



Worth Noting

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Worth Noting is the journal of research and conferences company L21. It is focused on issues of relevance and interest to senior executives.

Remember relations with Malaysia? Remember the irascible Dr. Mahathir and his feud with our prime ministers from Hawke to Howard? Things always appeared like they were going from bad to worse.

In 1986, Prime Minister Hawke labeled the execution of two convicted Australian drug smugglers in Malaysia as a 'barbaric' act. Then in 1993, a new low point was established when Prime Minister Keating labeled then Malaysian leader Dr. Mahathir 'recalcitrant' for boycotting the inaugural Asia-Pacific Cooperation Forum. Dr. Mahathir responded with a sustained attack on Australia and our various policies that has lasted up till the time of his retirement in 2003.

The attack from the Malaysian side has been a wide ranging one: accusations of Australians being 'racist' during the rise of Pauline Hanson; continual accusations of Australian culture being 'lazy' and 'indulgent'; and periodic accusations that Australians have 'neo-colonialist' designs in the region.

This has caused Australians themselves to either reflect awkwardly on how we have managed to offend Dr. Mahathir or else go right back on the attack against a man who has been called by commentators here as the 'despot of S.E. Asia'.

In summarizing negative attitudes toward Australians by Malaysians, a couple of Malaysian commentators perceive four stages that have damaged Australian-Malaysian relations:¹

¹ Drs. Siva Muthaly & Janek Ratnatunga.

1. The Drug Traffickers Phase (Hawke)
2. The Recalcitrant Phase (Keating)
3. The Racist Phase (Hanson)
4. The 'Deputy Sheriff Phase' (Howard – referring to Howard's characterization of Australia as America's 'Deputy Sheriff' in the region.)

However, in a strikingly short space of time, things seem to be changing. In July last year, the two trade ministers from the respective countries met and agreed to conduct a 'Scoping Study' into a possible Free Trade Agreement (FTA) between the two countries. In terms of economic symbolism, a FTA is about as close as two countries can get.

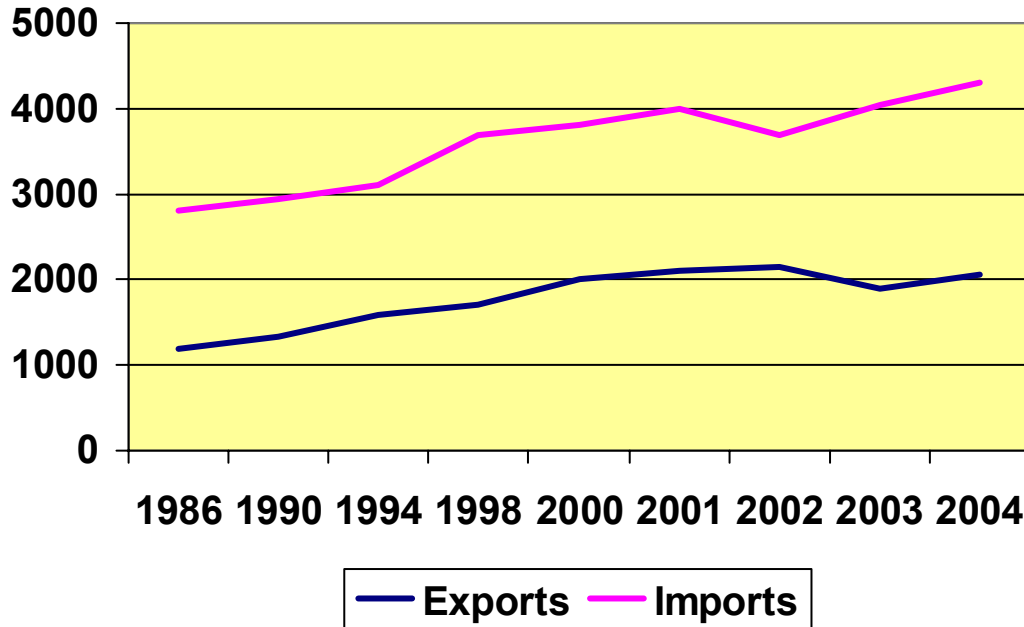
To many, this seems remarkable. How have we come so far in our relations in so short a space of time? What has changed to make this possible?

In this edition of Worth Noting, we will look at why these two countries are interested in moving closer together even though it seemed so unlikely not too long ago.

Political statements do not always match economic reality

There is the frequent assumption that political statements indicate the general state of affairs between two countries. This is frequently not true and is certainly not true when one considers the trade patterns between Australia and Malaysia.

Australian Trade with Malaysia: Exports and Imports, 1986-2004
(\$millions Aust)



Source: DFAT; ABS

The basic story is that trade remained largely unaffected notwithstanding what Dr. Mahathir and various Australian Prime Ministers have said about each other. It is almost inevitable that the two countries would discuss closer formal trade relations given this trend. Hence, there is strong argument here that nothing changed leading up to present discussions about a FTA.

Moreover, when you look at the so-called four phases of animosity between the two countries, they can largely be easily dismissed as instances of political grandstanding or personal animosities that are not serious enough to threaten billions of dollars of trade.

