Chapter 7

Summary, Conclusions and Policy Recommendations

7.1 Summary

The survey in the Petaling Jaya and Shah Alam Industrial Estates in 1993 led us to conclude that the most consistent and important priorities for affiliates' investments in Malaysia are political stability, access to markets, and the economic status of Malaysia. Ironically, government incentives have been found to be relatively marginal in most cases. Also, socio-cultural factors and access to factors of production are unimportant factors.

Within the set of accessibility to factors of production, human resources (quality, skilled and unskilled labour) were the only significantly important motives for NICs. Japanese investors were more concerned with access to quality of labour than low-cost skilled labour. In terms of 2-digit industrial subsectors, the only statistically important motive for the food and beverages industry (industry 31) was access to quality of labour. As in industry 38 (fabricated, machinery manufacturing, electrical and electronic, transport equipment, and scientific and measuring equipment), investors were also concerned with cost of skilled as well as unskilled labour. The importance of human resources was also expressed by both non-experienced and experienced respondents in foreign investments before Malaysia, as well as export-oriented companies.

Regarding the factor of accessibility to markets, to match rival investments was only found significantly important for the food and beverages industry. In terms of market orientation, export-oriented firms were more concerned with production for home country and third countries, while production for the Malaysian market was cited significant by local-market oriented companies. This variable was also found significantly important in industry 31, industry 35 (chemicals, petroleum and coal, rubber, and plastic products) and industry 38; experienced investors; and respondents from NICs and EC.

Four of the twelve motives in economic status namely, size, growth, infrastructure facilities and cheap land were the most frequent variables cited as important and significant by respondents. Respondents from NICs and industry 31 expressed the importance of size, growth and infrastructure facilities. However, Japanese and industry 38 were concerned with infrastructure facilities and cheap land. The importance of growth was also found in industry 38. In terms of market orientation, local-market oriented firms cited size and growth motives as important, but infrastructure facilities and cheap land were important to export-oriented industries. To some extent, domestic prices were cited significantly important by NICs and local-market oriented firms. However, export-oriented firms and companies from Japan concerned with exchange rate. These two motives were significantly important to the food and beverages industry.

Within the set of political stability, all the four motives i.e. frequent changes in government, political ideology, sabotage occurrences, leadership crises, and relationship between civil servants and political leaders were cited important for export-oriented firms. The first two mentioned motives were significantly important for Japanese, NICs, industry 31, industry 38, and experienced investors. The importance of political ideology was found in industry 35 and non-experienced investors.

Export-oriented firms cited tax exemptions, trade exemptions, other incentives, foreign exchange remittance and equity requirements as important under the category of fiscal incentives and disincentives. The last motive was also found important in industry 31, 38, and experiened investors. Of particular interest, the Japanese firms, which tended to be the largest firms studied as well as being exporters, expressed concern with fiscal incentives and disincentives variables. However, these variables are relatively unimportant to the decision-making process of foreign direct investment entities in Malaysia.

It is interesting to note that within the set of socio-cultural factors, diligence of labour and host government attitude towards foreign investors were found significantly important for all types of respondents. Also, literacy rate, people's attitude towards foreign investors, labour movement and political ties to capital exporting countries were cited importance for Japanese. However, the first three mentioned motives were only found important for NICs. In terms of industry subsectors, literacy rate and people's attitude towards foreign investors were

statistically significant for industry 35. However, industry 31 was concerned with the former while industry 38 was concerned with the latter. From the point of experienced investors in foreign investment before Malaysia, the survey found that experienced investors cited literacy rate, people's attitude towards foreign investors, quality of life and labour movement as important. None of these motives was found statistically significant to non-experienced investors. On the other hand, they were concerned about political ties to capital exporting countries. All the above stated motives were also found important for export-oriented firms. However, local-market oriented firms cited only literacy rate as important.

Despite being relatively successful in offering political and social stability and having a sound macro-economic environment, the rapid influx of FDI into Malaysia has resulted in a considerable number of difficulties to foreign investors. First and foremost, the shortage of labour at all levels is apparently growing. At one time, Malaysia was relatively successful in attracting FDI because of her cheap labour. However, as the economy operates at an above full-employment situation, low wages can no longer be a drawing factor for FDI.

Although Malaysia is endowed with rich mineral, agricultural and manufacturing inputs in varying degrees, the inflows of FDI which were expected to develop forward and backward linkages in economic development, as suggested by Hirschman, are not evident from the survey. The linkages achieved are insignificant because the majority of the respondents opined that most of the inputs

are of inferior quality, or are unavailable domestically or the prices are not competitive.

