Chapter 1

Introduction

1.1 Background of the Study

During the 1960s and 1970s, doubts about the positive contribution of foreign direct investment (FDI) to economic development led to a general practice in the developing world of adopting restrictive policies to regulate the entry, activities and operations of multinational corperations (MNCs) (UNCTC, 1992b: 1). However, changing conditions in the world economy during the 1980s renewed the interest of developing countries in FDI as a source of capital, technological know-how and organisational and management skills. This resulted in a shift in attitude and a gradual liberalisation of the regulatory framework for FDI in developing countries in general.

Malaysia, always has a positive attitude towards FDI. In 1970, agricultural products accounted for 30 per cent of gross domestic product (GDP), while the manufacturing sector's share was 14 per cent. In 1985, Malaysia experienced negative growth for the first time since its independence. The manufacturing sector constituted only 20 per cent of GDP, while the agriculture sector's share was 21 per cent. Painfully aware of the need to wean herself for 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 policy towards, foreign investment. Although the role of FDI has been highly recognised since Indenpendence, its role has been enhanced since the mid-1980s. Since 1988, the real GDP (in 1978 constant prices) on average, has grown by more than 8 per cent a year (1988-93), allowing the manufacturing sector to surpass the agriculture sector's share in GDP and reaching almost 30 per cent in 1992. In the process, manufactured exports and their share of exports in the total exports have increased tremendously. Manufactured exports expanded by between 23 per cent to 36 per cent every year while their contribution to total exports increased from 35.3 per cent in 1985 to 76 per cent in 1993.

The successful transition to an industrial structure and the economic growth of Malaysian economy are an indication of the growing importance of FDI as a dynamic stimulus to economic development in Malaysia.

1.2 Definition of Foreign Direct Investment

There is a continuing debate about the definition of "FDI". There is not a single simple definition that can explain it well due to the complexity of the real world. The lack of an international consensus on the definition of FDI has resulted in inconsistency of data collection and incomparable statistical results among countries[1]. To determine whether a particular investment should be considered as foreign direct investment or not, the effective voice in management, ownership and control are

criteria that should be taken into consideration.

Knickerbocker defined FDI as: "when an enterprise invests in assets outside its home country, in order to control partially or fully the operation of these assets, the result in capital flow is called a foreign direct investment" (Knickerbocker, 1973: 2).

In the IMF Balance of Payments Manual (Dunning, 1992: 5), FDI is defined as investment that involves a long-term relationship reflecting a lasting interest of a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the investor. The direct investor's purpose is to exert a significant degree of influence on the management of the enterprise resident in the other economy. However, there is no international consensus on the minimum equity stake deemed necessary for an effective voice. According to the benchmark definition of the Organisation for Economic Co-operation and Development (OECD), 10 per cent is the minimum equity stake deemed to classify an investment as direct (Dunning, 1992: 12). But, for the majority of countries (e.g. Canada and Australia), it varies between 10 per cent and 25 per cent of the total equity stake of an enterprise. By contrast, the normal cut-off percentage for Germany and France is 20 per cent, and for New Zealand is 25 per cent (Knickerbocker, 1973: 2).

For the purpose of data collection in Malaysia, the Malaysian Industrial Development Authority (MIDA) defines FDI inflows as loans attributed to foreign investors, approved foreign equity in new projects and expansions of existing production capacities for

the manufacture of additional products. Loans attributed to foreign investors are apportioned from the total loans according to the percentage of the foreign share in the equity of each project (UNCTC, 1992b: 157). To exert a significant degree of influence on the management of the foreign enterprise in Malaysia, the Department of Statistics states that the foreign companies must hold more than 50 per cent of the equity; those with 50 per cent or less, are classified as locally-controlled companies and are regarded as portfolio investments (UNCTC, 1992b: 157).

Recently, several scholars have voiced the need to differentiate between FDI and "new forms of investment". Following Oman (1984: 14-17), new forms of investment are defined as international investments in which foreign investors do not hold a controlling interest via equity participation, i.e. investments in which foreign-held equity does not constitute majority ownership. Specifically, new forms of investments are characterised by:

(i) joint international business ventures in which foreign equity does not exceed 50 per cent.