For example, Hawke's comment about the 'barbaric' act of hanging the two Australian drug traffickers clearly did not affect the enthusiasm for the Australian-Malaysia Business Council which was actually set up in 1986, the same year Prime Minister Hawke made his 'barbaric' comment. Keating's comment about Mahathir being 'recalcitrant' seem to genuinely strike a raw nerve with the Malaysian leader but once again, trade relations between countries are more pragmatic than to allow a spat between leaders have too much effect. The rise of Hanson did trigger some genuine alarm in ordinary Malaysians but Hanson was never truly successful and Mahathir made more noise about her emergence than was due for reasons of his own political standing.

Finally, some believe that Howard's 'Deputy Sheriff' comment could have had wider ramifications for bi-lateral relations since this involved a statement of fundamental foreign policy. However, although not sensitively phrased, such a comment signals no genuine change in Australia's role in the region for the last two decades. There is unstated acceptance of U.S. influence in the region as stabilising and perhaps even desirable given that emerging China is perceived to be a greater threat than the U.S. by S.E. Asian nations. Moreover, Australia has always been the clear ally of the U.S. in this region. Howard's phrase was therefore perhaps a more unfortunate way of saying something which is known and accepted anyhow rather than expressing anything new.

But the question still remains. Trade relations between Australia and Malaysia have always been strong. But why are there official moves toward a FTA now? Something must have changed.

Correct Political Conditions

There are several things that have happened in the past year which have made the conditions much more favourable for an FTA. Even though free trade agreements are largely about trade – that seems obvious – the conclusion of one is also about political intent and relations, and the statements they make.

Bi-lateral relations between countries can go along for years where trade strengthens, tariffs in particular industries are lowered, and individual agreements are concluded here and there. These might fill up one paragraph in the third page of the Business Section.

A FTA is really just a set of agreements on trade that can encompass as much or as little as the countries want. However, once you start talking about FTAs, not only do they tend to be more comprehensive but they also make a statement about the optimism of economic and political relations between two countries. FTAs attract much fanfare. The leaders of the two countries meet publicly, shake hands, make speeches about how important the other country is to each other, release lots of media releases about why the FTA is important, return to their countries heralding a major triumph of diplomacy and mutual interest, and opens the gateway for more economic agreements and quite often political ones. In other words, once you sign a FTA, it is very hard to go back.

We believe that there are three reasons why a FTA between Australia and Malaysia are on the cards. These are below.

a) *Australia's FTA with the U.S.*

In February 2004, we released a Worth Noting on the FTA with the U.S. In that issue, we addressed the argument put forward by Professor Ross Garnaut that a FTA with the U.S, would harm our relations with countries in our region. Disagreeing with this viewpoint, we argued then that:

“... it does not follow that just because we sign a FTA with the U.S., our trade relations with Asian neighbours will be harmed. The global trade regime is generally a bit more pragmatic than that and trade history confirms this over and over again. Take Singapore as an example. The U.S.-Singapore FTA has not in any way diminished Singapore's reputation or capacity to benefit from trade in the region. In fact, evidence strongly suggests that Singapore's prestige has been greatly enhanced through her FTA with the U.S. and Asian partners are more likely to want to form agreements with Singapore and jump in before someone else does. This applies as well to reactions from some Asian neighbours toward Australia. For example, Thailand's view of Australia as a trading partner has certainly been enhanced following the U.S. FTA announcement. And remember that China – the real prize in Asia – was happy to suggest an interest in a FTA with Australia following the announcement of a possible Australia-U.S. FTA.”

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The proposed FTA now is arguably an instance of the 'prestige factor' we spoke about. There is no doubt that countries in our region are much more likely to examine the feasibility of FTAs with us following our U.S. agreement. The logic here is simple. A country like Malaysia benefits greatly from especially imports into Australia (more so than we benefit from exports to Malaysia.) Several aspects of the FTA will lower the price competitiveness of some goods from Malaysia – hence, better to compete on a level tariff playing field than be shunted by a U.S.-Australia FTA. Second, everyone wants access to the U.S. market. It becomes relatively easier to find common ground with the U.S. and joint partnerships with U.S. firms if Malaysia has an FTA with Australia in complementary industries.

Economically, Australia is riding high and fast on a wave of prestige in the region – advanced discussions for trade agreements with the U.S., China and Thailand is no easy feat. Other countries in our region want in.

b) *Common threats leading to decreased suspicions*

The media made much of Howard's 'Deputy Sheriff' comment and the harm this would do to relations with neighbours. That was always a piece of reasoning that we believe would be exposed as shortsighted.

The comment did receive negative media attention in several S.E. Asian countries. However, as we mention previously, that was really just an unfortunate choice of phrase. Some Australian's cringed because it made us appear subservient to U.S. policy; some S.E. Asians were outraged because it

suggested to them Australia did not consider herself as part of the politics and concerns of their own region. But diplomats knew nothing had really changed and trade ministers continued their work unaffected after the comment.

