4. REGIONAL ECONOMIC INTEGRATION AND GOVERNMENT POLICIES

4.1 THE INTERNATIONAL TRADE FRAMEWORK

Changes in worldwide affluence have affected the total value of world trade and investment, the types of products involved, as well as the proportionate value of international business accounted for by individual countries. Each country adopts trade policies of either being open or protected. The various trade controls imposed by the respective governments, in respect of changes or modification made to the prices, volume and product composition as well as the direction of import and export, thus govern the international business environment.

4.1.1 World Trade Organisation

The World Trade Organisation (WTO) was set up in January 1995 as the successor body to the GATT and upon the conclusion of the Uruguay Round (UR) of multilateral trade negotiations. Its principal tasks include facilitating the implementation of the UR results, as well as a forum for the on-going multilateral trade negotiations. It provides the world with an opportunity to institute more transparent and consistent multilateral trading rules, besides increasing market access in the areas of merchandising trade and trade in services. The dispute settlement body that is established within the WTO during 1995 helps to curb the use of unilateral trade measures to resolve disputes, particularly by the larger developed countries.

Generally, the overall improvement in market access for Malaysian products in the world market due to tariff reductions, and the increase in the scope of bindings of tariffs would provide better market opportunities for Malaysian producers and exporters.

However, as they will also be subjected to keen competition from other foreign exporting nations, the Malaysian producers and exporters have to be competitive and aggressive in their marketing strategies.

4.1.2 The General Agreement on Tariffs and Trade (GATT)

GATT provides a forum for negotiating mutual reductions in trade restrictions. It is the principal global arrangement for trade liberalisation. Through tariff conferences, restrictions have been reduced on most items in the world trade, and countries have agreed on the procedures to simplify the conduct of international trade. Most countries, including Malaysia, are participants in GATT. However, negotiation broke down in the late 1990s, creating uncertainty on its future.

4.1.3 United Nations Conference on Trade and Development (UNCTAD)

UNCTAD was first convened in 1964 and attended by representatives of 119 nations. UNCTAD represents the trade interests of the developing countries with the primary objective of international redistribution of income through trade. Although it has no executive powers, UNCTAD's main activity of sponsoring a meeting every four years has become a major inter-governmental forum for examining North-South issues in trade, finance and development. Among the issues that resulted from these meetings was the Generalised System Of Preferences (GSP) where the industrialised countries had reduced tariffs for fixed amounts or specific amounts of specific manufactured imports from the developing countries.

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a) Export Credit Refinancing (ECR) scheme;

b) Export credit insurance and Guarantee (ECIG) schemes;

c) Double deduction for promotion of exports.

One of the facilities offered under the ECIG schemes is the Overseas Investment Guarantee which serves to protect the investment of Malaysian individuals and companies in a foreign country against political risks. (*Economic Report 1996/97*)

4.1.6 Bilateral Payment Arrangements

This is basically a system of settling monetary obligations arising from trade between pairs of countries. The system is set up to promote trade in the context of diversifying the country's trade from the traditional to non-traditional markets, and to foster closer economic and banking relationship between Malaysia and the respective countries. The central banks of both countries enter into an arrangement to pay each other, or guarantee payments for imports undertaken by corporate or individual residents in the respective countries. By doing this, the commercial risk relating to trade will be converted to a sovereign risk.

Currently, there are four types of arrangement that Bank Negara has signed with various countries, namely, the Iranian Model, the ALADI model, the Revolving Credit, and the Palm Oil Credit and Payments Arrangement.

4.1.7 ASEAN Economic Link

Subsequent to the Fifth Leaders' Summit in December 1995, ASEAN has focused on deepening and widening economic cooperation among its Member States. Key to the renewed efforts in enhancing such cooperation has been the acceleration towards establishing the ASEAN Free Trade Area (AFTA) from 15 to 10 years. ASEAN economic cooperation has also expanded into other areas such as services, intellectual property and the development of ASEAN Investment Area (AIA). A plan for Action on Cooperation and Promotion of Foreign Direct Investment and Intra-ASEAN investment has been endorsed. The main objective of the AIA is to increase investment in the region both from ASEAN and non-ASEAN sources by enhancing ASEAN's attractiveness and competitiveness through progressive reduction, or elimination of impediments to investments.

