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Malaysia-China trade: old and new routes

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The opening up of China and its subsequent rapid integration into the global economy provided opportunities for Malaysia to increase trade with China through their respective participation in global value chain activities. This paper aims to examine the nature of Malaysia-China trade and the contributory factors to this bilateral trade pattern and to assess the prospects and challenges for this bilateral trade, with the new Silk Road initiatives.

The main findings of this paper show increased information and communications technology and palm oil trade between the two countries. But the trade pattern also indicates Malaysia's trade in electronics and palm oil with China is facing either stagnating or declining revealed comparative advantage. Instead, China's rise has also raised severe competitive pressures as each country tries to shift up the global value chain. Internal weaknesses also contributed to the weakening competitiveness of Malaysia's electrical and electronics sector so that the share of this sector's manufacturing and exports fell substantially, while the share of resource based manufacturing activities gained ground.

Malaysia is trying to tap the promises of the new Silk Road initiative for enhancing its trade and investment relations with China. However, realizing this potential faces several hurdles, such as the viability of this initiative and internal challenges within China and Malaysia. The most urgent of the three challenges is for Malaysia to overcome its domestic challenges, since without the requisite domestic changes, no investor, including China, will venture into the country.

JEL classification: F10, F14, N75
Keywords: Malaysia, China, trade, Silk Road, electronics, palm oil

1. Introduction

Malaysia's strategic geographic location in Southeast Asia has facilitated its trade between the East and West since the time of the Malacca Sultanate in the 14th and 15th century A.D. Malacca's importance as a center for entrepôt trade along this old trade route led to close relations between the Malacca Sultanate and several countries, including China. This in turn paved the way for the establishment of Malacca-China diplomatic relations and the arrival of traders from China to Malacca. The subsequent waves of migration of Chinese workers to Malaysia and a growing Chinese population led to a significant share of Chinese people in Malaysia's total population (38 percent)[1] in 1957.

Although bilateral relations between Malaysia and China waxed and waned over time, Malaysia became the first member country of the Association of Southeast Asian Nations (ASEAN) to normalize relationships with China in 1974, thereby laying the foundation for cordial bilateral relations, including trade relations, between the two countries. Not surprisingly, Malaysia's first free trade agreement is the ASEAN-China Free Trade Agreement, which was signed in 2002. The growing importance of China as a trade partner of Malaysia is manifested in the upward trend of exports and imports between the two countries since 1990, with the exception of a dip during the years of the 2008-2009 global financial crisis. In fact, China became Malaysia's largest trading partner since 2010. Within ASEAN, Malaysia has been China's largest trading partner since 2008. It is also China's third-largest trading partner in Asia, after Japan and South Korea, despite the relatively small size of Malaysia's economy. Both sides have pledged to aim for a trade volume of US$160 billion by 2017.[2]

Since China's reforms in 1978 and the opening up of its economy in the 1990s, China has grown to become the second-largest economy in the world and has joined the upper middle income economies in 2012. Demand from China, including the demand from its rising middle-income group, has and will undoubtedly continue to influence global and regional trade. China's increasing economic size and grand plans, as manifested in the new Silk Road or the "One Belt, One Road" development strategy and the Asian Infrastructure Investment Bank in 2014, and its trade ambition may offer a window of opportunity for Malaysia to deepen its economic relations with China in the coming years. This is especially important at this juncture of Malaysia's economic development as domestic growth is faltering in the midst of restructuring problems, political unrest, and global uncertainties.

The objectives of this paper are twofold. First, we seek to examine the nature of Malaysia-China trade and the contributory factors to this bilateral trade pattern.

[1] This figure is an estimate by Hirschman [1980].
[2] This figure is an estimate by Sta Maria [2014].

Second, we assess the prospects and challenges for Malaysia-China trade, given the new Silk Road initiatives. The paper is organized as follows. In the second section, we examine two important sectors in the bilateral trade between Malaysia and China. In the third section, we look into the prospects and challenges of the new routes. In the final section, we summarize the main findings of this paper.

2. Two major sectors

Despite the importance of Malaysia in China's trade, the bilateral relations between these two countries are not well explored, except as part of ASEAN's trade with China (see, for example, Mendoza et al. [2015]). The only recent study that examined the bilateral trade relations is that of Lee [2014] which examined it from China's perspectives, namely within the context China's economic engagement with Southeast Asia. Lee's focus is on the electrical and electronics sector where he finds increasing competition between the two countries due to weaknesses in Malaysia's economy and China's move up the manufacturing value chain.

While the bilateral trade relation is very much focused on electrical and electronics, palm oil constitutes another important export from Malaysia to China. China is Malaysia's largest export destination for palm oil products, taking up 20.4 percent of Malaysia's global exports. It is therefore pertinent to include this sector in analyzing the trade links between Malaysia and China.