In addition, the rapid influx of FDI has resulted in an infrastructure bottleneck. Also, problems related to government policy or document processing were also matters of great concern. One of the local financial controllers said that it was not the policy of the company to hire expatriates to run company activities since the cost of employing foreign staff is much higher than that of their local counterparts. However, in view of the shortage of suitable local personnel, the company was compelled to source from abroad. What is causing distress is the policy limiting the number of expatriate staff in foreign companies. This has directly or indirectly retarded the company's plan to upgrade its operations in Malaysia.

7.2 Conclusions

The depression in commodity market prices in 1983 and 1986 forced Malaysia to deal with severe economic adjustments. Malaysia had enjoyed brisk growth due to the abundant inflow of foreign exchange earnings generated by exports of crude oil and primary commodities. Painfully aware of the need to wean herself from her heavy reliance on the primary products by pressing ahead with industrialisation of the economy, the government sought to invite foreign capital by relaxing restrictions against, and by reorientating her policies toward, foreign investment.

Consequently, FDI inflow rose twenty-three-fold between 1980 and

1992, increasing at an average annual rate of 39 per cent, to reach RM17.8 billion in 1992. In the period of most rapid growth, from 1988 to 1992, FDI inflows increased, on average at the unprecedented rate of 52 per cent per year. This rapid growth is an indication of the growing importance of FDI as a dynamic stimulus to economic development in Malaysia.

According to indicators such as share of GDP and contribution to export earnings and job creation, manufacturing is now the single most important sector of the Malaysian economy. Furthermore, FDI brings managerial ability, technical personnel, technological knowledge, administrative organisation, innovations in products, and production techniques to the recipient country -- all of which are in short supply. In the past thirty-four years, the rapid expansion of the sector has transformed Malaysia from an agriculture-based economy into a second-tier NIC (Brien, 1993: 148).

What is even more striking is that the export growth performance of each industry sub-sector, except for palm oil and iron and steel, has exceeded the Industrial Master Plan targets. The manufacturing sector today is of tremendous and relative significance.

The significance of FDI in transforming Malaysia from an agriculture-based country into an industrialised nation is indeed tremendous. Its contribution is expected to continue to be important in the future, too. Of critical interest, however, is whether Malaysia is capable of maintaining its competitive edge

in attracting FDI into Malaysia in the near future, even with a stable political and social environment as well as sound macro economics management for investing countries. In the past, Malaysia's success stood in sharp contrast to other developing countries which have experienced a falling share of global FDI.

Given the rapid influx of FDI in labour-intensive processing industries in the past, there were sharp increases in labour wages and more constraints in infrastructure growth. Wage increases have been outstripping production growth, and attempts to hold wages down have caused an outbreak of wildcat strikes. On the other hand, China and Vietnam have become far more competitive than Malaysia. They are attracting plenty of foreign investment because of their cheap labour apart from their huge and potential domestic markets. With the 'open door' policy promulgated by China and her stable political environment, a large amount of Taiwanese investments have entered China at the expense of Malaysia. A similar phenomenon is happening in Vietnam. The lifting of the US trade embargo on Vietnam recently is anticipated to increase the flow of US and Vietnam trade as well as investment.

Official figures show that the inflows of FDI into Malaysia decreased substantially (by 60 per cent) in 1993. On the contrary, China and India have performed excellently. FDI grew by 385 per cent in China, and 93.7 per cent in India during the same period (Sin Chew Jit Poh, 16 April, 1994).

Also, the emergence of NAFTA and the EC single market will

certainly affect the flow of American and European investments into Malaysia in the near future.

The central problem now is for the policy-makers to devise policies that will encourage greater inflow of foreign capital.

7.3 Policy Recommendations

7.3.1 Investment Incentives vis-a-vis Non-tax Incentives

What are the policy implications of this study? First and foremost, Malaysia must take a closer look at its non-tax measures to promote FDI into Malaysia in order to keep its competitive edge as an attractive haven for FDI. The government should realise that the attractiveness of Malaysia as a locale for foreign investment activities is principally attributed to its size and growing market, good infrastructure, human resources, and political stability.

To some extent, investment incentives and government restrictions are important to the Japanese affiliates and export-oriented firms. But it seems clear that fiscal incentives and disincentives are not the driving force behind the decision to invest in most other countries. Detailed opinions, particularly regarding the investment incentives, were sought from respondents who are presently receiving the perks. The findings showed that they were not so attracted by the perks. Without the incentives, they would find ways to maintain their competitive edge if

policy-makers simultaneously withdraw the restrictions imposed on their activities. In other words, respondents treated the incentives as a compensation for restrictions.