4.1.8 South-South Cooperation

The South countries include the People's Republic of China, Vietnam, Myanmar, Cambodia, Laos, Mauritius, Namibia, Nigeria, India, Bangladesh, Pakistan, Sri Lanka, Egypt, United Arab Emirates, Saudi Arabia, Turkey, Iran, Jordan, Algeria, Libya, Mexico, Panama, Brazil, Chile, and Papua New Guinea. However, these countries are spread out over a large geographical area and are at various stages of development. The political, cultural and socio-economic backgrounds vary. Hence, different strategies would have to be adopted to enter these markets due to the peculiar situations and difficulties encountered, such as weak financial position and the political and other risks involved.

Malaysia's economic linkages with these South countries have strengthened by a number of favourable developments that have taken place in the recent years. The presence of significant market opportunities, the liberalisation measures undertaken by these countries to open up their economies, and the rapid improvement in transport and communication have facilitated travel and trade. Significant improvements have been made in trade as well as other economic sectors, such as construction, export of services, reverse investment in manufacturing activities and tourist related projects. Nevertheless, the prospects for further cooperation are immense, and sectors for cooperation include infrastructure projects, participation in government procurements, construction and utilities projects, consultancy, privatisation, mineral exploration and agricultural development projects. With their expertise, Malaysian firms are able to penetrate and compete in some of the markets.

To facilitate private sector efforts to undertake business ventures in the countries of the South, the Malaysian Government has strengthened the institutional framework arrangements by concluding Bilateral Trade Agreements with Zimbabwe in July 1993, and Albania in January 1994, and the Investment Guarantee Agreements (IGAs) with Chinese Taipei, Hungary in 1993, and Indonesia and Albania in 1994. In addition, agreements on Avoidance of Double Taxation were also signed with Sudan, Saudi Arabia and Albania. To overcome the financial difficulties faced by some countries in paying for their imports, the Government through Bank Negara, has signed Bilateral Payment Arrangements with a number of countries, including Uzbekistan, Argentina, Albania to ensure payments for the exports.

The Malaysia South-South Association (MASSA) has assumed an important role in promoting trade and economic ties at the private sector level between Malaysia and the South countries. MASSA has established MASSCORP, a consortium company comprising 46 shareholders, to expand trade and allied services in the South countries. MASSCORP has invested in property development, construction and utility privatisation schemes, in countries such as Vietnam, Mauritius, People's Republic of China, Namibia, Chile, Papua New Guinea, Iran, India, Sri Lanka and the Philippines.

In response to the problems arising from the lack of contacts and information concerning market opportunities, continued efforts have been made to improve information gathering and dissemination through MATRADE commercial library and publications, and the establishment of the South Investment, Trade and Technology Data Exchange Centre (SITT-DEC). Improvements on communication have made it easier for the Malaysian Government and businessmen to undertake more business visits and take advantage of the business opportunities.

4.2 MALAYSIAN GOVERNMENT POLICIES ON REVERSE INVESTMENT

Currently, Malaysian companies or individuals are free to invest abroad without having to obtain approval from any government agency, except under two circumstances. The current policies on Malaysian investments abroad include:-

a) **Fiscal Incentives**

All income from overseas investment repatriated to Malaysia are tax-exempt. Start-up expenditure such as for feasibility studies is tax-exempt.

b) **Non-fiscal incentives**

On November 7 1995, Malaysia signed a memorandum of understanding with Singapore in respect of establishing a Malaysia-Singapore Third Country fund to part-finance feasibility studies in a third country undertaken jointly by a Malaysian and a Singaporean company.

c) **Exchange control measures**

Capital outflows for overseas investment are freely permitted when,

- such outflows are financed by internal funds or retained earnings of the company; and
- the company investing abroad has no credit facility from any source in Malaysia.

Approval for overseas investments is only required when,

a) residents have borrowed from the domestic ringgit market; and
b) residents have raised foreign loans to finance the investments abroad.