Several things have occurred to allay fears that might have prevented thought of any Australia-Malaysia FTA in the past.

Australia bashing by countries like Malaysia and Indonesia brings less political points for leaders of these countries than it use to. For Indonesia, their economy has been brought to her knees, the anger about Australia's large role in securing the independence of East Timor is passing, and Australia's massive promise of \$1 billion aid over five years to tsunami ravaged Indonesia rubbishes any argument that Australia does not consider herself a member of S.E. Asia. The massive aid contribution was made clearly to not only relieve suffering but also strengthen our ties with Indonesia and reputation in the region.

For Malaysia, they have genuine concerns about their reputation as a haven or meeting place for terrorists against Western interests. Malaysia was particularly embarrassed that several members responsible for the 9/11 hijackings had met in Malaysia. Any notion that Malaysia is soft on terrorists would be extremely damaging for their reputation as a highly developed, stable and secure economy. Following the 1997 Asian crash, special efforts have been made to encourage foreign investment and discourage capital flight. Bashing the firm ally of the U.S. in the region does not serve that purpose. If neighbouring Indonesia is beginning to embrace Australia as a valuable partner on issues such as tsunami relief and fighting terrorism, it might seem recalcitrant of Malaysia to continue the Australian bashing.

Second, in what is certainly a diplomatic irony, Australian policy to publicly move closer to the U.S. has actually improved relations with Malaysia. Why? Relations between Australia and Malaysia diplomatically was actually at its worse during the Keating years because there was a feeling in Malaysia that Australia saw herself as the self-appointed and 'natural' leader in the region. Indonesia in the eighties and early nineties was the leader in the region by virtue of their population and seemingly vibrant economy but Malaysia also enjoyed an enviable status. Hence, Dr. Mahathir perceived that a rivalry was looming between a Keating led Australia who wanted a greater prestige in S.E. Asia and his own designs for Malaysia in the region. This partly explains the Australian bashing he engaged in continually for the next decade. With Australia now content not to be the proclaimed leader of the region, Malaysia is much more comfortable with welcoming Australia as a partner.

Third, pride begets a fall. This can certainly be applied to many countries in S.E. Asia – the 'economic tigers' as they became known. Up till 1997, countries like Malaysia genuinely believed that they had found a third way to increase national wealth. The 'Western obsession' with aspects such as transparency and

corporate governance and conflicts of interests were seen as speed bumps to a growing economy. If a deal was there to be made, these issues of prudence often slowed things down.

The Asian crisis in 1997 exposed the flaws in the 'third way'. It also meant that multinational companies were more reluctant to do businesses in economies without Western style micro-economic checks. Greater economic cooperation with relatively prudently managed systems like the Australian one became perceived as a benefit, not a liability.

c) Retirement of Dr. Mahathir

Still largely a hero to Malaysians, Dr. Mahathir was probably the most disliked S.E. Asia leader of our generation in Australia. He guided Malaysia from a racially fragmented colonial settlement into a dynamic, modern economy and country. He led a country with deep racial divisions and managed to create a secular society that lived together in relative harmony. As a self reward for these achievements, he ran Malaysia as somewhat of a personal fiefdom and retired last year as a multi-billionaire.

For a man use to such absolute control, any criticism of him was taken personally. Forgiveness was slow; hence, his animosity toward Keating who dared to call him 'recalcitrant'.

Mahathir gained political points for bashing Australia because he was perceived by Asians as a successful leader in the 'Asian style' of leadership – autocratic, unrestrained by Western bonds of prudence, decisive, and committed to better and faster results rather than compromise. When Australians criticized him using the usual Western terms of repudiation, he wore them as badges of honour that was unique to an Asian style of leader. If he was showing a brand of leadership in the post-colonial world that affronted Western leaders, then so be it. He believed he was more effective than they were and no Western style leader could have achieved as quickly and completely what Malaysia achieved in a short period. As Mahathir like to comment, while it took most Western countries three hundred years to form their modern economies, it took Malaysia thirty.

Mahathir therefore saw himself as a champion of the 'Asian way' of leadership and was always happy to take on Western leaders who dared criticize him. He was also applauded by many Asians for doing so. The fact that trade between the two countries was robust did not get in the way of a more interesting story about alternative visions of leadership.

Even though Mahathir was pragmatic enough to encourage increased trade with Australia during this whole period of animosity, he could not politically backtrack sufficiently to consider a FTA with Australia. As mention, there is too much symbolism and fanfare about a FTA and it would have seemed incongruous to

sign one with Australia after a decade of bashing them. The retirement of Dr. Mahathir in 2003 has opened up the possibility of the FTA as political and personal barriers have been removed.

His successor, Prime Minister Abdullah is a different kind of political animal. More reserved, reflective and even philosophical, Abdullah has not built a reputation for bashing Australia or Western systems. Rather, Prime Minister Abdullah sees himself as a reformer of the Malaysian economy and system – greater transparency, cutting back privileges for indigenous Malaysians, separating business and government, and better corporate governance. This has also increased the enthusiasm on the Australian side for greater economic cooperation.