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# **Sabah-Kalimantan Road Connectivity: The Effect of Common Border on Export**

idris, rafiq

University Malaysia Sabah

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Collection of Studies on

**SABAH-KALIMANTAN  
ECONOMIC RELATIONS**

*Towards Greater Economic Interaction in Borneo*

**Editors: Rafiq Idris and Kasim Mansur**



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# **List of Contributors**

## **DR RAFIQ IDRIS**

Senior Lecturer

Faculty of Business, Economics and Accountancy

Univerisiti Malaysia Sabah

## **PROF DATUK DR KASSIM MANSUR**

Professor

Faculty of Business, Economics and Accountancy

Univerisiti Malaysia Sabah

## **ASSOCIATE PROFESSOR DR WONG HOCK TSEN**

Associate Professor

Faculty of Business, Economics and Accountancy

Univerisiti Malaysia Sabah

## **DR RIZAL ZAMANI IDRIS**

Senior Lecturer

Faculty of Humanities, Arts and Heritage

Univerisiti Malaysia Sabah

## **DR JAMES ALIN**

Senior Lecturer

Faculty of Business, Economics and Accountancy

Univerisiti Malaysia Sabah

## **DR SARMA ARALAS**

Senior Lecturer

Faculty of Business, Economics and Accountancy

Univerisiti Malaysia Sabah

## **AZMI MAJID**

Lecturer,

Faculty of Business, Economics and Accountancy

Univerisiti Malaysia Sabah

**DR DALIA ARALAS**

Senior Lecturer  
Foundations of Education Department  
Universiti Putra Malaysia

**DAYANGKU ASLINAH**

Senior Lecturer,  
Faculty of Business, Economics and Accountancy  
Univerisiti Malaysia Sabah

**DR MARSO**

Department of Management  
Sekolah Tinggi Ilmu Ekonomi Bulungan Tarakan

**ZURAIDAH JAMRIN**

Lecturer,  
Faculty of Business, Economics and Accountancy  
Univerisiti Malaysia Sabah

**DATU RAZALI DATU ERANZA**

Lecturer,  
Faculty of Business, Economics and Accountancy  
Univerisiti Malaysia Sabah

**MAXI SONDAKH**

Department of Economics and Development Studies Sekolah  
Tinggi Ilmu Ekonomi Bulungan Tarakan

**DR LIU HAO**

Lecturer,  
School of Management  
Shandong Jiaotong University



# Acknowledgement

Kalimantan and Sabah are close neighbors that have huge potentials to build mutually beneficial ties. The book in general argues that it is time to consider the idea of having road connectivity with Kalimantan. Bigger per capita income (in North and East Kalimantan) and bigger market size among others are indeed important justification to consider.

This book is published to provide readers with an overview of the economic relations between Sabah and Kalimantan in general, the economy and economic research involving both areas. In the past years, together with the Society Empowerment and Economic Development of Sabah (SEEDS) headed by the late Datuk Badil Zaman, a series of round table discussions were held in Kota Kinabalu, Tawau and North Kalimantan involving various stakeholders such as business chambers representatives, authorities and academicians among others. In addition, newspaper, magazine and journal articles have been published. Moreover, some findings of early research have been presented in various international conference to stimulate the interest.

It is hoped that this book will contribute towards enriching the study of Sabah-Indonesia economic relations and beneficial for policymakers, academicians, students and other stakeholders. We would like to thank Universiti Malaysia Sabah (UMS), Society Empowerment and Economic Development of Sabah (SEEDS), the late Datuk Badil Zaman, Datuk Seri Panglima Abdul Rahman Dahlan, the writers, Mutma Inna and all who have contributed to the publication of this book. A special thank also to YB Awang Husaini Bin Datuk Sahari, the member of parliament of Putatan for his continuous support.

Dr Rafiq Idris  
and  
Prof Datuk Dr Kasim Mansur



# CHAPTER 1:

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## Introduction

*Rafiq Idris and Kasim Mansur*

Sabah and Kalimantan are part of the Borneo island, which is the third largest island in the world. Borneo is politically divided into three countries namely Malaysia, Indonesia and Brunei (see Figure 1).

Kalimantan consists of 5 provinces, namely North Kalimantan, East Kalimantan, Central Kalimantan, South Kalimantan and West Kalimantan. The major economic contributors to its economy include the mining and agriculture sectors among others. In terms of trade, mining products such as coal is the important export commodity of Kalimantan. The major trading partners of Kalimantan include Japan, China, India and Malaysia.

Both Sabah and Kalimantan are close neighbors that have huge potentials to build mutually beneficial ties. The market size is reported to be over 15 million in sum.

**Figure 1: Map of Borneo**



With the ongoing initiative such as Brunei Darussalam-Indonesia-Malaysia-the Philippines East ASEAN

Growth Area (BIMP-EAGA), ASEAN Free Trade Agreement (AFTA) and newly established ASEAN Economic Community (AEC), it is hoped that greater economic interaction would take place in Borneo.

The announcement of the formal establishment of the ASEAN Economic Community in December 2015 gives a new hope in the BIMP-EAGA region. In the context of ASEAN, AEC is an idea to establish a common market where there will be a freer movement for goods and services, capital and skilled labors that is to be implemented gradually. Hence, the main objectives are to facilitate the movement of investment, capital, goods, services and skilled labor within ASEAN in order to enhance ASEAN's trade and production networks, as well as establishing a more unified market for its consumers and firms.

In a recent development, the strategic action taken by the government to improve connectivity through the Pan Borneo road project will lower the logistic cost of transportation in Sabah, stimulate economic activities and growth in either domestic or foreign direct investments (FDIs). To ensure that Sabah further benefits from the ASEAN integration, we suggest that road connectivity within Borneo is to be further expanded and improved. For instance, road connectivity with Kalimantan that is proposed by the



government is indeed a positive move as it has the potential for greater economic activities where it can reduce the trade balance position with regard to Sabah's trade with Indonesia in general and Kalimantan in particular.

With the construction of the Pan Borneo highway project and the progress of Trans Kalimantan Highway, we believe there should be a program to integrate both highways to utilize the maximum economic potentials. Both, Trans Kalimantan and Pan Borneo can be the catalyst for economic growth of Borneo.