The paper will focus on information and communications technology (ICT) and palm oil trade between Malaysia and China, given the importance of these two sectors in the bilateral trade as well as Malaysia's policy focus in these two sectors.[3]

2.1. Information and communications technology

Within manufacturing, the ICT[4] sector stands out as the main contributor to the bilateral trade between the two countries. Table 1 shows that ICT goods (on average) contribute approximately half of Malaysia's total manufacturing exports and import to/from China from 2000 to 2013. The bulk of Malaysia's exports of ICT goods are in electronic components. In 2013, electronic components comprise 48 percent of total manufacturing exports to China. The second-largest share in ICT exports is contributed by computer and peripherals, averaging at around 19 percent for the period shown. However, its export share has fallen by more than half from a peak of 28 percent in 2001 to 11 percent in 2013. Imports from China are mainly in computer and peripherals (average of 21 percent for the period shown in Table 1) while imports of electronics component contribute

[3] See Tham and Kam [2015] for a summary on the information communications technology policies in Malaysia as a driver for the economy since the Seventh Malaysia Plan (1996-2000) onwards.

[4] ICT product classification is based on OECD [2011].

an average of 14 percent for the period shown. By 2013, the share of imports of electronics components and computer and peripherals are 20 percent and 10 percent, respectively.

Table 1 also indicates a diverging pattern between the import and export of Malaysia's ICT goods with China. The share of ICT imports in total manufacturing imports can be seen to decrease steadily from 2003 to 2013, excluding the year of the 2009 global financial crisis. On the other hand, exports show a converse pattern with the share of ICT exports to China falling before the global financial crisis from 2001 to 2007 and increasing after the global financial crisis to 67 percent in 2010 before falling slightly annually to 61 percent in 2013.

The share of electronics exports fell from 19 percent in 2000 to 12 percent in 2003, after which it fluctuated from 11 percent in 2004 to 14 percent in 2007. However, its share increased steadily from 37 percent in 2010 to 48 percent in 2013. This is accompanied by an increasing share of electronics components in total manufacturing imports from 2010 to 2013. Notably, although Malaysia has an overall trade deficit in manufacturing exports with China, Table 1 shows a surplus in Malaysia's trade in overall ICT and in the electronics sub-sector after 2008.

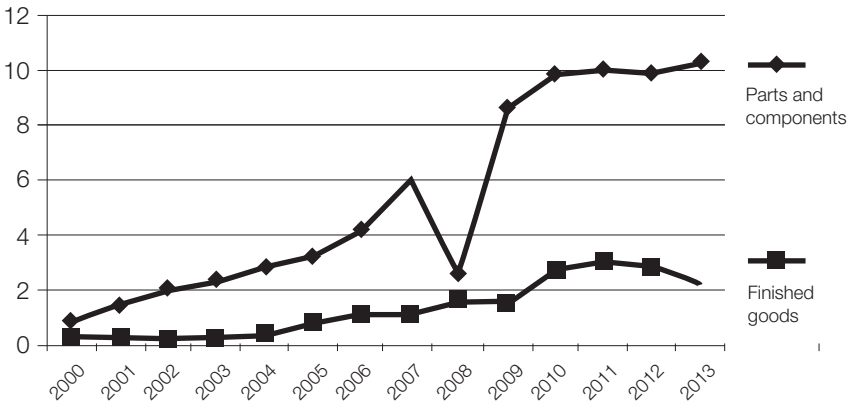
TABLE 1. Information communications technology (ICT) import and export of Malaysia to China, 2000-2013 (share of manufacturing export, percentage)

	Exports							Imports						
	Communication equipment	Computer and peripherals	Consumer electronics	Electronics components	Miscellaneous	Total ICT as share of manufacturing export	Trade balance, overall ICT (US$ billions) (X-M)	Communication equipment	Computer and peripherals	Consumer electronics	Electronics components	Miscellaneous	Total ICT as share of manufacturing import	Trade balance, electronics (US$ billions) (X-M)
2000	7.0	22.0	2.0	19.0	5.0	55.0	0.03	10.0	7.0	7.0	10.0	7.0	41.0	-0.02
2001	3.0	28.0	1.0	16.0	4.0	54.0	-0.13	12.0	15.0	6.0	14.0	5.0	52.0	-0.13
2002	1.0	21.0	1.0	18.0	2.0	44.0	-1.25	4.0	30.0	4.0	14.0	4.0	55.0	-0.20
2003	0.0	15.0	1.0	12.0	3.0	32.0	-2.18	2.0	34.0	4.0	13.0	4.0	57.0	-0.43
2004	1.0	17.0	1.0	11.0	4.0	34.0	-3.37	3.0	30.0	3.0	14.0	6.0	56.0	-0.91
2005	2.0	16.0	1.0	14.0	3.0	35.0	-4.30	3.0	30.0	2.0	16.0	5.0	56.0	-1.20
2006	2.0	18.0	1.0	11.0	2.0	34.0	-4.40	3.0	27.0	2.0	14.0	3.0	50.0	-1.36
2007	2.0	19.0	1.0	13.0	1.0	36.0	-3.96	2.0	25.0	2.0	13.0	3.0	46.0	-1.09
2008	3.0	29.0	1.0	12.0	1.0	46.0	-3.24	3.0	23.0	2.0	10.0	3.0	41.0	-0.99
2009	1.0	16.0	1.0	52.0	1.0	71.0	2.06	5.0	24.0	2.0	16.0	3.0	50.0	4.60
2010	1.0	26.0	1.0	37.0	1.0	67.0	4.46	5.0	15.0	2.0	12.0	6.0	41.0	4.18
2011	1.0	18.0	1.0	44.0	1.0	65.0	4.60	5.0	12.0	1.0	12.0	6.0	37.0	5.78
2012	1.0	15.0	1.0	44.0	1.0	62.0	2.01	5.0	10.0	1.0	18.0	4.0	38.0	3.80
2013	1.0	11.0	1.0	48.0	0.0	61.0	0.51	5.0	10.0	1.0	20.0	4.0	39.0	3.38
Average	2.0	19.0	1.0	25.0	2.0	50.0		5.0	21.0	3.0	14.0	4.0	47.0	

