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## EU-Malaysia Trade Talks: No End in Sight

by Giuseppe Spatafora

In March 2017, negotiators from the European Union and Malaysia agreed to resume talks for a free trade agreement (FTA). Despite the confidence displayed by the two delegations, there is limited hope for rapid progress, as the problems that caused a breakdown in talks back in 2012 remain unresolved today. Six months since the announcement, negotiations have not started and the objective of concluding the agreement by the year's end appears increasingly unlikely.

Negotiations for a Malaysia-EU Free Trade Agreement (MEUFTA) were first launched in 2010, born out of the failed attempt to negotiate a region-to-region trade deal between the EU and the Association of Southeast Asian Nations (ASEAN). For Malaysia, MEUFTA represents a great opportunity to ease access to its third largest trading partner, accounting for 9.8 percent of Malaysia's total external trade in

2016.<sup>1</sup> Putrajaya<sup>2</sup> runs a trade surplus with Brussels, to which it exports machinery and equipment, as well as commodities like palm oil, rubber and timber. Industrial products also dominate the EU's exports to Malaysia, its second largest trade partner in ASEAN and twenty-second worldwide. But Malaysia's true attractiveness for Europe lies in the business sector: its strategic position at the centre of Southeast Asia, the relatively skilled but cheap workforce and the widespread use of English make Malaysia a highly competitive hub for the provision of goods and services to the entire ASEAN region.<sup>3</sup>

<sup>1</sup> European Commission, European Union, *Trade in Goods with Malaysia*, updated 3 May 2017, <http://trade.ec.europa.eu/doclib/html/113416.htm>.

<sup>2</sup> While Kuala Lumpur is the official capital of the Federation of Malaysia, Putrajaya is the administrative capital and seat of the Government.

<sup>3</sup> Anne Pollet-Fort, "Economic and Trade

*Giuseppe Spatafora is MPhil Candidate at the Department of Politics and International Relations, University of Oxford. He has been Intern in the Asia Programme (January-April 2017) at the Istituto Affari Internazionali (IAI) and at the Institute of Strategic and International Studies (ISIS) Malaysia in Kuala Lumpur (June-August 2017).*

Talks were subsequently put on hold in 2012, after the parties were unable to find a compromise. The EU had requested a large liberalization of the service sector, the removal of caps on foreign equity holdings, clear rules on government procurement and intellectual property rights: in short, the EU followed the deep-trade agenda announced in the Global Europe communication (2006) *ad litteram*.<sup>4</sup> Malaysia, on the other hand, refused several EU requests, demanding concessions and exceptions that reflected the different levels of development between the two parties. On top of these negotiation disparities, the combination of Malaysia's 2013 elections and the parallel rise of the US-driven TPP negotiations encouraged the parties to interrupt negotiations.

The Malaysian cabinet therefore decided to transfer its efforts to the TPP. While still significant, the liberalization requirements contained in the TPP are not as stringent as those demanded by Brussels. In order to have developing countries like Vietnam, Peru, Chile and Malaysia on board with the TPP, the US needed to allow some concessions. In bilateral negotiations, however, the EU could exploit its stronger bargaining power to demand higher standards.

Cooperation between the European Union and Malaysia", in Christoph Marcinkowski, Constance Chevallier-Govers and Ruhana Harun (eds.), *Malaysia and the European Union. Perspectives for the Twenty-First Century*, Zürich-Berlin, Lit, 2011, p. 79-110.

<sup>4</sup> European Commission, *Global Europe: Competing in the World* (COM/2006/567), 4 October 2006, <http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52006DC0567>; Billy Alexis Melo Araujo, *The EU Deep Trade Agenda. Law and Policy*, Oxford, Oxford University Press, 2016.

These differences are evident in the negotiations regarding Malaysia's government procurement contracts: in the TPP, Putrajaya could secure a high liberalization threshold below which it could maintain its current legislation which favours ethnic Malays. The EU negotiating team, on the other hand, refused the same threshold on the grounds that it would not benefit European small and medium enterprises (SMEs) working in Malaysia and throughout Southeast Asia.<sup>5</sup>

In early 2017, the TPP gone or, at best, significantly re-dimensioned, contacts between the EU and Malaysia resumed. Yet, those same issues that led to a suspension of talks in 2012 are still present today, rendering rapid progress in the negotiations unlikely. While Malaysia concentrated its efforts on the TPP, the EU moved to complete two FTAs with Singapore (2015) and Vietnam (2016). These agreements are viewed in Brussels as models and benchmarks for further talks with other ASEAN members. The rationale is understandable: if a less-developed country like Vietnam agreed to a more comprehensive trade agreement than the TPP, covering government procurement, state-owned enterprises and intellectual property rights, why should Malaysia refuse a similar agreement?