The book in general argues that it is time to consider the idea of having road connectivity with Kalimantan. Bigger per capita income (in North and East Kalimantan) and bigger market size among others are indeed important justification to consider. The argument presented is based on various studies on Sabah-Kalimantan by several researchers. It also includes secondary data and conceptual views of the authors. It is with hope, that there will be more research to be undertaken by academicians and policymakers. We are also optimistic that in the future, various stakeholders would be willing to fund research projects similar to these topics.

## CHAPTER 2:

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# Malaysia-Indonesia Relations: an Overview

*Rizal Zamani Idris and Rafiq Idris*

### Malaysia-Indonesia Relations (1964-2016)

Malaysia and Indonesia have strong bilateral relations and are steady partners on numerous spheres. Both share diverse and expanding partnership. Both countries are integrated through the close cooperation in ASEAN. Verily, in the past 50 years Malaysia-Indonesia relationship is marked by cooperation despite bumpy ties that had shaped their relationship.

Malaysia and Indonesia cooperate closely on security matters, including maritime, counter terrorism, and regional stability. The relationship between the Malaysian and Indonesian militaries is also strong with numerous exchanges, training, joint exercises, and visits.

Besides that, Malaysia and Indonesia have strong people-to-people links which may be attributed to geographical factor and family relations. On education, in 2015, there were

over 4,417 Malaysians who studied in Indonesia (MOHE, 2015). In 2015 alone, it was reported that about 8,956 Indonesian students studied in Malaysia's higher public and private education institution (MOHE, 2015).

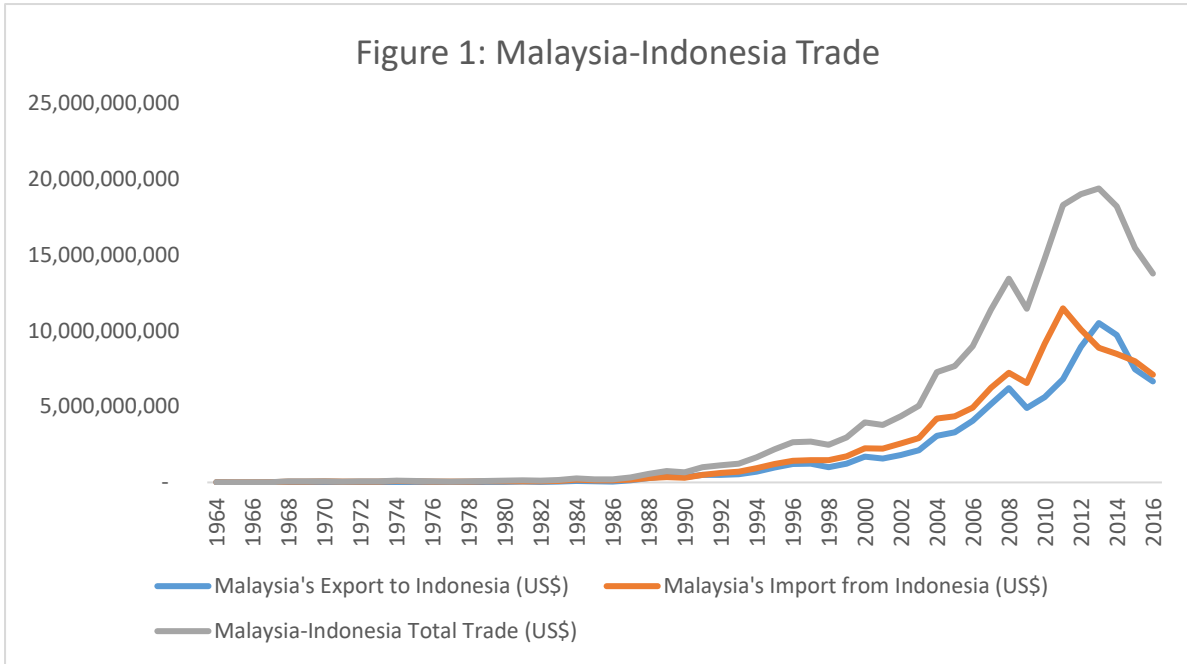
While both are experiencing strong diplomatic relations, there were circumstances where both countries faced difficult times. For instance, the confrontation in the 1960s had affected the relations during that era (Mohd Nor Yazid, 2007). However, the relations recovered after that. In addition, both countries have domestic concerns that affect their mutual interests and caused tensions in their relationship such as Indonesian maid issue.

With regard to trade relations, Malaysia's trade with Indonesia has always ameliorated besides the ups and downs in its bilateral relations. Trade has increased by more than 1000% between 1964 and 2016 (refer to figure 1 and table 1 for details). Trade rises in most years except for slight drop in the year 1965, 1971, 1975-1977, 1982, 1985, 1986, 1990, 1998, 2001, 2009, 2014, 2015 and 2016. Malaysia, most of the times experienced trade deficit in its bilateral trade with Indonesia which implies that Malaysia imports more than what it exports to Indonesia. The only few years where Malaysia experience

trade surplus were in 1989, 1990, 1991, 2013 and 2014 (figure 2).