(ii) Various international contractual agreements which involve at least an element of investment from the foreign firm's viewpoint but which may involve no equity participation by that firm whatsoever, as is frequently the case with licensing agreements, management services and production sharing contracts, and occasionally with sub-contracting and turnkey operations.

The new forms of investment may be thought of as constituting a deviation from the "classic" international activities of firms, namely wholly/majority-owned foreign direct investment. According to Oman (1984: 14), the new forms are rather heterogeneous, and perhaps can be defined simply by distinguishing them from what they are not. They are not investments in majority (or wholly) foreign-owned subsidiaries which are referred to as the traditional form of foreign direct investment, nor are they bank-lending (or other purely financial operations) although they may be used to finance new forms of investment.

In this study, FDI companies will be defined as those firms that had foreign ownership of more tha 30 per cent (for details, see 4.2: The Population and Sample).

1.3 Importance of FDI

In most countries at a low level of development, it is the foreigners who bring new techniques, and it is the spread of these new techniques which promotes development. The right amount of capital and appropriate modern technologies are crucial requirements for the successful industrialisation of developing countries. Malaysia is one such example.

Pesos (Dasari, 1972: 2) has emphasised the importance of FDI to the recipient country as follows:

> "Direct investment has the great advantage of bringing with it all the elements necessary to create new production units. It brings prefabricated

> industries to speak of, ready for use and guaranteed to operate satisfactorily. Direct investment brings with it ready made development in particular field to which it belongs. Practically, no effort is needed from the residents of recipient country. There is no wait for the training of technicians and managers nor for tryouts and the gaining of experience. If it comes in adequate volume to the proper fields and is accompanied by the necessary amount of loans to finance the overhead capital facilities, direct investment is a short-cut to development".

According to this view, FDI is instrumental in supplying "several missing factors of production ... which are simply and indisputably not to be found" (Hirschman, 1969: 4) in a developing country.

However, there exist counter arguments about the adverse effects of FDI. For instance, there are some who are against foreign investment since outflow of profits might be greater than the initial inflow. In spite of high return flow of repatriated capital to the investing country, the host country may still benefit, since the initial balance of payments gain from capital inflow may contribute to domestic resources and growth. It may also gain, even in terms of balance of payments, if there is a consequent rise in exports as a result of the new investment.

Many viewed FDI as the initiator and accelerator of industrialisation but an equally large number is of the opinion that the massive inflows of FDI into LDCs of late is an attempt by the developed advanced countries to perpetuate their control over LDCs which they had lost with decolonialisation.

Though it is being widely alleged that FDI is economic imperialism in disguise, the fact that many LDCs among them

Malaysia and even NICs are more aggressive than ever in promoting FDI, especially into the manufacturing sector suggests otherwise.

More often than not, capital formation is a major constraint to industrialisation efforts. For this reason, in recent years there has been a revival of interest in FDI, as a source of both foreign capital and more improved technology and management systems to developing countries.

Hughes and Dorrance argue that FDI is not a prerequisite to development. Japan's industrialisation utilised little of it. Nonetheless, East Asian experience demonstrates that, for countries seeking to compress industrialisation and transform a poor and predominantly agricultural economy into a wealthy modern state in a mere generation, FDI can complement and stimulate domestic investment (Hughes and Dorrance, 1987: 64).

The relationship between investment and growth is a very controversial issue. Rana and Dowling (1988) analysed the effect of foreign capital on growth in nine Asian countries, using a simultaneous equation model. The findings of their study suggested that foreign capital flows have made positive contributions to the growth of Asian development, contributing to growth by augmenting resources available for capital formation and by improving investment efficiency. Available evidence of Cohen (1968), Papanek (1973), and Dowling and Hiemenz (1983) also demonstrate the importance of foreign capital inflows to the economic growth in Asian and other less developed countries. On the contrary, the studies of Voivodas (1973), El Shibly, and

Mosley, Hudson and Horrel (Lamin, 1993: 30) in less developed countries failed to reach the above conclusion. This suggests that foreign capital inflow is a necessary, rather than a sufficient, condition for a high rate of economic growth.

