A Brief on the Potential Economic Impact of TPPA on the Oil & Gas Sector in Malaysia

The Trans-Pacific Partnership Agreement ("TPPA"), in a nutshell. is a free trade agreement (FTA) that provides the 12 prospective member countries (Malaysia, Canada, USA, Mexico, Peru, Chile, Japan, Vietnam, Singapore, Brunei, Australia and New Zealand) market access to ~40% of the global economy with a cumulative GDP of almost USD 30 trillion.

The TPPA will provide Malaysia with market access to 4 trading partners that Malaysia presently has no FTA with; Canada, Mexico, Peru and US. These 4 countries accounted for about 74% of the market size of the TPPA economic bloc, with a GDP of about USD21 trillion as of 2014.

The government sees the participation in the TPPA as an opportunity to deepen Malaysia's integration in the regional and global supply chain, by providing Malaysian companies with more open markets which will enable or force these companies to compete more efficiently and effectively at the global level. Further, participation will also booster investor confidence and drawing foreign investment into Malaysia.

The ultimate outcome, arising from the TPPA, will see greater competition and economies of scale and the government hopes that this will compel local firms to raise production efficiency and thus lower the cost of goods and services to consumers.

Unlike the FTAs in the past, the TPPA seeks to harmonise the government procurement, competition with state-owned enterprises ("SOE"), intellectual property rights, the digital economy, labour and environment in the TPPA countries.. Thus, providing plenty of ammunition for consternation amongst the sceptic public that the TPPA would benefit the country.

The government is adamant, however, that the TPPA would, on the whole, present positive economic advantages to Malaysia, Admittedly, the Government recognizes that there will be costs to local firms in adjusting to increased competition especially in oil & gas, construction and retail sectors. However, the Government believes that by complying with TPPA obligations and by going through structural reforms the country and the local firms would be able to maximise and realise the full potential benefits under TPPA.

What will TPPA mean to Oil and Gas sector in Malaysia?

The Government appointed PwC to conduct an objective analysis of the potential economic costs and benefits of Malaysia's participation in the TPPA. The study does not, however, require PwC to make strategic recommendations on Malaysia's position towards TPPA membership.

The study analyses the potential economic costs and benefits of the TPPA on the Malaysian economy and 10 selected key economic sectors including oil & gas.

The followings are the summary of the key findings by PwC on the potential impact of the TPPA on the O&G sector in Malaysia:

Finding No.1 : Minimal benefits from lower trade barriers

PwC found that the benefits to the O&G sector from lower trade barriers would be small. This is because **most tariffs for the export of petroleum-related products to TPPA countries are already at or close to zero percentage.**

For example, PETRONAS would gain vey little from lower trade barriers as 74% of PETRONAS' exports are to non-TPPA countries. In addition, a significant portion of PETRONAS' exports to the TPPA countries (except for USA) are already incurring zero tariffs. For example, 60% of PETRONAS' export of liquefied natural gas (LNG) are destined to Japan at zero tariffs.

Finding No.2: PETRONAS's rights and obligations under Petroleum Development Act 1974 (PDA '74) largely protected

The safeguards under the TPPA will preserve PETRONAS' rights, vested by the PDA 1974, to determine the selection of contract parties and the forms and conditions of contractual arrangements for foreign participation, except in 12 goods and services*. **This will allow PETRONAS to largely continue supporting the growth and development of Malaysia's O&G sector, including through technology transfers, and advancing nation building agendas, such as local capability building.**

. **The liberalisation of the 12 goods and services under the**

TPPA is also not expected to incur significant adverse implications on domestic firms. This is because the business operations in the 12 goods and services are already dominated by foreign companies. Licensed vendors with PETRONAS in the 12 goods and services constitute only 10% of its entire vendors (389 of 3,636).

(*note: 1.Seismic data acquisition, 2.Directional drilling services; Gyro while drilling services; Measurement while drilling services; and Logging while drilling services, 3.Cementing-related services, 4.Gas turbines and related maintenance and repair services, 5.Control valves services, 6.Oil country tubular goods, 7.Induction motor services, 8.Distributed Control System (DCS) services, 9.Transformer services, 10.Structural steel, 11.Line pipes and 12.Process pipes)

Finding No.3: Threshold on local preference could raise level of competition

There are safeguards under TPPA that allow PETRONAS to continue with its Bumiputra development agenda. PETRONAS can still accord preferential treatment to local companies (mostly Bumiputra companies) in its purchase of goods and services in Malaysia, except for the 12 goods and services, up to the following thresholds: for upstream activities up to 70% in the first 5 years upon signing and 40% for downstream activities, within the territory of Malaysia

As of 2014, PETRONAS contracted approximately 70% of its purchase of goods and services for commercial activities in Malaysia to majority Bumiputera companies.

Given the capping of domestic preferences, local companies are expected to be ready to face increasing competition. However, it is important to note that contracts awarded to local companies based on merit are not considered as domestic preferences.

Finding No.4 : PETRONAS benefits very little from TPPA

PwC found out that even without the TPPA, Malaysia has already attracted over RM 330 billion worth of upstream investments cumulatively as of 2013.

Malaysia is already exporting 74% of its oil & gas related products to non-TPPA countries. For example, 60% of PETRONAS's LNG exports designated to Japan is alrady attracting zero tariffs.

In 2013, 98.4 Mbbls of crude oil and petroleum products were exported with minimal to near zero tariffs.

Further, 5% of PETRONAS group's revenues are from Petrochemical products, which have tariffs of zero to TPPA countries due to existing FTAs with the exception of urea to Singapore and Ammonia to Japan

Finding No.5: Stronger investor protection in TPPA countries

The increase in investor protection under TPPA will provide PETRONAS with greater security for its investments in the TPPA countries. At present, 5 out of the 12 countries where PETRONAS has foreign operational presence are TPPA countries.

The stronger investment protection mechanism under the TPPA will also support, and potentially further spur, the growing investments by Malaysian firms in the O&G sectors of the TPPA countries. Thus, Malaysian companies that have been awarded contracts in Mexico, Vietnam and Australia would enjoy greater protection for their investments.

(note: Malaysia ranks no.4 in terms of protecting minority investors ahead of countries like Canada (6), USA (35) and Japan (36).

A Special Mention on the Impact on State-owned Entrprise (SOE) and Bumiputra Vendor Development Programme (BVDP)

SOEs under TPPA are expected to conduct its businesses that are similar to a privately owned enterprise in the relevant industry when purchasing goods or services. This inevitably may constrain the role of some SOEs in supporting local enterprises. Any policy by some SOEs, which may not be consistent with commercial considerations such as price, quality and availability of the good or service to be purchased has the potential to breach the commitments set out in the TPPA.

In addition, the prevailing procurement mechanisms under the

BVDP (for example, preferred suppliers) could be limited under TPPA participation. Such preferential treatment will be capped at a maximum of 40% of the SOEs' annual budgeted purchase of goods and services under TPPA. As of 2014, SOEs' spending on Bumiputera businesses exceeded 40%.

On the whole, however, due to safeguards negotiated and secured earlier, the overall Bumiputera businesses are not adversely affected under the TPPA. This is because under the safeguards the Government maintains the flexibility: a) to set aside up to 30% for Bumiputera contractors in construction services that is open to TPPA members; and b) SOEs will have the flexibility to give preferences to Bumiputera and SME suppliers up to 40% of their annual budgeted purchases in the territory of Malaysia.

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Prepared by SOGDC

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