Thus we strongly support the argument for limiting or eliminating incentive schemes gradually for FDI. These schemes are not only costly to recipient countries in terms of lost revenue, but also they strain the balance of payments deficits due to remittance of untaxed profits.

In terms of restrictions, some of the existing restrictions seem to lack a rational economic basis, for instance, equity requirements, number of expatriates in a company, individual tax for employment of foreign workers and bureaucratic red tape in applying for work permits for foreign staff. As the economy is operating in a full-employment situation, the tight labour market situation has emerged everywhere. To overcome this problem, the government resorted to a 'stop-gap' policy of importing labour from labour-abundant countries. However, to employ foreign workers, employers need to apply for work permits for their employees. These permits are valid for a short-term period only, and furthermore, employers have to pay individual tax for hiring foreign workers. In addition, employers are facing frequent changes in foreign worker policy and procedures, which have caused disruption to production and expansion plans. These situations have incited grievances among foreign enterprises. These disincentives, if not reviewed immediately, will tend to retard FDI activities in the long-run. Malaysia then will lose her competitiveness to other ASEAN member countries, China,

Vietnam, and South Asian countries such as India, which have adopted new policies for FDI. In the 1994 World Competitiveness Report, Malaysia was ranked 35 out of 41 for its immigration laws. These laws have prevented companies from employing foreign skills. In comparison with other ASEAN countries (except Brunei), the only country ranked lower than Malaysia was Indonesia, which was ranked 39.

Recently, the government announced plans to award permanent residence status to foreign scientists in Malaysia (New Straits Times, 17 June, 1993). This policy should be extended to all types of skilled labour that are in short supply. Our neighbouring country, Singapore, has long adopted this policy. A large pool of skilled workers has migrated to Singapore. The rationale in awarding permanent residence status is that the country can save tremendous expenditure on education. In returns she gets a "ready-made" product to serve the nation. If the country is prepared to grant permanent residence status to foreigners and simplify the bureaucratic rules in applying for visas, Malaysia could become a haven for FDI since she provides a stable political and economic environment to foreign investments. On the other hand, if policy-makers have the political will to minimise the restrictions, namely equity requirements, minimising bureaucratic red tape, simplifying the bureaucracy and allowing market forces a greater leeway (as suggested by prominent economist in Malaysia), the various investment incentives can be withdrawn with positive budgetary and balance of payments effects without dampening FDI inflows into Malaysia (The Star, 15 March,

1993).

7.3.2 Infrastructure Facilities

Good infrastructure has always been a selling point for Malaysia in attracting foreign investments into the country. However, respondents opined that infrastructure has not been keeping pace with the rapid growth of the economy in recent years.

From the survey, feedback on the power supply suggested that there have been frequent interruptions. Moreover, telecommunication facilities are also lagging behind demand. These problems have resulted in considerable output loss and increased cost of production. In terms of physical infrastructure, existing road links to ports are nearly saturated and are experiencing congestion during peak hours. In Port Klang, the two major roadways to the North Port, i.e. Federal Route II and North Klang Straits Bypass, have reached the limits of their capacity.

Facilities at ports, particularly container haulage, are overwhelmed by demand for services. The Federation of Malaysian Manufacturers (FMM) (The Star, 15 March, 1995) reported that only 700 to 800 containers could be handled per day, but daily volume had reached 1000 to 1300 containers. At airports, the MAS Air Cargo Complex is also facing space constraints.

Regarding the infrastructural problems faced by the respondents, efforts should be stepped up to maintain and provide good infrastructure facilities to all investors. The implementation of

infrastructural development should be carried out at a pace appropriate with the current economic growth scenario. To maintain its competitive edge, the Malaysian government is investing heavily in infrastructural development, including the expansion and upgrading of port facilities, road and railroad transport and telecommunications networks. Under the Sixth Malaysia Plan, the government has committed RM19 billion to complete infrastructure development programmes already under way. In addition, new projects, such as the new RM20 billion international airport in Sepang, Selangor to replace the current heavily trafficked Subang International airport, have been launched. To overcome the telecomunications problem, Telekom Malaysia, the partly state-owned national telecommunications provider, plans to install 4 million new digital telephone lines over the next five years. Tenaga National (electricity provider) has arranged to purchase a host of new gas turbines from foreign suppliers which will boost the country's generating capacity by 800 megawatts to 5850 megawatts by 1995 (Nazari, 1993: 319).