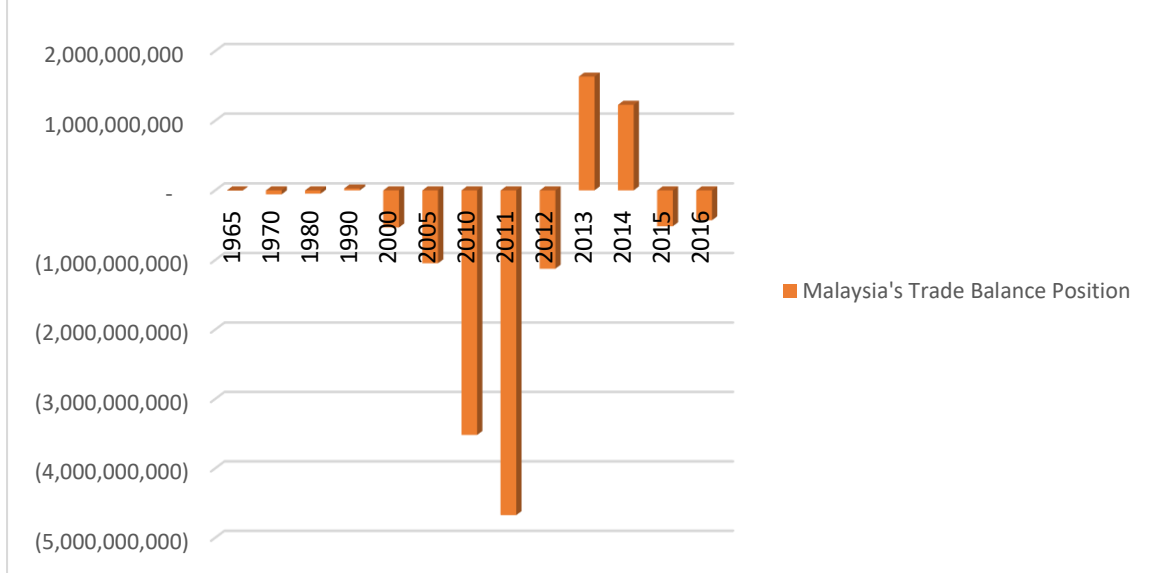
Regarding broader classification of trading products where both countries trade with each other, table 1 gives the details. Table 1 specifies the bilateral trade by product categories at 1 digit code based on Standard International Trade Classification (SITC).

Figure 1: Malaysia-Indonesia Trade



Source: United Nations (2017)

Figure 2: Malaysia's Trade Balance Position on its trade with Indonesia (US\$)



Source: United Nations (2017)

**Table 1: Malaysia-Indonesia Trade by Product Categories**

Commodity Code	Commodity	Malaysia's Export to Indonesia (US\$)	Malaysia's Import from Indonesia (US\$)
0	Food and live animals	508,017,884	857,336,582
1	Beverages and tobacco	112,652,106	161,055,967
2	Crude materials, inedible, except fuels	200,033,053	92,599,456
3	Mineral fuels, lubricants and related materials	1,658,668,236	1,478,407,253
4	Animal and vegetable oils & fats	50,291,319	1,169,759,859
5	Chemicals	1,520,437,757	590,296,362
6	Manufact goods classified chiefly by material	796,337,652	1,279,565,913
7	Machinery and transport equipment	1,410,428,810	1,087,321,004
8	Miscellaneous manufactured articles	366,541,284	360,935,455
9	Commod. & transacts. Not class. Accord. To kind	39,796,634	15,296,440

*Source: United Nations (2017)*

Table 1 depicts that Malaysia's top 3 export products at 1 digit level are mineral fuels, lubricants and related materials (SITC-3), Chemicals (SITC-5) and Machinery and transport equipment (SITC-7). Concerning Malaysia's main import from Indonesia, Malaysia's top 3 import products at 1 digit level are mineral fuels, lubricants and related materials (SITC-3), manufacturing goods classified chiefly by material (SITC-6) and animal and vegetable oils and fats (SITC-4).

Bilateral trade is at an increasing trend with the exception to recent years when there is a crisis, recession or slowing down of the world economy.

In the context of Sabah-Indonesia ties, the relationship has always been cordial for the past 50 years with exception to very few incidences such as the 1960s confrontation. People-to-people relations have been very strong. Many Sabahans have relatives in Indonesia. Many Malaysians consider Indonesians as their brothers and sisters.

Many Indonesians have been working in Sabah for more than 50 years. Indonesians among others, have contributed to Sabah's economy by working at the plantation and construction sector.



Regarding education link, there have been thousands of Sabahans who have studied in Indonesia overtime and vice versa. Concerning economic ties, Sabah is integrated with the Indonesian economy through ASEAN, ASEAN Free Trade Agreement (AFTA) and Brunei-Indonesia-Malaysia-Phillipines East ASEAN Growth Areas (BIMP-EAGA).

Sabah's trade with Indonesia has an incremental trend. In 1963, Sabah's export to Indonesia was just US\$279,053 while import was amounting US\$7,889,182, hence causing a trade deficit. However, in 2015, Sabah recorded an export worth RM1.7 billion with a trade surplus amounting RM697.9 million.

From movement of people perspective, data for the past 15 years show that Indonesians are the most prominent visitors by nationality who visited Sabah from the ASEAN region. In the year 2016 alone, 162,935 visitors from Indonesia visited Sabah.

Despite all the achievements, there were also issues and challenges. Some of the challenges faced by the business community in the context Sabah-Kalimantan trade ties are, the change in the provision of the use of *Kumpit* (wooden hull), the use of barter trade jetty, the creation of ESSCOMM/ESSZONE and others. Such circumstances may have affected business

activities. However, it is important to note that all policies being implemented by the government have its justification such as for security reason. All in all, while both countries experience challenges in their relations, trade have always ameliorated and the benefits for cooperation in all situations exceeded the costs.

## **Reference**

Mohd Nor Yazid (2007). *Hegemonic powers, radical politics and development state: the case of Indonesia-Malaysia political relations during the cold war*. Penerbit Universiti Malaysia Sabah

Ministry of Higher Education (MOHE) (2015). Data obtained from MOHE's website.

United Nations COMTRADE (UN COMTRADE) (2017). United Nation's Commodity Trade Statistics (COMTRADE).



## **CHAPTER 3:**

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### **Sabah in ASEAN under the initiative of AFTA, BIMP-EAGA and AEC**

*Rafiq Idris and Kasim Mansur*

Under the Association of South East Asian Nation (ASEAN), Malaysia has benefited significantly through various agreements, initiatives or programs. On this regard, Sabah as a state in Malaysia is not an exception.

When ASEAN was established in 1967, various agreements were signed and many programs were organized and executed. Among the big ones were the ASEAN Summit which was first held in Bali Indonesia in 1976, ASEAN Free Trade Area (AFTA) Agreement signed in 1992, Brunei Darussalam-Indonesia-Malaysia-the Phillipines East ASEAN Growth Area (BIMP-EAGA) formed in 1994, ASEAN Regional Forum (ARF) established in 1994, ASEAN +3 in 1997, ASEAN-China Summit in 1997, ASEAN +6 or also known as East Asia Summit where the first meeting held in

2005 and the recent initiative known as ASEAN Economic Community (AEC) among others.

