

TAKE AFTA CHALLENGES SERIOUSLY OR LOSE OUT

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To many, January 1, 2002 marked the start of new year, but very few Malaysians realised its other significance, one which inevitably affects the country’s economic and business environment, and hence our livelihood. This is because the date marked the full implementation of the ASEAN Free Trade Area (AFTA) for the six original members of ASEAN comprising Indonesia, Brunei, Malaysia, Philippines, Singapore and Thailand. By now, more than 95 per cent of the products that are traded by the six ASEAN countries have been covered in the AFTA schemes. Common Effective Preferential Tariff (CEPT) is targetted at to 0-5 per cent.

In the case of Malaysia, with a few exceptions, about 96.6 per cent of the products have already been covered, 92 per cent of which are at 0-5 per cent tariff level, while 60.4 per cent are at zero tariff. The average CEPT tariff rates for Malaysia was 2.5 per cent in 2001 and is expected to be reduced to 2.45 per cent this year and 2.07 per cent next year. Compared to other members of ASEAN, with the exception of Brunei and Singapore, Malaysia’s commitment to AFTA has been more advanced in terms of both product coverage and depth of tariff cuts.

The lack of appreciation of the significance of AFTA among local business communities, and more so among the general public, is easily understood. The majority of them still regard AFTA as one of those voluntary and legally non-binding trade agreements such as APEC, in which case Malaysia can easily suspend or even withdraw from the pact without incurring heavy penalties and adverse repercussions.

On this point, they are wrong and grossly misled. The AFTA agreement is a legally binding document. Malaysia has signed, ratified and finally enacted the

agreement into domestic law which is now being enforced in Malaysia. Malaysia cannot easily reverse the process or withdraw from the agreement except for a temporary delay in the inclusion of a product into the scheme or to temporarily suspend its concession on a product which is already being included. Even a temporary delay or suspension of commitment will involve very cumbersome and costly procedures, while the outcome might even be counter-productive giving a bad image for Malaysia as a major trading nation. It would involve compensatory payment to other member countries which have principal or substantial supplier interests in the particular product in ASEAN. If there is no agreement and Malaysia insists on proceeding with the delay or the suspension of the concession, then the other ASEAN member countries with principal or substantial supplier interests are free to retaliate by withdrawing their own concessions.

Another reason for the lackadaisical attitude of Malaysia's business community towards the effect of AFTA has been the often repeated assertion, that if a firm was not affected during the run-up to the AFTA 2002, it would not be affected at all in the post-AFTA era. The basis of the argument is that, *de facto*, Malaysia was already implementing AFTA in the last couple of years as it had more than met the AFTA target in terms of product coverage and the 0-5 per cent terminal tariff. Hence, the firms concerned need not be overly worried over the adverse impact of AFTA, if they had not been affected previously.

Superficially, the argument sounds plausible but one must not be lulled and caught unprepared by a false sense of security. Malaysian products appear to be unaffected and remain competitive vis-à-vis similar products from the other ASEAN countries. There has not been any significant influx of cheaper imports from other ASEAN countries that may cause serious injury to domestic producers of the same products.

There are many explanations for this. First, it normally takes some time for the business communities in the other ASEAN countries to be aware of, and to respond to, the new business and economic environment created by the AFTA process. Production and marketing strategies need time to be rationalised to take advantage of the expanded ASEAN market. For sure, once this transitory phase is

over, we can expect stiffer competition from import from the other ASEAN countries.

Malaysian producers or products may have not felt yet the pressure of competition from other regional producers/products despite the lowering of the CEPT tariff to 0-5 per cent, because they might still enjoy protection in one form or another. There is evidence to show that the average nominal and effective rate of protection of Malaysia's manufacturing sector has increased since the crisis struck the economy. For instance, the overall simple average tariff rate had increased from 8.1 per cent in 1997 to 9.2 per cent in 2001. Overall MFN tariff escalation which measures the effective rate of protection, has been more pronounced in 2001 than it was in 1997.

The number of tariff lines subject to import licensing and restriction also appear to have increased since 1997. Some 27.3 per cent of Malaysia's tariff lines are subject to such import measures compared with only 17.0 per cent in 1997. These measures are most pervasive in wood and wood products (involving 11.3 per cent of Malaysia's total tariff lines), animal and animal products, vegetable products, tropical fruits, rice products and transportation equipment (notably automobiles).

This implies that Malaysian manufactures still enjoy increasingly high MFN tariff protection, duty-free import of their intermediate and capital requirement, subsidised and cheaper fuel inputs, low and preferential cost of funds mainly due to a more relax monetary policy, and an array of increasing quantitative import restrictions.

Under these conditions, it is possible that the high implicit protection accorded to the Malaysian manufacturers is cushioning the adverse impact of the AFTA implementation, if there is any.

However, this situation may not last much longer. Under the CEPT agreement, all quantitative restrictions will have to be eliminated immediately upon enjoyment of the CEPT preferences, and all non-tariff barriers (NTBs) will have to be abolished in stages within five years of the CEPT implementation. This means

that all trade measures that limit and/or distort trade, which include among others quota, import licensing, and production subsidies, will have to be abolished. And going by the strict definition of the NTBs, even domestic price controls currently being enforced by the Ministry of Domestic Trade and Consumer Affairs, too, will have to be discontinued.

One wonders how our competitiveness would be affected, once all aspects of the CEPT agreement have been fully implemented. Withdrawal of subsidies, particularly those involved in the pricing of fuel, will increase the cost of energy to industries. Those industries that are energy-intensive will experience an increasing cost of production and hence, other things remaining the same, an erosion in their competitiveness.

Similarly, we would expect stiffer competition resulting from the full liberalisation of other forms of import restrictions and NTBs. Given that the products are currently being protected by such measures as indicated above, and are produced domestically at a much higher cost of production, we can expect that the latter would be adversely affected, unless strategic mitigating measures are taken by the producers concerned. Among the products involved are unprocessed agricultural products (particularly rice, poultry, tropical fruits and vegetables) which are categorised as sensitive products in the CEPT scheme, wood and wood products, and automotive products.

Given the seriousness of the AFTA impact, the initial years of AFTA's implementation are the most opportune time for members of the local business communities to monitor closely its impact and to adopt the most appropriate strategies. There are many ways of doing it but the most basic ones are as follows.

First and foremost, they need to thoroughly examine and assess the likely impact of AFTA on all aspects of their activities. The latter include their product composition, input and cost structures, product lines and processes, etc. It is theoretically possible that the AFTA process would cause their products to be uncompetitive, the cost of production to increase due to, say, withdrawal of

subsidies on some of the inputs; or certain process or activities to be too costly to operate locally.

There are many ways to respond to the problem. One may undertake (a) upgrading of the products and processes, (b) shedding off of unprofitable products, processes or activities, (c) relocating costly products, processes and activities to a more profitable and competitive location within the country or in other ASEAN countries, and (d) forming strategic alliances with other ASEAN businesses taking advantage of the ASEAN Industrial Cooperation and the ASEAN Investment Area programme.

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