Source: Authors' calculations using OECD 2011 classifications. See Appendix 1.

The concentration of electronics exports to China can be attributed to China's rapid integration into the global value chain in this sector since opening its economy to foreign direct investment in the 1990s (Lee [2014]; Kong et al. [2015]). Both Malaysia and China used foreign direct investment policies to attract foreign multinational companies in the electrical and electronics sector for the development of their respective manufacturing sector (Xing [2013]; Tham and Kam [2015]) and are linked to each other's production through the global value chains in this sector.

It can be seen that Malaysia's exports of electronics goods is more concentrated in parts and components, rather than finished goods (Figure 1). However, although exports of parts and components increased rapidly before the global financial crisis, its increase has slowed down after the crisis. For example, in the four years before the global financial crisis, exports of parts and components to China grew by 156.6 percent but subsequently grew by only 18 percent from 2009 to 2013, due in part to the global slowdown after the global financial crisis.



Note: Parts and components and finished goods are aggregated based on Aldaba [2015].
Source: Calculated from COMTRADE

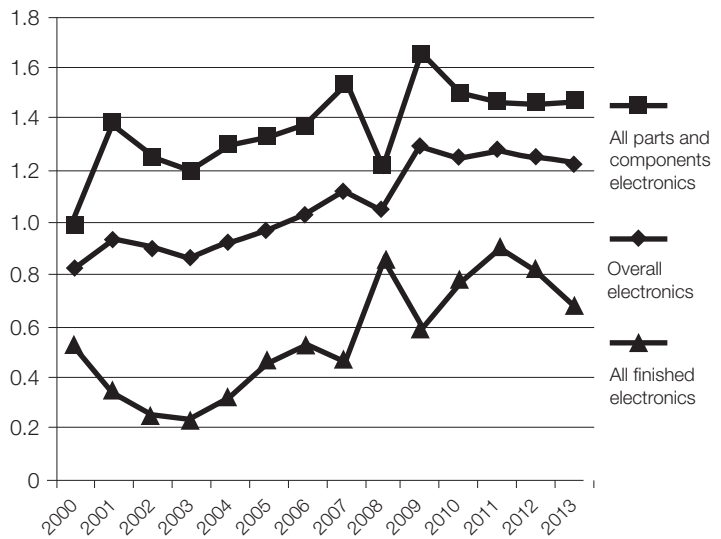
FIGURE 1. Malaysia's electronics exports to China by parts and components and finished goods, US$ billions

Bilateral revealed comparative advantage[5] in Figure 2 shows Malaysia having a comparative disadvantage in overall electronics exports to China prior to 2005. After 2005, the revealed comparative advantage for overall electronics increased steadily to a value that is above one, barring the year of the global financial crisis.

[5] Bilateral RCA = (Exports of product *Xi* from Malaysia to China/All manufacturing exports of Malaysia to China) / (All exports of *Xi* from Malaysia/All manufacturing exports of Malaysia). A value above one represents comparative advantage of product *Xi* in China's manufacturing sector.

The revealed comparative advantage for all electronics components is above one, while the converse holds true for finished goods. This suggests that the electronics sector in Malaysia may have undergone some form of industrial upgrading in order to compete in the Chinese manufacturing market.

The emergence of wafer fabrication and R&D centers is an indicator of functional upgrading in a country. According to Shan and Rasiah [2015], foreign multinational companies have established four chip design centers, one R&D support facility, five wafer fabrication plants, and 28 assembly and test plants, while national firms have two wafer fabrication plants and seven assembly and test plants (Table 2). They attribute the "shift to wafer fabrication" to the investment grants offered to foreign firms. Therefore, a few firms such as Infineon, OSRAM, and ON Semiconductor have embarked on wafer fabrication in Malaysia since 2005. China is also rapidly upgrading, as shown in Table 2. The race to move up the global value chain in both countries has led to a slight stagnation in the revealed comparative advantage for parts and components electronics observed after the global financial crisis (Figure 2).