This chapter focuses the most significant initiatives which are namely the AFTA Agreement, BIMP-EAGA and the ASEAN Economic Community. The AFTA Agreement was signed in 1992 during the ASEAN Summit in Singapore with the goal to integrate the ASEAN market where there is a freer movement of goods and services by reducing trade barriers gradually. Since the AFTA Agreement was signed, it has attracted many questions from the general public. Have bilateral trade between Sabah and its neighboring countries increase significantly?

In 1994, the BIMP-EAGA was established with the goal to stimulate growth in key areas involving four countries which are namely Brunei Darussalam, Indonesia, Malaysia and the Philippines. The critical areas in BIMP-EAGA are the agro-industry, fisheries, tourism, energy, transport and shipping. Since the establishment of this sub regional cooperation, has growth in the key areas increased? Has regional trade increased significantly? Figure 1 and 2, illustrates how trade between Sabah and Indonesia have changed after AFTA and BIMP-EAGA were launched.

Figure 1 shows that export to Indonesia has increased overtime post the AFTA Agreement 1992 and BIMP-EAGA 1994 initiative even though at times there was a reduction. However, export to Indonesia did not increase sharply immediately after the AFTA Agreement was signed and after the BIMP-EAGA was launched. It took several years before it happened. The increase was visible post the 1997/98 Asian Financial Crisis.

In terms of Sabah's import from Indonesia, a clear pattern of increase started after the 1997/98 Asian Financial Crisis. However, it is hard to attribute the increase to BIMP-EAGA since the focus was more on stimulating the growth in the 5 Strategic key areas.

Figure 1: Sabah's Export to Indonesia



Figure 2: Sabah's Import from Indonesia





In an effort to further integrate ASEAN, ASEAN countries had agreed to establish the ASEAN Political-Security Community, the ASEAN Economic Community and the ASEAN Socio-cultural Community. The 27th ASEAN Summit in Kuala Lumpur recorded a history when the ASEAN Leaders announced the formal establishment of the ASEAN Community in December 2015. For that purpose, the ASEAN Community Vision 2025 and the ASEAN Community Blueprint 2025 were announced where it is being targeted for the period 2016-2025, and are intended to establish the ASEAN Political-Security Community, the ASEAN Economic Community and the ASEAN Socio-cultural Community.

The ASEAN Economic Community (AEC) is a type of economic integration where it further expands the previous form of integration known as the ASEAN Free Trade Agreement (AFTA). Although Malaysia has FTA agreements with all other AEC members, the AEC is seen as a positive step towards deeper economic integration within the region.

In the context of ASEAN, the AEC focuses on the idea of establishing a common market where there will be a freer movement of goods and services, capital and skilled labors which is to be implemented gradually. Hence, the primary objective is to facilitate the movement of investment, capital,

goods, services, and skilled labor within ASEAN in order to enhance trade and production networks and to establish a more unified market for its consumers.

In sum, after few processes of integration and cooperation, it is expected that the diplomatic and economic relationship is further strengthened under the AEC. It is projected that both will gain more than before through the further opening up of the economy under the framework of AEC.

### **Reference**

Malaysia's International Trade and Industry Ministry (MITI)  
(various years) MITI's annual report (various issues)



## **CHAPTER 4:**

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# **Malaysia's Consumer Products in North Kalimantan**

*Rafiq Idris, Azmi Majid and Liu Hao*

### **INTRODUCTION**

There are vast potentials of integrating the economy of Sabah and Kalimantan. Bigger per capita income and market size in Kalimantan is an excellent reason to integrate both economies further. Table 1 gives a snapshot of Sabah and Kalimantan economy in general.

In recent years, the idea to strengthen economic relations with Kalimantan has become a subject of interest. Business chambers, non-governmental organizations (NGOs) and academicians among others, have highlighted their interest in the effort of having greater economic interaction between these neighboring states. The interest is further stimulated when there was a proposal for having road connectivity with North Kalimantan which is still under consideration.

**Table 1: Key facts about the economy of Sabah & Kalimantan**

Indicator	Sabah	North Kalimantan	East Kalimantan	Central Kalimantan	South Kalimantan	West Kalimantan
Capital City	Kota Kinabalu	Tanjung Selor	Samarinda	Palangkaraya	Banjarmasin	Pontianak
Population (based on 2010's census)	3.5 Million	622,350	3.03 Million	2.2 Million	3.36 Million	4.4 Million
Major exports (2015)	Petroleum, palm oil	Coal, lignites, food products, wood products	Coal, natural gas, lignite, petroleum, chemical products	Coal, lignites, metal ores, food products, rubber & plastic products	Coal, lignites, food products	rubber curing, plywood
Total Exports (2015) (US\$)	10.9 Bil	301.7 Mil	18.4 Bil	1.06 Bil	5.7 Bil	561.9 Bil
GDP Per Capita (US\$)	4934 (RM19734)	7170	11,645	2763	2515	2095
Main Export Destination	India, China, EU, Singapore	India, Japan, China, Taiwan, Malaysia	Japan, India, China, South Korea, Taiwan	Japan, India, Pakistan, China, Malaysia	India, China, Japan, Thailand	Japan, Korea, China, Malaysia, India

In relation to this, a few questions arise. If there is a road, are we going to lose out in competition? Is there any Malaysian consumer products currently consumed in Kalimantan? What are examples of products that are currently available on the shelf in some of the shops in North Kalimantan? This short survey intends to document products which have penetrated the neighboring market. There are more Malaysian products available and not limited to those listed in this study.

## **SURVEY**

The survey and compilation of products are based on a observational survey and assistance from research assistants in Indonesia. Over 20 shops were visited randomly in Tarakan. The objective was to identify examples of Malaysian consumer products which are available in Tarakan, North Kalimantan.

## **EXAMPLES OF MALAYSIAN PRODUCTS**

Based on the survey conducted, the study is able to identify the following products (refer to table 2 and 3) which are available in Tarakan. The major product categories which are namely food and beauty products are being classified in this study but not limited to those in table 2 and 3 only.