Another argument for FDI is that FDI is a means of obtaining not only capital but also technology, management and skills, and imported marketing "know-how" and outlets for non-traditional exports of manufactures, processed commodities and traded services. These permit the development of a stable and strongly export-oriented industrial base. The inflow of foreign capital represents an indispensable financial underpinning for growth (Guillouet, 1990: 17).

1.4 Role of FDI in the Malaysian Economy

Modern economic growth, as emphasised by Simon Kuznets, is always accompanied by structural changes which are marked by a rapid decline in the agricultural labour force. In a similar vein, Chowhury (Lim and Toh, 1992: 3) defines structural change as changes in the relative share of industrial sectors in total production or employment. Such changes can be statistically measured at different levels of aggregation. At the more disaggregated level, it can be recognised through the shift in the relative contribution of the various subsectors to total sectoral output, employment, exports and imports. At the more aggregated macro-level, structural change may be identified by shifts in the relative percentage contribution of various

sectors, namely, primary, secondary, and tertiary to a nations's GDP, total employment, exports and imports.

Industrialisation is seen as the new source of rapid economic growth and employment opportunities, as well as a vehicle for greater Malay participation in the economic activities of the country. Also, it is regarded as the agent that will bring about structural changes within the economy and will eventually establish greater economic stability and a more equitable distribution of income and wealth. Most influential Malaysians view industrialisation as the nation's greatest priority and ticket to progress in the future (Jomo, 1993: 1).

The second Prime Minister of Malaysia, Tun Abdul Razak (MIDA, 1975: 3) remarked that:

> The future of Malaysia's industrial development lies in two major directions, both of which are pointed towards the export sector. Firstly, increasing export of Malaysia raw material resources in processed and manufactured form, and secondly, the establishment of export-oriented manufacturing industries which are labour intensive and high technology oriented.
>
> If Malaysia is to depend upon the export sector for its industrial future, the role of the foreign investor becomes of primary importance. Malaysia will continue to need the technical know-how, management skills and most important of all, access to international markets which foreign investors can provide in full measure. Malaysia also expects the private sector within the country to gear itself to meet this challenge and to participate in full with the foreign investor in areas where such foreign technology, know-how and marketing skill is required.

At a press conference, the then Malaysian Minister of Finance Tengku Razaleigh said "I will attempt to create a healthier

investment climate and would like to see more foreign capital coming to Malaysia" (Malaysia Industrial Digest, 1976: 1).

The above quotations illustrate Malaysia's recognition of the critical role played by FDI in its industrial development. With FDI, Malaysia could have accerelated her structural changes, from one dependent on primary commodity exports to import-substituting industrialisation in the 1960s and 1970s, and to export-oriented manufacturing since the 1970s. This is chiefly attributed to its lack of industrial technology, know-how and experience, and managerial expertise at the time of Independence.

In Malaysia, the development of modern economic growth was marked by the rise of the manufacturing sector at the expense of the agricultural sector.

As presented in Table 1.1, the share of manufacturing output to GDP of the Malaysian economy was about 9 per cent in 1960 with agriculture taking up a strong 38 per cent. Rapid growth in industrial output increased its share to 12 per cent by the end of 1970. The agricultural sector continued to dominate the economy over the same period, accounting for 32 per cent of output. By 1980, there was a considerable decline in the share of agriculture to total output (26%) and a concomitant rise in the share (17%) of manufacturing sector's contribution to GDP. During most of the 1980s, the agriculture sector's share continued to fall, though at a much reduced pace, while the manufacturing sector's share continued to increase and at a faster pace. Manufacturing's share of GDP reached a high of 23 per cent,

surpassing for the first time agriculture's (22%) in 1987. Since then, the manufacturing sector has taken a lead over agriculture as the largest contributor to GDP in the economy (excluding other services).

The export pattern also reflects the shift from agriculture to manufacturing. As depicted in Table 1.2, the positive effects of FDI can be seen in the increase in the country's industrial output and manufactured exports. The country's traditional dependence on exports of primary products, such as rubber and tin, has decreased over time. Since 1985, manufacturing exports have overtaken agricultural exports as the major foreign exchange earner. By 1993, exports of manufactures were 74 per cent of total exports.