Source: Calculated from COMTRADE

FIGURE 2. Revealed comparative advantage for electronics exports to China, 2000-2013

TABLE 2. Integrated circuit firms facing upgrading in Malaysia, China, and Vietnam, 2011

Countries	National companies					Foreign companies					Total
	R&D	Chip design	Support R&D	Wafer fabrication	Assembly and test	R&D	Chip design	Support R&D	Wafer fabrication	Assembly and test	
China	1	3*	2#	25	34	0	11	8	6	58	148*#
Malaysia	0	0	0	2	6	0	4	1	5	25	43
Vietnam	0	1	0	1	0	0	3	1	0	2	8

Notes: Firms are defined by the registration status, and hence, some subsidiaries of the same firm are counted more than once.
* Denotes firms having both R&D and chip design in the same registration premises;
# Denotes firms having both R&D and other supportive R&D in the same premises.
Source: Shan and Rasiah [2015]

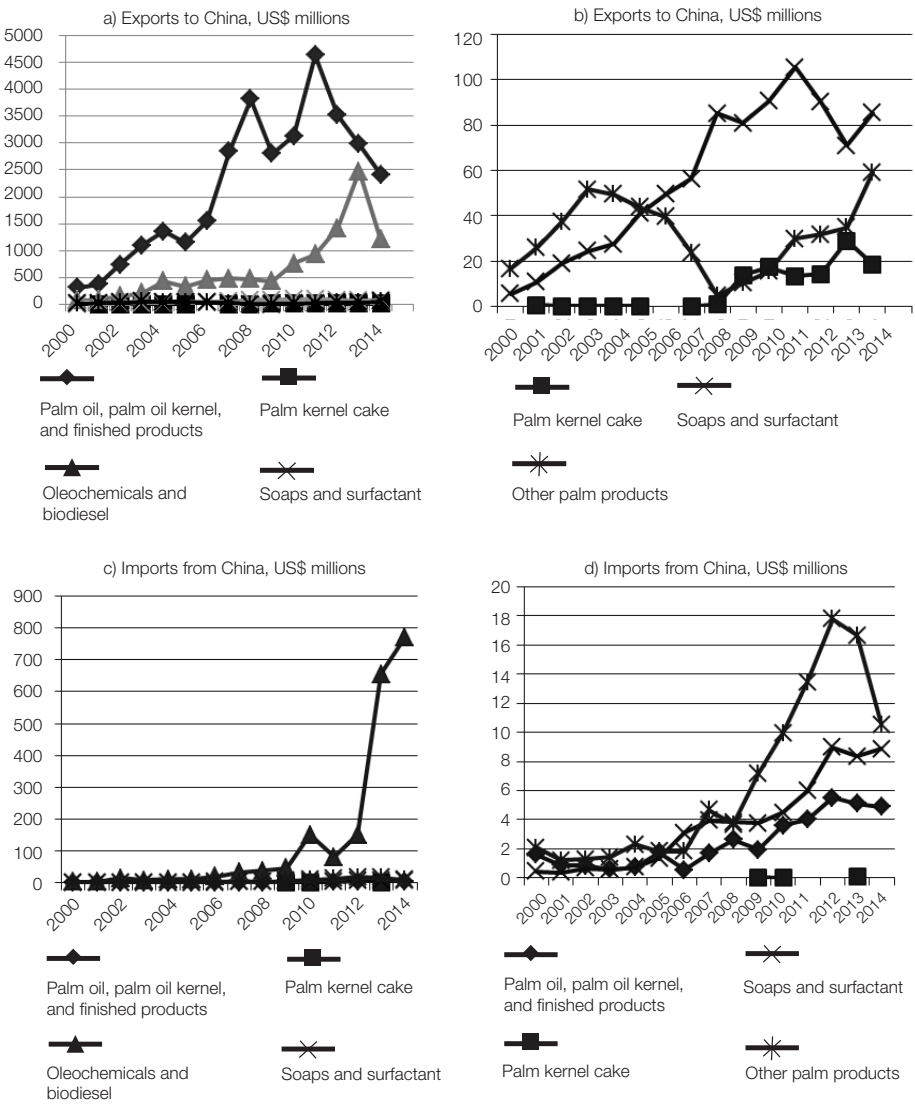
2.2. Palm oil

There are two main sub-sectors dominating palm oil exports to China, reports the Malaysian Palm Oil Board: palm oil, palm oil kernel, and finished products; and oleochemicals and biodiesel. In Figure 3a, it can be seen that the largest contributor to exports is palm oil, palm oil kernel, and finished products. Figure 3a also shows that exports of both products have increased substantially since 2000. This is essentially contributed by the increasing demand from China, which does not produce any palm oil. The nation uses the oil in its food processing industry, especially in the production of instant noodles, as palm oil is relatively cheaper than soybean oil and rapeseed oil. Figure 3b shows the trend in the exports of palm oil products—excluding palm oil, palm oil kernel, and finished products—and oleochemicals and biodiesel due to the significant difference in value for the latter two products. Soaps and surfactants show increasing trade value since 2008, as shown in Figure 3b.

