereby preventing effective utilisation of capital and other resources. TRIMs covers the investment restrictions and performance requirements which include export-minima, local-content requirements, local-equity requirements, trade-balancing requirements, technology transfer requirements, licensing requirements, remittance restrictions, manufacturing limitations and product mandate requirements. These measures which are normally imposed by host countries have the impacts of either denying foreign cooperation, access to the markets of host countries or subsidizing exports, both of which subvert the underlying principles of the GATT system. While these restrictions and requirements do not always appear in the form of explicit border taxes or subsidies, the US tends to view them as having similar effects and hence they deserve to be included in the present GATT round. On the other hand, most developing countries are of the opinion that any multilateral agreement which constraints domestic investment policies represents a frontal attack on their sovereignty. They do see the need to attract a substantial volume of DFI in order to grow, but at the same time they also need to control foreign investment to ensure that other national developmental and social objectives are also met. Seen from this perspective, investment policies fall within the sovereign domain of each country.

Without going into the details, the Malaysian approach to these various issues varies with the type of TRIMs under consideration. For investment measures relating to content requirements and export-minima requirements, Malaysia would continue to intensify its application, especially in investments in resource-based industries (rubber products, wood-based, palmoil based and tin-based products), electronic, textile and apparel industries which have been identified as export-oriented industries. With regards to local-equity requirements, the Malaysian government has already responded to liberalize the restrictions wherever possible as long as the national and social objectives are not sacrificed.

Malaysia's general approach to these issues is to highlight the developmental aspect of the country's investment policies and to avoid taking confrontational role in the negotiating group.

OPTIONS AND STRATEGIES

With respect to trade issues in the present MTN round, Malaysia's success in getting favorable bargains depends very much on the options and strategies adopted, whether individually or collectively. At the outset, it must be made clear that Malaysia cannot expect much from the present round if it does not take an active role. This implies that Malaysia needs to take all the responsibilities that go with it – the willingness and ability to make concessions while receiving concessions and to abide by the rule of the game all the way.

The time has come when Malaysia can no longer expect receiving concessions without itself offering reciprocal offer of concessions however limited they may be. There is no such thing as "free-ride" any more for Malaysia. The developed countries are less willing to offer "one-way" concessions. In this context, Malaysia has a reasonable scope to offer concessions in exchange for bigger concessions from the developed countries. In other words, Malaysia can subscribe to less-than-full reciprocity in a number of areas commensurating with her level of development. In fact, Malaysia has stated to liberalize some of he trade policies (protection policy in particular) as well as her industrial policies (particularly those involving investment incentives and regulations). Such policy reforms themselves can be viewed as a "down-payment" offered by Malaysia in the present MTN which should be credited and reciprocated by the other parties.

As far as Malaysia's strategies in the present MTN is concerned, being a marginal player in the entire exercise, it will be a futile effort if Malaysia were to go alone against the might of the US, Japan and the EEC. Furthermore, Malaysia lacks the necessary experience and expertise for striking hard bargain on its own. Hence, Malaysia needs to approach the round in coalition with other country groupings based on common issues and interests. In this context, Malaysia has the following options.

First, Malaysia has the Group-77 (G-77) option. Being an active member, Malaysia must capitalize on its position to its best advantage by gathering support from the group on her issues of interest in the present MTN.

Second, Malaysia has the Non-Aligned Movement (NAM) and the Association of the Commonwealth Nations to rely on. Within the latter, the role of Britain in most relevant to lend support in some common trade issues, in particular pertaining to the protectionist tendency of the EEC.

Third, Malaysia could rely on foreign investors in the country to lobby on its behalf, their respective home governments. They can enlighten their governments on the potential benefits of liberalized trade and investment regime to all parties.

Fourth, Malaysia should find considerable wisdom in sticking together within the ASEAN for better or for worse. No other grouping can effectively present Malaysia's case across the negotiating table better than ASEAN itself. ASEAN's quest for a regional approach is expected to lead to common positions on a number of key issues. ASEAN countries have proven to be able to work together well in order to chart out strategies to be adopted in the Uruguay round.

With respect to increasing manufactured exports, market intelligence and the export targeting system for the economy should be developed at this transitory stage of export-oriented industrialization. Diversification of industrial productions and export markets will make Malaysia less dependent on her traditional markets of the OECD countries. Similarly, Malaysia is yet to come up with a more comprehensive industrial research and development and technology policies in support of all the other industrial and trade policy measures implemented thus far.

CONCLUSION

All these efforts notwithstanding, Malaysia could not escape from focussing inwards and examining its domestic policies closely with the view of eliminating some serious impediments to her industrial development and trade performance and widening the domestic markets in the 1990s. In this respect, there are rooms for selective import-substitution strategies which should continue to supplement the export-oriented strategies. Aggressive promotion of investment in existing as well as new industries should be carried out.

NOTES

[1] This is largely attributed to the world economic recession and price downfall of Malaysia's major export commodities as well as the domestic structural problems of the economy.

[2] Most western industrialized countries have already completed the second transition; in Asia, only Japan has completed it. The Asian NICs like Taiwan and South Korea, completed the first agro-industrial transition sometimes in the 1970s and now are about in the mid-second transition period. (see Oshima, 1987)

[3] The manufacturing sector is estimated to have expanded by 17.6 percent in 1988 compared with 8.7 percent in terms of real GDP, the highest in this decade.

[4] It may be noted, for example, that in 1982, the free trade zone accounted for more than half of Malaysia's total export of manufactured goods (Warr, 1987).

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