**Table 2: Malaysian Food Products in Tarakan**

<b>NO</b>	<b>PRODUCT NAME</b>
1	3 IN 1 IPOH WHITE COFFEE - KING
2	3 IN 1 ORIGINAL HORLICKS
3	3 INI 1 IPOH WHITE COFFEE - COFFEE AND CREAMER
4	AIK CHEONG - MINUMAN COKLAT
5	ALICAFE
6	APOLLO
7	APOLLO - ROKA KOKO
8	APOLLO - ROKA SUSU
9	AYAM BRAND - CHUNKS IN OIL TUNA
10	CACAO COCONUT CANDY
11	CADBURRY - DAIRY MILK BLUEBERRY
12	CHUNKYBAR
13	COCOALAND - CHOCO JELLY
14	F&N MILK
15	GEE - OATBAR WITH CHOCOLATE
16	GIANT SHEET KOREAN SEAWEED
17	GREEN TEA LATTE
18	HITEA - TONGKAT ALI DAN GINSENG
19	INSTANT GINGER TEA
20	JACK 'N JILL - CLOUD9 CLASSIC
21	LA FONTE PASTA
22	LA FONTE PASTA SAUCE
23	LEXUS - PEANUT BUTTER
24	LONDON - CAKE ROLL
25	MA LUNG - GREEN PEAS

26	MAGGI - CUKUP RASA
27	MAGGI - MI
28	MAGGI - SOS OLI THAI
29	MAIZENAKU
30	MELILEA - MINUMAN SERBUK KEDELAI
31	MILO
32	MILO
33	NESCAFE
34	NESTLE - NESTUM
35	PMN - STRAWBERRY COOKIES
36	PRESERVED FRUITS
37	PRESERVED PLUM
38	PROCHIZ - CHEDDAR
39	QUAKER - INSTANT OATMEAL
40	SEEDLESS PLUM
41	SERBUK KARI DAGING
42	SKA - HAPPY POP
43	SUPER POWER TEA TARIK
44	TONG GARDEN - HONEY MACADAMIAS
45	TOTOLE - VEGETARIAN FOOD
46	TSF - BISKUIT KELADI
47	WHO HUP - SOS HUISIN
48	WIN2 - CHOCOLATE COATED WAFER ROLLS
49	WIN2 - POTATO CRISPY



**Table 3: Malaysian Beauty Products in Tarakan**

<b>NO</b>	<b>PRODUCT NAME - PRODUCT TYPE</b>
1	AP24 - WHITENING FLOURIDE TOOTHPASTE
2	BDL - FACIAL WASH
3	CARRIE JUNIOR - HAIR AND BODY WASH
4	COLGATE - TOOTHPASTE
5	DARLIE - TOOTHPASTE
6	FAIR AND LOVELY - ADVANCED MULTI VITAMIN
7	KOJI SAN - BODY LIGHTENING LOTION
8	KOJIE SAN - FACE WASH
9	LEIVY - DOUBLE MOISTURISING SHOWER CREAM
10	NU SKIN - BODY LIQUID LUFRA
11	NU SKIN - LIQUID BODY BAR
12	NU SKIN - NAPCA MOISTURE MIST
13	PALM OLIVE - AROMA THERAPY
14	PAPAYA - WHITENING SOAP
15	RDL - BABY FACE PAPAYA EXTRACT
16	SHURAH - MANDIAN WANGI
17	SHURAH PENCERAH - PEMBERSIH MUKA
18	SOFIA - GOATS MILK
19	SUMMER - BODY SHAMPOO
20	VELVET - BODY THERAPI
21	VELVY - LULUR MANDI SUSU KAMBING
22	VELVY - MILK BODY LOTION

## **CONCLUDING REMARKS**

It is evident that the consumption of Malaysian consumer products has been held for many years. With the idea of the road connectivity and the fact that the per capita income in the East and North Kalimantan are higher, there is potential that Sabah can increase its export to North Kalimantan. However, this is again very much dependent on various factors such as the export promotion activities and the supply of other products which potentially have popular demand in Kalimantan.



## CHAPTER 5:

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# **Sabah-Kalimantan Road Connectivity: The Effect of Common Border on Export**

*Rafiq Idris*

### **INTRODUCTION**

In an effort to explore new economic window, there was a suggestion to further integrate the economies in Borneo island by improving connectivity. Road connectivity with Kalimantan has been proposed as having the potential to further stimulate Sabah's economic growth. One of the suggestions was to have road from Serudong to Simanggaris from Malaysia's side of Sabah.

In the context of Sabah, several questions arise: how does this benefit the state? Should there be additional efforts to connect Sabah and Kalimantan via road? Should Sabah spend money to improve logistical connectivity with Kalimantan? This chapter discusses briefly the latest proposal by the government to establish a road connectivity with North

Kalimantan, by estimating the effect of common border when having good road on export.

Generally, there are limited studies assesses the impact of Sabah-Kalimantan Road Connectivity from Sabah's perspective. This study shall give an overview and fill in the literature gap by providing an estimation of the common border effect through road connectivity in the context of Sabah-Kalimantan further economic integration.

## **METHODOLOGY**

The study primarily uses gravity model to assess the impact of road connectivity with border country on trade. Part of this study has been presented in an international conference in University of Cambriedge (Rafiq Idris, 2017). Since there is no proper road connecting Sabah and Kalimantan, the study estimates the effect of common border on Malaysia's export. The effects on Malaysia as a whole may project similar results for Sabah by having road link with Kalimantan. Equation (1) of gravity model is used to assess the effect of common border when there is road connectivity on Malaysia's export.

$$\ln(XM_{ijt}) = \beta_0 + \beta_1 \ln D_{ij} + \beta_2 \ln(Y_i Y_j)_t + \beta_3 \ln(N_i + N_j)_t + \beta_4 \ln E_{ijt} + \beta_5 FTA_{ijt} + \gamma CB_{ijt} + \epsilon_{ijt} \dots \dots (1)$$

where in equation (1) subscript  $i$  denotes the exporter (Malaysia) while  $j$  denotes the importer. In addition  $\ln(.)$  denotes the natural logarithm operator. The data source and independent variables are defined in Table 1.