In terms of imports, oleochemicals and biodiesel comprise the largest import value from China (Figure 3c). Figure 3c further shows that oleochemical and biodiesel imports have increased sharply since 2012, amounting to over US$770 million in 2014. Other palm oil imports from China are also increasing gradually over the years as well (Figure 3d).

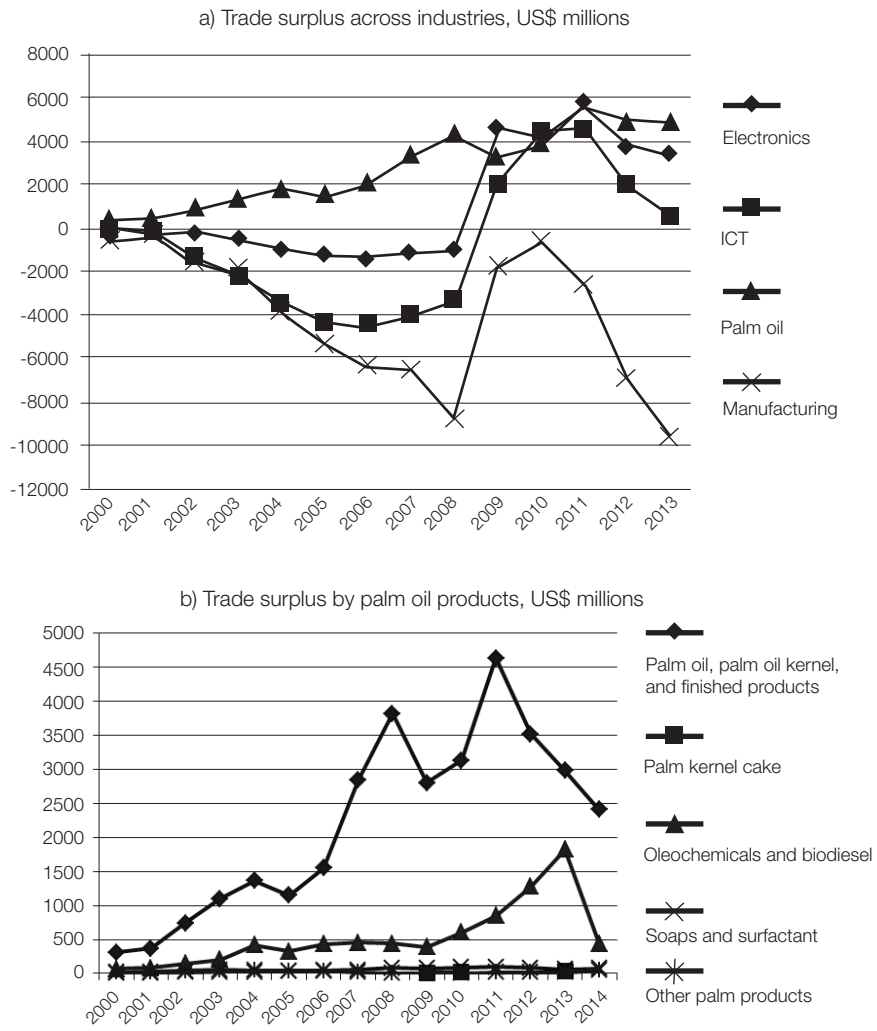
One important distinction between manufacturing and the palm oil exports is the trade balance. While Malaysia has a trade deficit in the manufacturing sector, trade in palm oil products has always been at a surplus since 2000. Figure 4a shows the surplus from Malaysia's palm oil trade with China increasing steadily until 2011, after which the surplus narrowed slightly. ICT and electronics trade also show trade surpluses only from 2008 to 2013. Figure 4b shows that all

subsectors of palm oil have generated trade surpluses for Malaysia since 2000. This surplus is led by palm oil, palm oil kernel, and finished products, followed by oleochemicals and biodiesel.