To improve the infrastructural problems in the near future, FMM suggested that:

(i) Port Klang should be developed as a "hub" port with other ports acting as feeder ports. This shows that sufficient facilities should be put in place ahead of demand with sufficient excess capacity.

(ii) The construction of package B of the Shah Alam Expressway which leads to the West Port, scheduled to be completed by the year 2001, should be expedited so that the expressway

could be completed by 1997.

(iii) Cargo handling and management facilities at airports and ports should be developed with sufficient excess capacity to handle rapid increase in demand, even during peak periods.

(iv) Investment in telecommunications and electronic infrastructure, which are rapidly developing technologies, should allow inter-connectivity and multimedia usage, even before such technology is widely used in Malaysia.

In ensuring reliabilty and efficiency in the supply of infrastructural facilities, healthy competition must be emphasised.

In this regard, the policy-makers should allow more cargo hauliers and handlers to operate, including opening up such services to foreign operators, and relax regulatory requirements in telecommunications development, including upgrading of knowledge and expertise to match technology requirements of the private sector.

7.3.3 Human Resources

Results from the survey show that all respondents identified human resources as an important factor. Nevertheless, eight years of consecutive growth have resulted in high wages at all levels of operations. It is pertinent to note that Malaysia is a relatively high-wage country in the third world. This seems to suggest that the manufacturing sector is at a critical stage

where Malaysia will soon lose its comparative advantage in labour-intensive industries. Malaysia should therefore embark on new strategies to ensure that it does not lose its comparative advantage.

Malaysia should continue pursuing the export-oriented industrialisation policy, focusing more on capital-intensive, skill-intensive and high value-added activities. This would lead to greater technological development and subsequently this would overcome the acute labour shortage problem. However, the dilemma is that there is also a shortage of skilled manpower in the country. It is not possible to increase the domestic supply of skilled labour within a short period. These phenomena underscore the need for the continued presence of immigrant workers until such time as the country is ready to take on skill intensive manufacturing in a big way. However, as pointed out by Ariff and Ng (1994: 49) this option has its weaknesses. Firstly, companies are unwilling to invest in skill development of foreign contract workers. Secondly, the availability of such workers would remove the pressure on companies to adopt technology-intensive methods of production. Therefore, they argued that there is a need to strike a balance, i.e., the dependence on guest workers needs to be phased out gradually without disrupting the industrial activities. Also, there is an urgent need for the manufacturing sector to increase its efficiency and productivity; this should lead to reductions in production costs. In this regard, workers must be trained with the most up-to-date skills; discipline and a sense of belonging should also be instilled among the workers.

The Malaysian government should encourage the setting up of more skill development centres and industrial training institutes to alleviate the problems of skilled labour shortages.

For Malaysia to move towards high value-added and high-technology industries, R&D must be given due attention. R&D should, however, consist of a two-way orientation, that is involving government support and a serious commitment by the manufacturing sector. Under the Second Outline Perspective Plan (OPP2), the nation's R&D expenditure as a percentage of GNP would double from the present one per cent by the year 2000. This amount still lags behind most developed countries. Under the Sixth Malaysia Plan, the government has allocated RM600 million for R&D activities. Research undertaken by the public sector research institutions is also usually under government surveillance or support. All these efforts reflect the government's emphasis on demand-driven research activities.

The manufacturers, on the other hand, should be encouraged to set up R&D centres in Malaysia. Special fiscal incentives can still play a useful role although they are not amongst the most important factors for foreign investments in Malaysia. For instance, tax rebates on R&D expenditure could stimulate industrial upgrading. This would make considerable economic sense, since social benefits of such activities greatly exceed private benefits. Usually, firms are reluctant to undertake such investments because costs, but not benefits, are internalised. Tax incentives, therefore, can persuade the firms to pay more attention to this important aspect (Ariff and Ng, 1994: 48). To

those who find it too costly to conduct activities due to the small domestic market, export incentives should be provided to encourage exports since they play an important role in attracting FDI inflows. Results from the survey show that equity requirements play a significant role in explaining FDI inflows. Therefore, to ensure that R&D centres are successfully set up, 100 per cent foreign-owned R&D companies should be permitted. In addition, employers should have the freedom to employ foreign researchers. At present, employers are only allowed to employ a maximum of five expatriates in a company. To rectify the situation, the policy-makers could perhaps adopt a policy to regulating the number of foreign workers as a ratio of total employment in a company. This ratio could be regulated accordingly to economic and market conditions, and the nature of the firm's business (The Star, 15 March, 1995). Furthermore, new systems and mechanisms must be instituted to nurture the development of R&D in the private sector, such as through contract research, R&D consortiums among industries, and government-industry joint facilities.