With a robust standard error and 21 years of observation from 1990 to 2010, regression analysis involving Malaysia's trade data with its 188 countries are being undertaken. In addition, a sensitivity analysis by cutting the observation into half were made.

**Table 1: Data and source**

<b>TYPE OF VARIABLES</b>	<b>DATA</b>	<b>SOURCE</b>
Dependent Variable $\ln XM_{ijt}$	Natural log of annual exports of Malaysia to country $j$ (involving 188 countries), in real US dollars (in equation (1))	United Nations Commodity Trade (2017)
Independent Variables $\ln D_{ij}$	the distance between country $i$ and country $j$ in natural logarithmic form (capital city distance in kilometer)	Geobytes (2012) websites
$\ln (Y_i Y_j)_t$	GDP of country $i$ and $j$ in multiplicative and logarithmic form (in real US dollars)	World Bank (2017)
$\ln (N_i + N_j)_t$	the sum of population in country $i$ and $j$ in logarithmic form	Heston, Summers and Aten (2012)
$\ln E_{ijt}$	Bilateral exchange rate. Trading partner's units of currency that can be purchased by one RM (for equation 1)	World Bank (2013)
$FTA_{ijt}$	Dummy variable of FTA. The value is unity if country $i$ and country $j$ both belong to the same bilateral/regional trade agreement and zero otherwise	World Trade Organization's website, Malaysia's International Trade and Industry Ministry (MITI) annual report (various issues)[for equation (1).
$CB_{ijt}$	is a binary variable which is unity if $i$ and $j$ share a land border	

**Table 2: Regression Results**

<b>Dependent variable: Log Export</b>	<b>Total Export</b>	<b>Total Export (Sensitivity Analysis)</b>
<b>Independent variables:</b>		
Ln Distance	- 1.015*** (0.065)	-1.111*** (0.057)
CB	0.625*** (0.157)	1.242*** (0.166)
$\ln Y_i Y_j$	0.879*** (0.017)	0.95*** (0.012)
$\ln(N_i + N_j)$	0.287*** (0.048)	
FTA	0.897*** (0.134)	
$\ln E_{ijt}$	-0.109*** (0.011)	
Constant	-22.822*** (0.828)	
Observation	3597	3597
R-Squared	0.664	0.646

**RESULTS & CONCLUDING REMARK**

The regression results using ordinary least square (OLS) as estimation method shows that common border is positively linked to trade of Malaysia. Table 2 depicts the results for both with 6 variables and sensitivity analysis with 3 variables only.



The results in table 2 shows that common border has positive and significant association with Malaysia's export for the period under investigation. Similarly, it is expected that the road connectivity with Kalimantan is projected to increase Malaysia's and Sabah's export. The effect of common border on export in this study is consistent with theory and many past studies such as in Rose (2004), Yamarik and Ghosh (2005) and Ruzita *et.al* (2009) at least for certain disaggregated product categories. Therefore, it is expected that road connectivity could stimulate demand from North or East Kalimantan for Sabah's products and this could increase Sabah's export.

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## CHAPTER 6:

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# **Sabah-Kalimantan Road Connectivity: Effect of Cultural Affinity on Sabah's Export**

*Rafiq Idris, Kasim Mansur, Rizal Zamani Idris,  
Zuraida Jamrin and Marso*

### **INTRODUCTION**

As depicted in Chapter 4, there was a proposal of establishing road connectivity between Sabah and North Kalimantan, where there was an idea to connect Serudung and Simanggaris via road. This indeed has the potential to add impetus for greater economic integration between Sabah and North Kalimantan under the framework of AEC. This chapter highlights the finding of a study which examines the effect of cultural affinity on Sabah's export econometrically, based on Sabah's 16 years export data to each and every country of the world using gravity model.

## METHODOLOGY

The study uses gravity model to assess the impact of cultural affinity on Sabah's export. The findings of this study has also been presented and published in an academic journal (Rafiq Idris et.al, 2017). Since there is no proper road connecting Sabah and Kalimantan, the study estimates the effect of cultural affinity on Sabah's export. With cultural and language similarities which are due to few common ethnicities in these two areas, what is the the effect on Sabah's export? This paper estimates the impact of cultural affinity in general on export looking at Sabah's experience.

Equation (1) is used to assess the effect of cultural affinity on Sabah's's export:

$$\ln(XS_{ijt}) = \beta_0 + \beta_1 \ln D_{ij} + \beta_2 \ln(Y_i Y_j)_t + \beta_3 \ln(N_i + N_j)_t + \beta_4 \ln E_{ijt} + \beta_5 FTA_{ijt} + \gamma CA_{ijt} + \epsilon_{ijt} \dots \dots \dots (1)$$

where in equation (1) subscript i denotes the exporter (Malaysia) while j denotes the importer. In addition  $\ln(\cdot)$  denotes the natural logarithm operator. Table 1 describes the variables.

**Table 1: Data and source**

TYPE OF VARIABLES	DATA	SOURCE
<b>Dependent Variable</b> $\ln XM_{ijt}$	Natural log of annual exports of Sabah to country $j$ (involving 182 countries), in US\$	Department of Statistics, Malaysia, (various issues)
<b>Independent Variables</b> $\ln D_{ij}$	the distance between country $i$ and country $j$ in natural logarithmic form (capital city distance in kilometer)	Geobytes (2017) websites
$\ln (Y_i Y_j)_t$	GDP of country $i$ and $j$ in multiplicative and logarithmic form (in real US\$)	World Bank (2017) and Department of Statistics, Malaysia, (various issues)
$\ln(N_i+N_j)_t$	the sum of population in country $i$ and $j$ in logarithmic form	World Bank (2017) and Department of Statistics, Malaysia, (various issues)
$\ln E_{ijt}$	Bilateral exchange rate. Trading partner's units of currency that can be purchased by one RM	World Bank (2017) and Currency Converter Website
$FTA_{ijt}$	Dummy variable of FTA. The value is unity if country $i$ and country $j$ both belong to the same bilateral/regional trade agreement and zero otherwise	World Trade Organization's website, Malaysia's International Trade and Industry Ministry (MITI) various annual report (various issues)
$CA_{ijt}$	is a binary variable which is unity if $i$ and $j$ have similarities in culture	

With 16 years of observation from 2000 to 2016, regression analysis involving Sabah's export data with 182 countries are being undertaken. Two estimation method are being used which are namely the Ordinary Least Square Method and Heckman Selection Model. The coefficient of interest in this study is cultural affinity, where countries that have communities with similar language and culture are taken into account. The countries identified as having common culture with Sabah are Brunei, Philippines and Indonesia. The finding of this study may provide additional justification together with other factors, whether to have or not to have road with North Kalimantan.