Source: Computed from COMTRADE

FIGURE 3. Palm oil trade between Malaysia and China, US$ millions

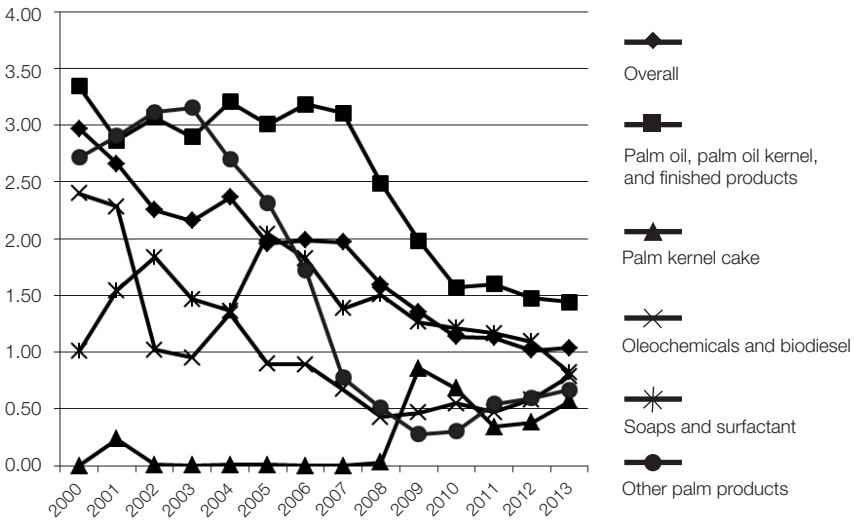


Note: * "Electronics" is based on consumer electronic equipment and electronic components in Appendix 1.
Source: Computed from COMTRADE

FIGURE 4. Trade surpluses/deficits, US$ millions

However, Figure 5 provides some cautionary notes on the performance of Malaysia's palm oil exports to China. Since 2000, the revealed comparative advantage for overall palm oil has been declining, where in 2013, it is considered as a product with marginal comparative advantage in China (slightly above one). The declining trend is striking as it holds true for all the product groups—except for palm kernel cake, which does not show a comparative advantage for the period shown. Even though the main palm oil products (palm oil, palm oil kernel, and

finished products) still have a comparative advantage in the Chinese market, the second most traded product (oleochemicals and biodiesel) has lost its advantage since 2005. Other palm products have lost their comparative advantage since 2007, while soaps and surfactants became comparatively disadvantaged in 2013.



Source: Computed from COMTRADE

FIGURE 5. Revealed comparative advantage for palm oil products, 2000-2013

The drop in comparative advantage for Malaysia's palm oil exports may be due to excess supply as the rise in global demand and high commodity price had encouraged production to escalate. The average annual growth in palm oil production from 1993-2012 was 7.3 percent; the same figure for palm kernel oil production in the same period was 6.3 percent [Basiron 2013]. Total world supply outstripped world demand for every year shown in Table 3, except for 2009. In 2013, for example, the growth of palm oil production in both Indonesia and Malaysia in 2013 surpassed palm oil demand and resulted in a high inventory and a price decline.

TABLE 3. Palm oil supply and demand, 2005-2012 (million tonnes)

	2005	2006	2007	2008	2009	2010	2011	2012
Supply	33.4	36.0	37.7	42.6	45.3	45.9	50.1	51.2
Demand	32.7	35.4	37.4	41.3	45.4	46.5	48.7	51.0

Source: European Delegation to Malaysia, 2012

In addition, there was also increasing competition from Indonesia as it changed its export duty structure to favor production and export of processed palm oil [European Delegation to Malaysia 2012]. Hence its export duty on crude palm oil increased while the export duty for processed palm oil products went down from 25 percent to 13 percent. This posed considerable competition to Malaysia as 68.8 percent of its export revenue is from the processed product segment.

3. Prospects and challenges

The new Silk Road was announced by the Chinese Premier in 2013 during a visit to Kazakhstan. This was subsequently renamed "One Belt, One Road" as it encompasses two routes: a land trade route linking China with Central Asia, Russia, and Europe; and a second route or the Maritime Silk Route, stretching from Fujian on China's coast, through the Malacca Straits, around the horn of Africa, and ending in Venice. This second route is of particular relevance to the maritime countries in Southeast Asia, including Malaysia.

The "One Belt, One Road" initiative promises to enhance trade links along the area covered by this initiative. This is estimated to include about 50 percent of the world's GDP and approximately the same for global trade [Bloomberg Brief 2015]. The use of the Asian Infrastructure Investment Bank, also proposed by China, to fund the infrastructure needs along these routes envisages a reduction in transportation costs that should stimulate more trade. This is backed by a us$40-billion Silk Road Fund and a promise of US$50 billion for the Asian Infrastructure Investment Bank and the proposed new BRICS New Development Bank by the Chinese government.

