Dossier on Preferential Trade Agreements

January 2008
(Vol. II, No. 1)

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1. Pakistan-Malaysia FTA to be operational

Pakistan and Malaysia have entered into a free trade arrangement (FTA) from today under the Malaysia-Pakistan Closer Economic Partnership Agreement (MPCEPA) 2008-2014. Pakistan has announced customs duty reductions on the import of 5,921 items under a tariff reduction schedule spanning 2008-2014 and has also come up with rules of origin for goods to facilitate the proper conduct of bilateral preferential trade under the agreed framework.

The agreement is an initiative by the government of Pakistan to secure a market for its exportable products in Malaysia and deepen its economic and trading relationship with an important member of the region. While Pakistan's duty reduction schedule on goods covers 23 percent of its current imports from Malaysia, Malaysia will eliminate tariffs on 78 percent of imports from Pakistan. The Pakistan-Malaysia FTA is the first bilateral FTA between two members of Organisation of The Islamic Conference (OIC).

This agreement is Pakistan's first comprehensive FTA incorporating trade in goods, trade in services, investment and economic co-operation and Malaysia's first bilateral FTA with any South Asian country. This agreement shall provide a strong foothold to Pakistan in the ASEAN region and help Pakistan achieve a summit level partnership with ASEAN. The Agreement will enable Pakistani core exports to compete with those from ASEAN on equal terms in the Malaysian market

Through the Agreement the two countries have provided WTO plus market access to each other in services trade. Mutual recognition agreements (MRAs) are also part of the Agreement. These MRAs will pave the way for effective and efficient delivery of services, especially in fields such as higher education, health etc.

CUTS Comments *A Joint Study Group (JSG) was set up in March 2005 to explore the feasibility of the Comprehensive Economic Cooperation Agreement (CECA) between India and Malaysia. The JSG is yet to submit its report despite having met four times and gone through several inter-sessional exchanges of drafts.*

Malaysia has taken a tough stand on India's negative list which includes Malaysia's most important export item, palm oil. The Indian government also has its compulsions. India is a big importer of vegetable oils and its opening up (eliminating tariffs) to palm oil imports would pose a serious threat to millions of poor Indian farmers who still grow oilseed crops. The same issue is also delaying the signing of the India-ASEAN FTA.

Pakistan, thus, has gained a trading advantage over India by signing and implementing the CECA with Malaysia (in accordance with its "Vision East Asia" policy, very similar to India's "Look East Policy") and has consolidated its position in the Malaysian market. An FTA with Malaysia implies that Pakistani exports might be diverted from India to Malaysia because of the tariff reduction on these exports which has made Malaysia a more attractive destination. This increase in attractiveness might more than overwhelm factors such as savings in terms of time and transport cost which give India an advantage as a destination for Pakistani exports.

Pakistan exports to Malaysia many commodities like rice,wheat, fish and fish preparations made-up articles of textile materials, synthetic fabrics, cotton yarn etc. where it will now gain an advantage over India (as India currently exports similar commodities on WTO bound tariffs). In some export commodities India is more competitive than Pakistan and this competitive advantage might be reversed by the Malaysian CECA with Pakistan which will thus create some diversion of Malaysian imports from India to Pakistan.. The signing of CECA by Pakistan with Malaysia (and in due course with other ASEAN countries) will thus hurt Indian exports to some extent till such time that India also signs such an agreement with Malaysia or with ASEAN. India's exports are just one-fourth of its imports from Malaysia; with the CECA the trade deficit might widen.

Pakistan and Malaysia through this comprehensive FTA have incorporated services trade which will allow Pakistan to supply labour, both skilled and semi skilled, to Malaysia which is facing an acute shortage of such labour.Though India's services trade with Malaysia is not important currently, however, the FTA between Pakistan and Malalysia has given the former first mover advantage to shut out entry by Indian labour into the Malaysian market even if a FTA between Malaysia and India is negotiated in the future.

2. Malaysia-US FTA talks resume

The US and Malaysia are going to resume their talks for negotiating an FTA in January, 2008 and are expected to finalise the deal by the middle of this year. The last round (the fifth) between the two countries ended in a deadlock in February last year.

Though both sides are enthusiastic to strike a deal for a FTA, the Malaysian domestic civil society groups have been claiming from the very beginning that such an agreement would harm Malaysia. According to these groups, analyses of past FTAs involving a developing country and the US indicate that this agreement will bring fundamental changes to Malaysia's socio-economic priorities and policies, leaving Malaysia a the net loser.

<u>CUTS Comments</u> *The US-Malaysia FTA might affect India largely in non-agricultural commodities, which are being exported by India to Malaysia. These Indian exports might be replaced by US exports and to that extent India would lose the Malaysian market. By becoming more efficient through technological improvements and trade facilitation India can to some extent mitigate such adverse effects till such time that India and Malaysia finalise a FTA agreement. India has signed an investment incentive agreement (on reciprocal basis) in 1997 (still in force) with US ,with the intent of the agreement being to promote and protect US investments into India by facilitating investment support to US investors from Overseas Private Investment Corporation (OPIC).*

Both India and US are currently busy exploring the possibility of negotiating a bilateral investment agreement. The US-Malaysia FTA is yet to be signed and without knowing fully the provisions of the agreement it is difficult to derive any conclusions a priori for the direction and magnitude of US investments. However, some diminution of U.S. investment in India as a result of the Malaysia-U.S pact is a possibility.

3. Sri Lanka negotiates more trade, investment deals

Sri Lanka is currently actively engaged in negotiating more free trade and investment deals with some key countries, from within and outside the region with an objective to enhance its trade and investment. Already two rounds of talks have been held in January with neighbouring India and Pakistan for free trade and investment agreements.

Sri Lanka has recently concluded an investment promotion and protection agreement with Kuwait on January 30. An agreement of a similar nature is expected to be signed soon with Jordan.

With India the 11^{th} round of technical level negotiations were held for proposed India-Sri Lanka Comprehensive Economic Partnership Agreement (CEPA) during 2-4 January, while the second review meeting of Pakistan-Sri Lanka free trade deal and first round of technical level talks on a Comprehensive Economic Cooperation Agreement (CEPA) took place during January 24-25 in Colombo.

In order to provide a congenial and conducive legal environment for foreign capital inflows into the country, the Sri Lankan government has negotiated over 26 investment promotion and protection agreements with several countries both within and outside the region during the last few months.

<u>CUTS Comments</u> *Sri Lankan efforts to sign more investment promotion and protection agreements with a large number of countries both within and outside the region would not only improve its investment climate and make foreigner investors more confident and secure in Sri Lanka but would also certainly bring much needed foreign capital into\the country. India and Sri Lanka already have a FTA agreement in force and are currently negotiating for a CEPA. Both countries would gain from such an agreement. There is a possibility of Indian investment getting crowded out because of more market competition generated by investment from other countries facilitated by agreements. However, one will have to awiat the details of the agreements.*