## **RESULTS & CONCLUDING REMARK**

The results in table 2 shows that cultural affinity has positive and significant association with Sabah's export for the period under investigation. The results are similar using two estimation methods which are the OLS method and Heckman Selection Model.

**Table 2: Data and source**

<b>Dependent variable:</b> <b>Log Export</b>	<b>Total Export</b>	<b>Total Export (Heckman Selection)</b>
<b>Independent variables:</b>		
Ln Distance	-3.01 *** (0.166)	-2.529*** (0.184)
CA	3.679*** (0.791)	2.745*** (0.584)
lnY <sub>i</sub> Y <sub>j</sub>	1.633*** (0.055)	1.279*** (0.103)
ln(N <sub>i</sub> + N <sub>j</sub> )	0.515*** (0.117)	0.588*** (0.092)
lnE <sub>ijt</sub>	-0.342*** (0.037)	-0.231*** (0.036)
Constant	-49.5*** (2.521)	-36.706*** (3.881)
Observation	2855	2855
R-Squared	0.524	

The effect of cultural affinity on export in this study is consistent with many past studies such as in Rose (2004) and Yamarik and Ghosh (2005) where the studies used common language as one of the variables. A common language which is associated with common culture is observed to reduce



translation expenditure and hence transaction costs. This leads to higher export for both parties.

Road connectivity with North Kalimantan where it involves population who may share some similarities in terms of culture has the potential of bringing many economic benefits. The regression results indicate that from Sabah's experience, cultural affinity has increase Sabah's export to Indonesia. With road connectivity with North Kalimantan, due to common border and cultural affinity, it is projected that Sabah's export will further increase. Cultural affinity lowers transaction cost such as translation cost and that makes communication to be easier.

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## CHAPTER 10:

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### **Sabah-Kalimantan Road Connectivity: Potential Economic Benefits**

*Rafiq Idris and Kasim Mansur*

As discussed in earlier chapters, there are many potential benefits of constructing a road to link these two regions. This chapter attempts to justify the efforts to integrate both economies for instance through road connectivity. It is important to explain some of the potential economic benefits.

Even though Borneo states are integrated via the AFTA or AEC or BIMP-EAGA, there is no evidence which shows economic interaction or trade volume is substantial.

Further economic integration through road connectivity with North Kalimantan is important because it supports the AEC initiative for deeper economic and people to people integration and interaction. A freer movement of investment, skilled labor and capital through the AEC would mean that ASEAN strives to further enhance its image as an

attractive investment destination on a global scale through the establishment of a transparent, open, and predictable investment regime in the region (Rafiq, 2016). The amelioration of investment environment in ASEAN is to be achieved by the implementation of the ASEAN Comprehensive Investment Agreement (ACIA), which provides for progressive liberalization of existing investment restrictions in manufacturing, agriculture, fishery, forestry and mining and the services incidental to these sectors, giving more investment protection and ensures transparency of investment regulations, laws and administrative guidelines (AEC Blueprint 2025, 2015).

As a result of the reform, it has the potential of attracting more foreign direct investments (FDIs) to enter Sabah or other locations in ASEAN. Besides attracting investment from countries outside ASEAN, it also may add impetus for ASEAN investors to invest within ASEAN and specifically, in Sabah. More FDIs into Sabah would mean more job and income and wealth creation in the state as a result of a spin-off effect or a multiplier effects. Thus, it gives a positive impact on Sabah's gross domestic product (GDP). Many past studies have shown that FDI has positive effects on the

economy. For instance, Rafiq Idris and Rizal Idris (2013) found that FDI granger causes Malaysia's export.

Malaysia and other ASEAN members have been integrated much earlier through the ASEAN Free Trade Agreement (AFTA). In continuation of earlier efforts, ASEAN will continue to eliminate or decrease border and behind-the-border regulatory barriers that affect trade. This can make trade cheaper and hence may have positive effects on trade. Table 3 shows Malaysia's trade value with its ASEAN counterpart and the trade balance position. Table 1 shows Sabah's trade value with its ASEAN counterpart.

Table 1 indicates that Sabah had trade deficit in its trade with Cambodia, Indonesia and Singapore. It is hoped that AEC will stimulate export activities in Sabah to reduce the trade deficit. This can be done by having more promotion activities especially for product categories where Sabah has a comparative advantage.

**Table 1: Sabah's trade value with its ASEAN counterpart and the trade balance position.**

Year	ASEAN Trading Partner	Sabah's Import (in RM)	Sabah's Export (in RM)	Trade Balance Position (in RM)	Trade Balance Position
2013	Singapore	4.8 bil	1.18 bil	(3.6 bil)	Trade Deficit
2013	Thailand	1.017 bil	1.7 bil	746 mil	Trade Surplus
2013	Indonesia	849 mil	471 mil	(378 mil)	Trade Deficit
2013	Viet Nam	364.4 mil	1.19 bil	827 mil	Trade Surplus
2013	Philippines	283.8 mil	704.8 mil	421 mil	Trade Surplus
2013	Myanmar	5.67 mil	9.07 mil	3.4 mil	Trade Surplus
2013	Cambodia	10.7 mil	2.48 mil	(8.2 mil)	Trade Deficit
2013	Brunei Darussalam	17.4 mil	396 mil	379 mil	Trade Surplus

*Source: Rafiq Idris (2016)*

In a recent development, the strategic action taken by the government to improve connectivity through the Pan Borneo Highway project will indeed lower the logistic cost in Sabah, will stimulate economic activities and attract foreign direct investment. To ensure that Sabah further benefits from ASEAN integration, the study suggests that road connectivity within Borneo island is to be further improved. For instance, road connectivity with East Kalimantan proposed by the government indeed is a positive move as it has the potential for

higher economic activities and engagement where it can reduce the trade balance position with regard to Sabah's trade with Indonesia.