Table 1.1: GDP by Industrial Origin
(percentage)

	1960	1965	1970	1975	1980	1985	1987	1990	1991	1992	1993
Agriculture, Livestock Forestry & Fishing	38	32	32	30	26	21	22	20	17	17	16
Mining	6	9	6	4	4	10	11	10	9	9	8
Manufacturing	9	10	12	14	17	20	23	25	29	28	30
Construction	3	4	4	5	5	5	3	3	4	4	4
Finance, Insurance Real Estate & Business Services	6	6	8	7	7	9	9	9	10	10	11
Other Services	38	39	38	40	41	35	32	33	31	32	31
Total	100	100	100	100	100	100	100	100	100	100	100

Source: Malaysia, Ministry of Finance, Economic Report, various issues.

Table 1.2: Component of Malaysian Exports
(percentage of total value)

	1960	1965	1970	1975	1980	1985	1990	1991	1992	1993
Petroleum	4	2	16	9	24	27	13	11	9	9
Manufactured Products	n.a.	n.a.	10	17	21	35	59	65	67	74
Rubber	44	40	35	20	17	8	4	3	2	2
Palm Oil	2	3	5	16	9	10	6	5	5	5
Tin	16	20	20	14	9	3	1	1	1	1
Others	34	35	14	24	20	17	17	15	16	9
Total	100	100	100	100	100	100	100	100	100	100

Source: Malaysia, Ministry of Finance, Economic Report, various issue.

What is even more striking is the industrial restructuring taking place within the manufacturing sector. Table 1.3 shows that electronics and textile products spearheaded manufactured goods for export throughout the period of 1975-93. These industries are relatively labour-intensive. Nonetheless, the former are considered high-tech industries, as compared to the latter[2].

Besides the major export items, there are numerous products that are still exported in small amounts but which register high growth rates, viz. chemicals, non-metallic minerals, food manufacturing, and wood products (see Table 1.4).

The significant diversification in exported products implies that the manufacturing sector has gradually matured, although it is still in the process of moving from traditional labour-intensive industries to more capital-intensive activities. This industrial

restructuring is welcomed by the Malaysian government as the country is facing labour shortages.

Table 1.3: Exports of Manufactured Goods, 1975-93
(RM million)

	1975	1980	1985	1986	1987	1988	1989	1990	1991	1992	1993
Food, Bev. & Tobacco	226	521	781	961	1227	1369	1788	2062	2263	2430	2547
Text. Clothing & Footwear	209	806	1289	1559	2031	2445	3190	3986	4784	5279	5520
Wood Products	204	470	365	537	852	955	1184	1362	2066	2643	4802
Rubber Products	42	84	113	239	485	919	1148	1534	1770	1929	2450
Chem. & Chemical Products	65	188	610	761	927	1557	1694	1889	2388	2898	3477
Petroleum Products	105	189	1041	720	836	766	1004	1285	1149	1338	1669
Non-metallic Mineral Prod.	22	61	150	191	301	450	658	771	888	893	1057
Iron & Steel & Metal Manuf.	40	250	357	523	769	1184	1463	1625	1873	2382	3160
E'cal & E'nic Machinery & Appl.	456	3016	6493	8492	11000	15162	20799	26503	35587	41601	55119
Transport Equipment		223	566	518	701	504	1184	1927	3279	3832	3631
Other Manufactures	417	511	706	851	1215	1537	2455	3891	5380	5899	6234
Total	1786	6319	12471	15352	20344	26848	35657	46835	59340	68867	89666

Source: Malaysia, Ministry of Finance, Economic Report, various issues.

Table 1.4: Growth of Exports of Manufactured Goods, 1986-93 (percentage)

	1986	1987	1988	1989	1990	1991	1992	1993
Food, Bev. & Tobacco	23	28	12	31	15	10	7	5
Text. Clothing & Footwear	21	30	20	30	25	20	10	5
Wood Products	47	59	12	24	15	52	28	82
Rubber Products	112	103	89	25	34	15	9	27
Chem. & Chemical Products	25	22	68	9	12	26	21	20
Petroleum Products	-31	16	-8	31	28	-11	16	25
Non-metallic Mineral Prod.	27	58	50	46	17	15	1	18
Iron & Steel & Metal Manuf.	46	47	54	24	11	15	27	33
E'cal & E'nic Machinery & Appl.	31	30	38	37	27	34	17	32
Transport Equipment	-8	35	-28	135	63	70	17	-5
Other Manufactures	21	43	27	60	58	-15	11	6
Total (RM million)	15352	20344	26848	35657	46835	59340	68867	89666

Source: Calculated from Table 1.3.