Prior to the announcement of the "One Belt, One Road" initiative, the Malaysian government has been actively courting closer economic cooperation with China. In 2012, the China-Malaysia Qinzhou Industrial Park was established. Then followed the establishment of the Malaysia-China Kuantan Industrial Park in 2013, which started operations in the same year. Sta Maria, the Secretary General of the Ministry of International Trade and Industry in her keynote address at the Symposium on the 40th Anniversary of China Malaysia Diplomatic Relations on May 22, 2014, noted that this is the first time a twin park model is introduced anywhere in the world, serving complementary roles with the same principles. The Chinese Central Government has approved a RMB2.4 billion development fund for Qinzhou Industrial Park, over and above the RMB1 billion pledged by the Government of Guangxi, where Qinzhou Industrial Park is located. In turn, the Malaysian Federal and State Government have allocated RM700 million to Malaysia-China Kuantan Industrial Park [Sta Maria 2014]. While Qinzhou Industrial Park will focus on food processing, biotechnology, and information technology, Malaysia-China Kuantan Industrial Park will host businesses engaged in steel manufacturing, aluminium processing, and palm oil refinery. This initiative is in line with Malaysia's ambitions to use this park

to increase Chinese investment in Malaysia [Khor 2013]. China has also been upgrading the Kuantan port with Beibu Gulf Holding (Hong Kong) Co. Ltd given a 38 percent equity share in a consortium that received a 30-year concession to manage, operate and develop the port as part of its move to secure more seaports [Pitlo III 2015].

Port Klang and Singapore's port are key ports in the Maritime Silk Route since the Straits of Malacca is a strategic passageway from China to the West. Port Klang is reportedly moving towards establishing sister-port relationships with seven ports in China—namely, Shanghai, Ningbo, Tianjin, Guangzhou, Xiamen, Dalian, and Fuzho—in order to enhance its status in the new Silk Road.

Malaysia also signed the Five Year Programme for Economic and Trade Cooperation with China in October 2013. The agreement aims to enhance bilateral cooperation in agriculture, energy, and mineral resources, information and telecommunications, manufacturing, infrastructure and engineering, tourism, logistics, and retailing. This program aims to engage the private sector to stimulate investment and trade, thereby signaling again Malaysia's intentions to attract more Chinese investment into the country.

Economic cooperation has recently expanded into the financial sector. Last year, the two countries' central banks agreed to establish a yuan clearing bank in Kuala Lumpur [Chew 2014]. This is part of China's quest to internationalize the renminbi, and Malaysia is the second country in Southeast Asia, after Singapore, to host a yuan clearing bank.

Apart from these bilateral initiatives, Malaysia is also part of the ASEAN-China Free Trade Agreement as well as the ongoing negotiations for a Regional Comprehensive Economic Partnership that includes the free trade agreement partners of ASEAN, including China.

All these initiatives indicate Malaysia's strategic interests to tap China's ambitious plans for catalyzing its own economic performance. This is especially important for Malaysia in view of the sharp fall in private investment after the Asian financial crisis and the moderation in its growth performance. Nevertheless, the prospects of tapping the economic potential of the "One Belt, One Road" initiative face numerous challenges, including domestic challenges within China and Malaysia. Ghosh [2015] points out the need for cooperation and partnership of the countries along the route for the maritime silk route to succeed, which is not likely to be forthcoming since opaqueness of the plan in general tends to breed suspicion rather than trust. More importantly, it remains to be seen as to how the proposed route can coexist with the existing system of maritime cooperation.

3.1. China shifts to slower growth

China has been growing at an average rate of 10 percent per annum for the last three decades. Clearly, a slowdown in growth, estimated to be seven percent

for 2015, is inevitable. Since the rapid growth in the past has generated excess production capacity, dissipated its low-wage advantage, increased resource constraints, and led to considerable environmental damage, China will have to manage an internal transition to a slower—but more sustainable growth rate. Specifically, China needs to rebalance its economy from export-led to domestic consumption led. This will shift China from being an export platform to a market provider so that its trade surplus will also decrease. Although the most recent International Monetary Fund review indicates an increasing role in domestic consumption driving growth in China and a reduction in the current account surplus, it remains to be seen if this rebalancing can be sustained in the longer term [IMF 2015].

Given that past overinvestment has contributed to the rising demand of China for commodities and the subsequent commodity price boom over the last decade, the shift to lower growth and reduced demand for commodities is expected to have significant spillovers on primary commodity-producing economies like Malaysia. Palm oil prices are trending downwards, and this can affect Malaysia's future trade surplus, which has also been trending downwards after the global financial crisis.

3.2. Malaysia restructures its economy

Economic restructuring is the key economic problem in Malaysia. Within manufacturing, resource-based industries have been the largest growth drivers of this sector from 2002-2012 due to the high commodity prices during this period [Rizwan et al. 2014]. The sector grew at 6.2 percent on a compounded annualized growth rate during this period, compared to the 1.5 percent growth in the electrical and electronics sector. It became the largest manufacturing sub-sector after 2005. Likewise, exports of resource-based industries grew at 10.3 percent on a compounded annualized growth rate basis during the same period. Its share in total manufacturing exports grew from 30 percent in 2002 to 51 percent in 2012, while exports of electrical and electronics fell from 70 percent to 49 percent over the same period.