To achieve a successful technological development, a nation must be well equipped with talent, skills, creativity, and interests, as pointed out by our Prime Minister. However, skilled labour supply is lagging far behind market demand. For successful technological development, improving the skills of labour is of utmost importance. The government should first give sufficient attention to the current education system. Instead of using Bahasa Malaysia as the sole medium of instruction, English

should also be emphasised. There has been feedback regarding the lack of English proficiency in the Malaysian labour force. This has resulted in a slow pace of technology transfer from affiliates.

Secondly, interest in science and computers should be further fostered among school pupils. As the country gears toward high-technology products and high value-added industries, usage of computer-aided manufacturing and robotics will increase. School-leavers who have a good grounding in science and computers, and speak and read English, are believed to be more easily trained to cope with skills needed for a rapidly industrialising economy. Continuous review and modification of the present education syllabus must also be undertaken to adapt the nation's knowledge to the dynamic changing environment.

Thirdly, creation of a more disciplined and technologically-oriented manpower will only be realised if greater vocational and technical training is introduced in schools to those who are less academically inclined. In view of the long gestation period needed to produce a pool of skilled workforce, the expansion of existing polytechnics, vocational schools, and private industrial institutions is urgently needed. At the university level, the emphasis must be on science and technology.

While the public education system focuses on creating a more scientifically and technically oriented pool of future workers, the private sector, especially industry associations, could play a very important role in retraining existing workers.

Industry associations can provide retraining to meet current skills requirements, and also training in future skills. However, such activity requires well-equipped and up-to-date training facilities. Therefore they would require a large amount of start-up funds, and once established, they would incur huge operational expenses.

However, industry associations cannot access the various incentives provided for establishing training institutions because they are not commercial businesses. Furthermore, the incomes of industry associations are taxed and this does not encourage fund accumulation, which is necessary to provide start-up funds. The policy-makers should provide tax-exempt status for industry associations, including donation funds, to facilitate fund accumulation and financing of building projects, especially skills training centres (The Star, 15 March, 1995).

7.3.4 Linkages

The creation of linkages is an important sine qua non for the development of sectoral interdependence in the economy. Despite the few backward and forward linkages created, as the results of the study have shown, it is believed that the situation can be improved in the long-run. In the past, the MNCs sourced from abroad because local vendors or small- and medium-scale industries (SMIs) were not producing the type of parts and quality that the MNCs needed. The small number of local vendors, and the low quality products of the SMIs, as pointed out by

Rafidah Aziz - Minister of International Trade and Industry - also affect the effectiveness of linkages with MNCs (The Edge, 13 February, 1995).

To overcome the problems raised by the respondents, the government should encourage the development of more SMIs, particularly of supportive industries. To encourage the establishment of SMIs, the government should facilitate access to financial grants and assistance for local manufacturers, regardless of their shareholdings. This would increase the establishment of indigenous R&D activities as well as induce a backwash effect on technology development in SMIs that supply inputs to the large manufacturers. In this regard, linkages can be established and strengthened in the near future.

In the future, the MNCs would source their parts locally when the SMIs are groomed into quality-conscious manufacturers and when the number of such establishments is larger. Nevertheless, the success of SMIs depends upon the willingness of the local vendors to make the necessary investment and effort to meet high quality standards, for instance the ISO 9000, and strict delivery schedules.

To develop the linkages, FMM suggested that policy-makers should extend the new incentive perks for high-tech production to encourage integrated manufacturing, and provide a 20 per cent abatement incentive on income for value-added locally to MNCs which sourced their supplies from majority-owned SMIs (New Straits Times, 11 July, 1994). In addition, selective tariff

measurements to discourage importation of foreign components which are domestically available must be strictly enforced. Also, present policy requirements on local content should be continued to encourage the sourcing of raw materials and components from domestic industries. The latter suggestion should not adversely affect FDI inflows since it does not seem to be a significant disincentive in the findings. Furthermore, the existing 5 per cent abatement of adjusted incomes given to large companies to source components from small industries should be extended to cover medium-sized industries supplying services such as heat treatment, tool and die, and casting. Specific incentives must also be initiated for the development of local component manufacturing and supporting industries.