News Extract

To get Malaysian business going, the Malaysian Prime Minister has spent the last four years leading groups of top Malaysian businessmen on visits to China, Latin America and Africa. As a result of his initiative, Malaysian overseas investment tripled, from $560 million in 1990 to $1.84 billion in 1994, according to the Ministry of Finance. Much of the new investment is going to developing Asia: $205 million in 1994 compared with $26 million in 1990. The Malaysian companies have also been cutting deals in India, Namibia, Zimbabwe and Ghana. According to the South African High

Commission in Malaysia, in South Africa alone Malaysian businessmen have committed deals worth $750 million.

The Malaysian formula is simple: The government offers development advice to developing countries, and Malaysian businesses offer deals. The Prime Minister has personally introduced many top businessmen to their counterparts in developing countries. Malaysia has even supplied Namibia with a central banker, as part of a programme to help train the government staff from so-called South countries in administration, banking and finance.

The Malaysian government reduces risk for its businessmen abroad in a number of ways, ranging from tax incentives to export credit insurance. The Export-Import Bank of Malaysia was launched in September 1995, and the government has also encouraged its two largest banks, Malayan Banking and Public Finance, to open offices in South Africa, Uzbekistan and Cambodia. Malaysian businesses often use a consortium, Malaysian South Corp., to test the waters in new markets. While others struggle through a sea of red tape in Vietnam, for instance, a MASSCORP-led group has become the first foreign company to obtain a build-operate-transfer licence for water supply in the country, a $30 million project. Early successes have been enough to persuade Malaysian businessmen to move out into the developing world - much more fearlessly than their developed-world competitors. (Adapted from *INSTITUTIONAL INVESTOR (INT. EDITION), 31/5/96. By Christine Hill, REUTER NEWS SERVICE*)

While reverse investment may adversely affect the country's balance of payment, the on-going restructuring of the international economy towards multilateral systems and regional trading blocs is pointing towards a bigger global market and international competitiveness. "Although such investments constitute capital outflows in the initial period, they would play a strategic role in enhancing international competitiveness and market strength for the local companies in the long run." This was pointed out by the Deputy Finance Minister, Datuk Mustapa Mohamed (November 1994) in his paper which focused on "*The Past, Current and Future Trends in Malaysia*". The Minister further mentioned that such ventures would generate a stream of profits and dividends which would be remitted to the country. The country's growing reverse investments have been cited as one of the major current trends and factors that are shaping Malaysia's capability of sustaining above the 8 per cent growth that it has been experiencing since 1988.

4.2.1 Incentives for Malaysian Companies Investing Overseas

In its 1991 Budget, under the provisions of the Income Tax Act 1967, the Malaysian Government has included incentives for approved investment overseas, as follows.

a) Income remitted back to Malaysia by companies having investment overseas would be allowed an exemption of up to 70%, and dividends paid from the tax exempt income will also be exempted from income tax.

   In the 1995 Budget, the Malaysian Government has removed the taxes levied on remittances to Malaysia earned from investments overseas.

b) The original period of exemption of five years after the investing company commences operation and makes profit has been abolished. This implies that the companies would enjoy the incentive for an indefinite period after they commence operation overseas.

c) For income tax purposes, an approved investment project is allowed to deduct the pre-operating expenses, such as cost of market research.

4.2.2 Qualifying Criteria

The qualifying criteria for a company having such an investment project are as follows.

a) Company must be of Malaysian origin, incorporated under the Company Act 1965, and at least 70 percent of the equity is owned and controlled by Malaysian citizens.

b) The Malaysian company directly holds at least 30 percent of equity in the overseas investment company.

c) The Board of Directors must reflect the equity structure of the overseas investment company.

d) The company must fulfill one of the following criteria.

   I. projects are undertaken to overcome market access problems and will utilise Malaysian raw materials, parts and/or components;

   II. projects will supply inputs required by domestic industry in Malaysia;

   III. projects that contribute to the "South-South Cooperation."

4.2.3 Investment Guarantee Agreements

The purpose of the Investment Guarantee Agreements (IGAs) is to ensure against non-commercial risks such as expropriation and nationalisation, and to allow for remittances of capital and repatriation of capital. For a developing country such as Malaysia, the IGAs could help to quicken the pace of industrialisation by encouraging inflows of foreign capital. It is generally considered that the IGAs, which prevent arbitrary action by a recipient country, will generate confidence in foreign investors.