Both electrical and electronics and palm oil industries face multiple challenges in their respective structural transformation. Deepening the electrical and electronics sector from low value added to high valued-added activities has been emphasized since the Second Industrial Master Plan (1996-2005). The plan advocated the use of a cluster concept for propelling manufacturing development forward to achieve economies of agglomeration. Unfortunately, the plan was deemed to be poorly executed [Danaraj 2011]. Since then, there are further efforts to shift the electrical and electronics sector towards higher value-added activities, but as noted in Tham [2015], a critical mass of local firms in the electronics sector has yet to be achieved (see Table 2). Although small, incremental changes have taken place within this sector, including the emergence of a few local design

houses as indicated earlier, they lack the critical mass to be catalytic in the desired shift. Thus, Malaysia has yet to make critical leap up the value chain, as observed in the Taiwan and South Korea's respective electrical and electronics sector. Instead, Malaysia's electrical and electronics sector continues to be dogged with a shortage of talents that is exacerbated by brain drain and inflows of less skilled workers. Weak industry-university linkages and inadequate R&D spending of 1.13 percent of its GDP, compared to China's 1.98 percent of its GDP, in 2012 are other contributory factors to the slow deepening of the electrical and electronics sector.

The palm oil sector is currently more concentrated in upstream and midstream activities rather than downstream. Similarly, palm oil export is highly biased toward the upstream and midstream segments, with a total contribution to the overall industry at 74 percent, while downstream contribution came in low at 17 percent in 2013 [Khoo 2014]. The industry faces multi-faceted challenges such as limited land, stagnating yields, dependency on foreign labor, trade wars from producers of other oils, increasing competition from Indonesia, and environmental concerns. Therefore, upstream activities need to enhance their productivity. The government is pushing for a shift to the more lucrative downstream segment, but this will require more private investment that is holding off largely due to the negative perceptions associated with numerous unresolved financial scandals that have emerged of late. In addition, there are ongoing leadership struggles within parties and nationally, while public acceptance of a one-party dominant political system continues to weaken [Alagappa 2015]. Fundamentally, there is a critical need for the country to politically shift from the "well-trodden but increasingly contested bases of race and religion" [Algappa 2015:72] discourse that is emphasized by the dominant party of the country.

While the government is also pushing for a shift towards services, exports in the country are still dependent on manufacturing. A shift to services will also face the same talent shortage challenges as in the manufacturing sector, if knowledge-intensive services are the focus. It will also face the same lack of investor confidence due to the ongoing political deadlock. Economic restructuring will be further derailed if the current political challenges are not surmounted in the near future.

4. Conclusion

The opening up of China and its subsequent rapid integration into the global economy provided opportunities for other emerging countries to have increased trade with the nation through their respective participation in global value chain activities. This is best reflected in Malaysia's ICT trade with China. Similarly, China's rise increased the demand for natural resources like palm oil, thereby contributing to the high commodity prices in the last decade and the growing importance of palm oil trade between Malaysia and China. But the bilateral trade patterns shown in this paper indicate that Malaysia is facing stagnating or

declining revealed comparative advantage in its exports of electronics and palm oil to China. This does not augur well for the future of Malaysia-China trade relations, from Malaysia's perspective.

Instead, China's rise also poses severe challenges to Malaysia through competitive pressures as each country tries to shift up the global value chain. Internal weaknesses also contributed to the weakening competitiveness of Malaysia's electrical and electronics sector so that the share of this sector in manufacturing and exports fell substantially, while the share of resource based manufacturing activities gained ground.

Malaysia is trying to tap the promises of the "One Belt, One Road" initiative for enhancing its trade and investment relations with China. Realizing this potential faces several hurdles, including the viability of this initiative and internal challenges within China and Malaysia. The most urgent of the three challenges for Malaysia is to overcome its domestic challenges; without the requisite domestic changes, no investor, whether domestic or foreign, will venture into the country. Overcoming domestic economic challenges, however, will require Malaysia's current political development to move beyond its racial and religious paradigms towards a more inclusive paradigm that embraces multicultural diversity and religious tolerance.

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APPENDIX 1. Information communications technology codes (HS 1996)

Computers and peripheral equipment	Communication equipment	Miscellaneous	Consumer electronic equipment		Electronic components
844351	851711	852390	851810	852190	852330
847050	851719	852410	851821	852210	852460
847110	851730	852491	851822	852290	853400
847130	851750	852499	851829	852530	854011
847141	851780	852910	851830	852540	854012
847149	851790	852990	851840	852712	854020
847150	852510	854381	851850	852713	854040
847160	852520	901320	851890	852719	854050
847170	852790		851910	852721	854060
847180	853110		851921	852729	854071
847190			851929	852731	854072
847220			851931	852732	854079
847290			851939	852739	854081
847330			851940	852812	854089
847350			851992	852813	854091
851721			851993	852821	854099
851722			851999	852822	854110
900911			852010	852830	854121
900912			852020	950410	854129
			852032		854130
			852033		854140
			852039		854150
			852090		854160
			852110		854190
			852190		854212
			852210		854213
					854214
					854219
					854230
					854240
					854290
					854890

Source: Organisation for Economic Co-operation and Development, 2011