To be fair, between 2009 and 2010, Malaysia did adopt an important policy

<sup>5</sup> Firdaos Rosli et al., *National Interest Analysis of Malaysia's Participation in the Trans-Pacific Partnership*, Kuala Lumpur, Institute of Strategic and International Studies (ISIS) Malaysia, 2015, [http://fta.miti.gov.my/miti-fta/resources/ISIS\\_The\\_Grand\\_Finale.pdf](http://fta.miti.gov.my/miti-fta/resources/ISIS_The_Grand_Finale.pdf).

of liberalization and divestment in light of its Economic Transformation Programme. The government also lifted caps on foreign ownership in 27 service sectors, including manufacturing. Yet, European negotiators argue that significant restrictions remain in target sectors such as real estate, telecommunications and financial services. Without a significant lifting of Malaysia's restrictions on foreign ownership in these sectors, Brussels's expected gains from the FTA would be negligible, studies claim.<sup>6</sup>

The main bone of contention remains the opening of government procurement bids to foreign companies. Most government-tendered projects require companies submitting tenders to be owned by *bumiputera*, that is, ethnic Malays or indigenous groups. Foreign tenders are accepted mostly when local expertise or resources are unavailable. The *bumiputera* requirement is a cardinal part of Malaysia's economic and development policies since the 1970s, and the government is unwilling to rescind it because it secures the support of the Malay majority in an ethnically mixed Malaysia (60 percent of the population is ethnic Malay and Muslim, while 23 percent are Chinese and 7 percent Indian).

Yet, the only realistic way that Malaysia can get political support in the EU for a highly beneficial FTA is by reforming its *bumiputera*-based system and allow for sweeping liberalization. If Malaysia does not secure privileged

access through a FTA to its third largest trade partner, other countries will do so instead. European businesses may eventually relocate their offices to Vietnam, a competitor of Malaysia with a concluded FTA with the EU. Others, like Indonesia and the Philippines, could soon follow suit.

Conversely, Putrajaya is asking the EU to grant unimpeded access to its commodities. Palm oil exports are a particularly hot issue in this context. Palm oil is among Malaysia's twelve National Key Economic Areas (NKEAs) that are meant to propel the country to a high-income status by 2020. Although Malaysia joined the Roundtable on Sustainable Palm Oil (RSPO) and has taken important steps towards curbing unsustainable expansion of palm plantations, authorities feel threatened by the EU's increasingly stringent legislation on biofuels. Last April, the European Parliament voted overwhelmingly to ban biofuels made from vegetable oils including palm oil by 2020,<sup>7</sup> following a similar announcement by France. Malaysia, together with Indonesia, even threatened to file a complaint with the World Trade Organization, citing discriminatory treatment.<sup>8</sup>

Current circumstances, therefore, are evidently not favourable to the resumption of negotiations. With new

<sup>6</sup> Christopher Napoli, "The Political Economy of an EU-Malaysia FTA", in *Journal of Southeast Asian Economies*, Vol. 30, No. 2 (August 2013), p. 213-227.

<sup>7</sup> European Parliament, *MEPs Call for Clampdown on Imports of Unsustainable Palm Oil and Use in Biofuel*, 4 April 2017, <http://www.europarl.europa.eu/news/en/press-room/20170329IPR69057>.

<sup>8</sup> "Malaysia, Indonesia to Counter EU Decision to Ban Palm Oil-based Biofuel", in *The Star Online*, 16 July 2017, <http://po.st/phoWbA>.

parliamentary elections scheduled in Malaysia for 2018, a similar conjuncture to 2012 is likely, with trade policy being halted due to its electoral sensitivity. Furthermore, EU-Malaysia trade has not suffered from the absence of a FTA, growing at a low but steady pace. The lengthy process of ratification at the EU level does not help either. The 2015 EU-Singapore FTA has yet to enter into force, pending ratification by European national parliaments. Why bother negotiating a deal, if the parties have to wait so long to actually enjoy the benefits?

All in all, the announcement made in March may have been too hasty: even if negotiations do resume before the end of 2017, there is no hope for a swift conclusion of the MEUFTA. Differences remain and the political climate in both Europe and Malaysia is not helping. The road ahead is still long and tortuous, yet the prospect of a Malaysia-EU FTA does provide significant benefits to both parties, especially Malaysia. Negotiators will therefore have to balance expectations with the deep political sensitivities surrounding trade liberalization, seeking a middle ground that is unlikely to be reached under a rushed timetable with largely arbitrary deadlines.

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Via Angelo Brunetti, 9 - I-00186 Rome, Italy

T +39 06 3224360

F + 39 06 3224363

[iai@iai.it](mailto:iai@iai.it)

[www.iai.it](http://www.iai.it)

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