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MALAYSIA

OECD finds serious flaws in seemingly negative TPPA impact study on Malaysia

In a report by Rashmi Banga ("the Banga report"), a researcher with the Centre for WTO studies at the Indian Institute of Foreign Trade, the author argues that Malaysia will lose out to other TPPA member countries. This is based on her claims that the domestic value-added content of Malaysian exports to many other TPPA members will decline.

The Banga report is dependent heavily on the database compiled by OECD-WTO. In a written communication with Malaysia's Ministry of International Trade and Industry (MITI), the Organization of Economic Cooperation and Development (OECD), which is the owner of the database, has strongly disputed the findings and conclusions of the Banga study.

MIDF Research, in its report "More considerations will show a better perspective of TPPA impact on Malaysia's domestic value-add" dated 29 October 2014, has also pointed out the significant gaps and shortcomings of the Banga report which have led to its distorted conclusions. In particular, MIDF Research highlighted its reservations on the appropriateness of the data that was being used and argued that more considerations are needed to give a better, fairer and more complete perspective of the TPPA.

This report further highlights the flaws of the Banga study. This is based on the OECD communique dated 20 November, 2014 which MIDF Research has been granted access to by MITI. The communique was authored by Mr Nadim Ahmad, the Head of Trade and Competitiveness Statistics Division, the Statistics Directorate, OECD, which is based in Paris.

In its damning verdict on the Banga report, the OECD communique pointed out three "fatal" flaws in the approach and analysis which render any conclusion or findings of the report unreliable, misleading or simply wrong. These serious shortcomings are:

1. The Banga report has misinterpreted the OECD-WTO database;
2. The methodology of choice is likely to be wrong;
3. The Banga report reflects an incomplete understanding and analysis on global value chain inter-linkages.

We elaborate each shortcoming below.

FLAW #1: MISINTERPRETATION OF THE OECD-WTO DATABASE

The OECD has clarified that the Banga report has wrongly interpreted the trade in value added (TiVA) database compiled jointly by the OECD and World Trade Organization. Due to the fatal misinterpretation of the database, the OECD has stressed that any analysis would be flawed regardless of the analytical model employed. For example, one of the Banga report's central arguments is that the domestic value add (DVA) of Malaysia's exports has been on a downward trend, even before TPPA. However, the fact is that based on the latest data available on the TiVA database, the DVA of Malaysia exports in 2009 was 62%, higher than the 58% in 2005 and 60% in 1995.

According to the OECD, the main reason for the mistake is that the Banga report has wrongly derived the DVA content of Malaysia's exports to the respective TPPA members, vice-versa.

For example, the Banga report claims that the DVA of Malaysia's exports to the US had fallen from 65% in 1995 to 42% in 2009 (that is, for every US$100 earned from exports to US, only US$42 stays in the country and contributes to Malaysia's GDP). In actual fact, the OECD pointed out, its database shows that the ratio had risen, albeit marginally from 56% in 1995 to 58% in 2009. The same mistake has also been detected in calculating the DVA content of US export to Malaysia. The Banga report claims that the ratio had increased from 85% in 2005 to 89% in 2009. In actual fact, the actual data presented by the OECD shows that the ratio had hardly changed from 90% in 1995 to 89% in 2009.

Table 1: Malaysia's Domestic Value Added Content of Exports to 10 TPPA* partners, %

	1995	2009	2009 (as derived by Banga report)
Australia	61	68	74
Canada	50	56	75
Chile	52	64	30
Japan	62	70	45
Mexico	49	50	92
New Zealand	61	64	76
United States	56	58	42
Brunei Darussalam	63	66	89
Singapore	58	61	71
Vietnam	63	65	77
World	60	62	62

*Source: OECD-WTO TiVA, Banga (2014). *Peru is not included due to lack of data.*

In general, the DVA content of Malaysia's exports to TPPA countries was actually much lower than what the Banga report has estimated. Meanwhile, only Canada and Brunei Darussalam have reported increases in the DVA content ratio in their exports to Malaysia. These evidences are not strong enough for the Banga report to make an assertion that Malaysia's DVA exports to TPPA members have already been on a steady decline while that of TPPA members to Malaysia have been rising.

Table 2: Domestic Value Added Content of Exports by 10TPPA* members' to Malaysia

	1995	2009	2009 (as derived by Banga report)
Australia	86	85	66
Canada	75	82	58
Chile	85	75	48
Japan	93	83	85
Mexico	74	59	-
New Zealand	83	81	74
United States	90	89	89
Brunei Darussalam	68	86	-
Singapore	47	44	64
Vietnam	78	70	70

*Source: OECD-WTO TiVA, Banga (2014). *Peru is not included due to lack of data.*

FLAW #2: CHOICE OF METHODOLOGY IS LIKELY TO BE WRONG

The Banga report employs the gravity model and dismisses the conventional and more commonly used Computable General Equilibrium (CGE) modelling. According to the OECD, there is not enough documentation to justify the shortcomings of CGE modelling. The organization stated that while every model has its limitations, the Banga report's documentation of the limitations is not sufficient.

In addition, the OECD finds the Banga report's choice of the gravity model rather contentious. The OECD argues that the application of gravity model to analyze DVA is inappropriate. This is due to the fact that DVA consists of both direct (produced by the exporters themselves) and indirect (produced by the suppliers). Those indirect effects are less affected by variables often used in traditional gravity model analysis such as GDP and geographical distance.

The OECD finds a big gap in the gravity model's explanation on why it has estimated a significant drop in the DVA content of Malaysia's exports and an even bigger drop in that of the US, post-TPPA. The gravity model estimated that the DVA content of U.S exports to the rest of the world dropped significantly to 51% in 2013. This implies a sharp drop from 88.7% in 2009, based on the OECD-WTO latest TiVA database. According to the OECD, for such a significant decline to have happened, the U.S must have experienced "the most significant structural change in history", something that would not have gone unnoticed by the U.S government. The OECD stated that even China, which had undergone big structural economic changes, including trade openness, did not experience a decline in DVA at the scale implied by the gravity model.

FLAW #3: INCOMPLETE UNDERSTANDING AND ANALYSIS ON GVC INTER-LINKAGES

The OECD argues that with Global Value Chain (GVC), the rise and fall of DVA matters less to countries. What is critical is creating a niche along the GVC. In dealing with DVA and global value chain analysis, it is more relevant to investigate the performance of those exports that are part of the GVC in terms of volume and whether the country manages to capitalize on GVCs by identifying comparative advantages and embracing specialization. The OECD cites the cases of Korea and China where DVA of theirs exports had trended lower but the volume increases because of their ability to specialize.

China is the only country in the TiVA database to which Malaysia's exports had showed significant decline in its DVA content, from 68% to 56% over the period 1995 – 2009. This reflects in large part, China's integration into the electronic value chains and in turn, Malaysia's integration into that chain too, with electronics making up 40% of Malaysia's DVA exports to China.

MIDF Research reiterates its view that any impact study on TPPA should be more comprehensive, covering the impact on investment, the services sector and the impact of Malaysia's integration into the GVC. The impact study should also analyze the net impact of Malaysia NOT joining TPPA, whether it will just be an opportunity lost to have greater access to the U.S markets, or cause Malaysia to lose market shares in other export markets. Notwithstanding that, any impact study of the TPPA will be **conjectural** at best, given that the agreement is still being negotiated behind closed doors.

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