With the construction of Pan Borneo Highway becoming a reality and the progress of the Trans Kalimantan Highway, there should be a project to integrate both highways to develop the possible economic potentials. Both highways can be the catalyst for economic growth of Borneo and begin by creating a corridor to link both highways and induce development along the corridor as the new growth cluster.

What are the potential benefits of strengthening economic relations with Kalimantan? From the international trade perspective, Kalimantan's market size is more than 4 times larger than that of Sabah, and this offers a lot of opportunities for Sabah. Road connectivity could stimulate demand from North or East Kalimantan for Sabah's products and this could increase Sabah's export. In this regard, there are product categories where both have a comparative advantage. In this respect, Sabah should initiate more trade based on comparative advantage.

From the investment perspective, Sabah can also focus on down streaming activities by processing resources where Kalimantan has an abundant stock of natural resources. Road



connectivity can lower the cost of importation from Kalimantan. Down streaming activities in Sabah will create more job opportunities and income generation. With road connectivity, it will open opportunities for both Malaysian as well as Indonesians investors to invest in both affected areas of Sabah and Kalimantan. These products can be re-exported to either side if the production cost is much lower.

From the small and medium enterprises' (SMEs) perspective, road connectivity will stimulate the SMEs' activities due to competition. In addition, it will complement the AEC's agenda where there will be a freer movement of goods and services, skilled labors, investment and stimulate innovations and creativity. Consequently, it may stimulate demand for Sabah's products if sufficient export promoting activities are to be undertaken.

Moreover, road connectivity would help Sabah exporters namely industry players to achieve economies of scale. One of among many possible reasons why trade occurs between countries is because they want to achieve economies of scale. The larger the production scale due to larger demand will lower the unit cost of production. Therefore, road connectivity is expected to open up business opportunities and create new demand for Sabah's products, hence would

stimulate trade. When there are more demand and trade, it has the potential of reducing the per-unit cost of production and hence expand Sabah's SMEs.

Furthermore, road connectivity will add an impetus towards the expansion of strategic sectors. In this regard, Sabah's tourism industry can be further boosted. More tourists are expected to visit Sabah. When there is connectivity, it may increase the possibilities of people from Kalimantan to acquire their quality tertiary education in Sabah. This will give a lot of positive return to Sabah's education sector. In addition, medical tourism can be further promoted and enhanced when there are roads connecting Sabah and Kalimantan.

Moreover, Sabah can be a gateway for Borneo if there are more direct flights from foreign countries. This can boost Sabah's tourism industry. Apart from that, roads will further increase the possibilities of increasing cargo traffic at the Sapangar transshipment hub. Goods can be transported to North or East Kalimantan via road from Sapangar Port if Sabah has good roads.

Strengthening bilateral economic ties can further improve Malaysia's trade balance position which recorded to be trade deficit most of the years. For the case of Sabah, it can

also ameliorate Sabah's trade balance position with Indonesia if we can harness the opportunities.

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## CHAPTER 11:

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### **Strengthening Sabah-Kalimantan Economic Relations: Concluding Remarks & Recommendations**

*Rafiq Idris and Kasim Mansur*

The collection of articles in this book does not cover all aspects of the economy to make it comprehensive. This book is an initial step made by a group of academicians from Faculty of Business, Economics and Accountancy, Universiti Malaysia Sabah (UMS) to compile research articles by academicians. In this regard, it has to be acknowledged that the Society Empowerment and Economic Development of Sabah (SEEDS) has been very supportive in this initiative. There is ongoing research related to cross-border trade between Sabah and North Kalimantan that might be considered for publication in the future.

In general, the articles have attempted to understand and analyse the similarities, differences and availability of infrastructure in both areas. In addition, the chapters have

attempted to highlight some of the potential economic benefits when there is deeper economic integration between both states.

The spirit and motives of these articles suggest that there should be an effort to strengthen the economic ties between these two areas further. There are certain things that need to be in place such as infrastructure.

Several recommendations have been put forth by the authors such as the need to conduct a comprehensive study, the need to link the Pan Borneo and Trans Kalimantan Highways, to prepare our SMEs for competition, to have a concrete and comprehensive roadmap and consider the idea of establishing special economic zone.

From theoretical and practical perspectives, road connectivity is something that should be supported. It has the potential of bringing many economic benefits. As discussed earlier, it has the potential of helping Sabah's exporters and producers to achieve economies of scale due to larger market size, lowering logistic costs, helping to improve Sabah's SMEs, encouraging investment and down streaming activities among others.

However, it is important to note that before the road connectivity is to be implemented, there is a need for a

comprehensive study which is in addition to this study is a must to quantify monetarily the potential economic benefits and costs. The idea of undertaking a fair cost-benefit analysis is not to discourage the idea but additional policies or measures can be introduced to cushion the impact of any possible adverse effects.

In addition, prior to implementation, more stakeholders' engagement program should be organized to obtain feedback. This helps to obtain information from various angles and those to be affected by the proposed project. It helps policy makers to design the right policy.

Moreover, strategic sectors must be assisted so that Sabah can realize its potential based on comparative advantage. Sabah should specialize and focus based on its strength which is its comparative advantage which can be viewed in the study of Rafiq Idris (2015).

Apart from that export promotion and investment activities should be increased. Agencies doing export and investment promoting activities should play a greater role by organizing programs such as trade expos in Malaysia and Kalimantan, business matching activities and business chambers engagement programs. Another example would be to

attract investment so that prominent foreign university campus or health centers will open in Sabah. Organizations such as SEEDS, local business chambers and relevant authorities in Malaysia and Indonesia can play greater a role.

Furthermore, issues related to security, movement of people, movement of goods, services, capital and investment should continuously be monitored and should not be overlooked. This is to ensure that Sabah gains from this integration.

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