TRADE LINKAGES BETWEEN MALAYSIA AND THE OIC MEMBER COUNTRIES: AN EMPIRICAL ANALYSIS ON PATTERNS, DETERMINANT FACTORS, AND PROSPECTS

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By

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ABSTRACT

International trade has always been playing a crucial role in the process of growth and development in Malaysia. This research attempts to analyze trade relations between Malaysia and The Organization of Islamic Cooperation (OIC) member countries for the period of 1997 to 2009. It is specifically aims to evaluate Malaysia-OIC trade pattern, identifies their determinants, and evaluate their future prospects. Towards these aims, the indirect quantitative analysis method and the panel data analysis using the gravity model of trade, exports, and imports are employed. The analysis of trade pattern reveals that the OIC countries have not used all their potential and resources available to establish a strong and effective intra-OIC trade. The gravity model estimates imply, among others, the importance of size effects, level of development, level of openness, and the FDI inflows in determining trade flows between Malaysia and the OIC member countries. The major determinants of Malaysia's exports to OIC are the size of the economies, level of openness of the economy, inflation rates, and the exchange rates. On the other hand, distance factor is not significantly influence Malaysia's imports whereas institutions is empirically proven to be a major determinant for the Malaysia-OIC of trade, exports, and imports. Findings from the aforementioned analyses are then to be constructed by employing the SWOT analysis to investigate future prospects of trade relationship between Malaysia and the OIC member countries. Based on the findings, some policy issues are highlighted and policy recommendations are developed, such as on fostering greater engagement with the OIC member countries in the African region, accelerating the effort to establish the Islamic Common Market (ICM), liberalizing the economy further, improving strategic sectors such as the Islamic Banking and Finance, and intensifying endeavors in curbing corrupt practices.

Keywords: International Trade, Gravity Model, Panel Data, Malaysia's Trade

ABSTRAK

Perdagangan antarabangsa telah memainkan peranan yang penting dalam proses pertumbuhan dan pembangunan di Malaysia. Kajian ini bertujuan untuk menganalisis hubungan perdagangan di antara Malaysia dengan negara-negara Pertubuhan Kerjasama Islam (OIC) bagi tempoh 1997 hingga 2009. Secara khususnya, kajian ini cuba untuk menilai corak perdagangan Malaysia-OIC, faktor-faktor penentunya, dan menilai prospek masa hadapan perdagangan Malaysia dengan Negara OIC. Metodologi yang digunakan adalah analisis kuantitatif tidak langsung dan analisis data panel bagi model graviti perdagangan, eksport, dan import. Analisis corak perdagangan menunjukkan bahawa negara-negara OIC tidak menggunakan sepenuhnya potensi dan sumber yang ada untuk mewujudkan perdagangan intra-OIC yang lebih kukuh dan efektif. Anggaran daripada model graviti mendapati bahawa antara faktor penentu kepada aliran perdagangan Malaysia-OIC antaranya ialah kesan saiz, tahap pembangunan, tahap keterbukaan, dan kemasukan FDI. Penentu utama bagi eksport Malaysia ke OIC pula ialah saiz ekonomi, tahap keterbukaan ekonomi, kadar inflasi, dan kadar matawang. Dalam pada itu, faktor jarak adalah tidak signifikan dalam mempengaruhi import Malaysia manakala institusi pula adalah faktor penentu utama kepada perdagangan, eksport, dan import Malaysia-OIC yang telah dibuktikan secara empirikal. Hasil dapatan daripada analisis-analisis ini digunakan untuk menganalisis prospek hubungan perdagangan di antara Malaysia dengan negara-negara OIC melalui analisis SWOT. Berdasarkan kepada dapatan kajian, beberapa isu polisi diketengahkan dan beberapa cadangan polisi dibentuk, antaranya ialah perlunya meningkatkan hubungan dengan Negara OIC di benua Afrika, meningkatkan usaha untuk mempercepatkan penubuhan pasaran Islam bersama (ICM), meliberalisasikan ekonomi dengan lebih lanjut, memfokuskan kepada sektor-sektor strategik seperti perbankan dan kewangan Islam, dan mempergiatkan lagi usaha untuk membenteras gejala rasuah.

Katakunci: Perdagangan Antarabangsa, Model Graviti, Data Panel, Perdagangan Malaysia

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LIST OF ABBREVIATIONS

AFTA – ASEAN Free Trade Area

APEC – Asia-Pacific Economic Cooperation

ASEAN – Association of Southeast Asian Nations

BNM – Bank Negara Malaysia

BO – Business Opportunities

CARSICM – Center of Advanced Research & Studies of the Islamic Common Market

CIA – Central Intelligence Agency

COMCEC – Standing Committee for Economic and Commercial Cooperation of The Organization of Islamic Cooperation

CM – Common Market

CU – Custom Union

DOTS – Direction of Trade Statistics

EMU – Economic Monetary Union

EPP – Entry Point Projects

ETP – Economic Transformation Programme

EU – European Union

FDI – Foreign Direct Investment

FTA – Free Trade Agreement

GCC – Gulf Cooperation Council

GTP – Government Transformation Programme

ICM – Islamic Common Market

IDB – Islamic Development Bank

IMD – Institute for Management Development

IMF – International Monetary Fund

KPI – Key Performance Indicators

LAS – League of the Arab States

LDC – Least Developed Country

MENA – Middle East and North Africa

MI – Middle-Income

MITI – Ministry of International Trade and Industry

NAFTA – North American Free Trade Agreement

NEM – New Economic Model

NKEA – National Key Economic Area

NKRA – National Key Result Area

NTP – National Transformation Policy

NVP – National Vision Policy

OE – Oil-Exporting

OIC – Organization of Islamic Cooperation

OPEC – Organization of Petroleum Exporting Countries

PPP – Public-Private Partnership

PTA – Preferential Trade Agreement

SESRTCIC – Statistical, Economic, and Social Research and Training Centre For Islamic Countries

SME – Small Medium Enterprise

SRI – Strategic Reform Initiative

TC – Transition Countries

TPS-OIC – Trade Preferential System – Organization of Islamic Cooperation

UAE – United Arab Emirates

UDEAC – Central African Customs and Economic Union

UN – United Nations

UN COMTRADE – United Nations Commodity Trade Statistics Database

WDI – World Development Indicators

WIEF – World Islamic Economic Forum

WTO – World Trade Organization

10MP – 10th Malaysia Plan

CHAPTER ONE

INTRODUCTION

1.1 Background

International trade has always been playing a crucial role in the process of growth and development in Malaysia, especially in transforming the economy from a low income to upper-middle income category. In 1992, Malaysia has achieved an upper-middle income status from low income economy. The significant role which trade has played in transforming the Malaysian economy can be seen primarily in the ratio of exports to gross national product (GNP) from 1965 to 1996, where it has increased from 48.2 per cent to 100.3 per cent (Ariff, 1998).

Low income country, according to the World Bank's definition, is a country of having a per capita gross national income (GNI) in the year 2005 of USD875 or less; while upper-middle income country is between USD3,466 and USD10,725 (Todaro and Smith, 2009). In line with the 1993 System of National Accounts (SNA), the World Bank has replaced the gross national product (GNP) terminology or concept into the new one called gross national income (GNI). GNI is defined as the total output of both domestic and foreign claimed by residents of

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