In terms of employment, the performance of the manufacturing sector was also impressive. The share of employment contributed by the manufacturing sector increased from 9.5 per cent in 1970 to 23.6 per cent in 1993. The employment share of the agricultural sector decreased from 38.3 per cent to 21.3 per cent over the same period (see Table 1.5).

Table 1.5: Employment by Sector (percentage)

	1970	1975	1980	1985	1990	1992	1993
Agricultural, Forestry & Fishery	38.3	47.6	37.2	31.3	29.9	22.9	21.3
Mining & Quarrying	1.3	2.2	1.3	0.8	0.6	0.5	0.5
Construction	2.7	4.0	5.6	7.6	6.4	7.1	7.4
Manufacturing	9.5	11.1	15.5	15.2	17.6	22.9	23.6
Finance, Insurance, Business Services & Real Estate	12.2	13.0	2.9	3.5	3.5	4.2	4.5
Transport, Storage & Communication	4.0	4.5	3.9	4.3	4.2	4.6	4.7
Others	32.1	17.6	33.6	37.3	37.8	37.8	38.0
Total	100	100	100	100	100	100	100

Source: Malaysia, Ministry of Finance, Economic Report, various issues.

The detailed employment and value-added profiles of the manufacturing sector during the period 1985-92 are shown in Table 1.6. From this table, it can be seen that throughout this period, the major industrial groups contributing to employment were electronics, food manufacturing, textiles and wood products. In

1985, electronics contributed 17.16 per cent of the industrial employment; food manufacturing, textiles and wood subsector each contributed between 12 to 13 per cent. Nonetheless, the contribution of the food manufacturing and textile groups decreased in 1992, while that of the electronics subsector rose to over 25 per cent. Industries, such as the rubber subsector, experienced a continued employment growth during the said period, except in 1992.

Since 1987, because of the impact of the 1986 Promotion of Investment Act, a large number of new industries, particularly electronics have been established (see MIDA, 1993: 9, Table IX). As this industry is considered labour-intensive it has absorbed a large pool of industrial employment.

The pattern in the industrial value-added profile paralleled that of the industrial employment profile. Three subsectors (food manufacturing, chemicals and electronics) constituted 45.3 per cent of total industrial value-added in 1985. The electronics industries, which ranked a step behind chemical industries in value-added contribution in 1985, have emerged as the largest contributor in 1992. Wood products, whose contribution to employment decreased from 13.4 per cent in 1985 to 13.1 per cent in 1992, increased its contribution to industrial value-added from 6.2 per cent to 6.5 per cent in 1992. Similarly, plastics, machinery and scientific equipment subsectors' value-added contribution also increased marginally.

Table 1.6: Value-added and Employment by Industrial Subsector 1985-92
(percentage)

	1985		1987		1989		1992	
	V.A.	Emp.	V.A.	Emp.	V.A.	Emp.	V.A.	Emp.
Food manufact.	14.4	13.1	13.5	13.5	11.9	10.6	8.5	7.6
Bever. & tobacco	6.7	2.1	6.4	1.9	3.7	1.5	1.1	0.4
Textiles, clothing & footwear	4.9	12.6	7.0	13.5	6.3	13.3	6.0	11.6
Wood & wood prod.	6.2	13.4	7.2	12.9	6.9	12.7	6.5	13.1
Paper, printing & publishing	5.2	5.8	4.8	5.6	4.7	4.5	6.3	5.1
Chemical & chemical prod.	15.8	3.4	14.7	3.2	11.9	2.9	11.1	2.6
Petroleum prod.	3.2	0.5	2.2	0.4	3.3	0.3	1.7	0.2
Rubber prod.	5.1	5.9	6.8	7.4	6.4	7.6	4.9	6.3
Plastic prod.	1.9	3.2	2.1	3.6	2.4	3.9	3.3	4.7
Non-metallic mineral prod.	6.9	5.7	5.9	4.8	6.3	4.4	5.5	3.9
Iron and steel & metal manufac.	3.8	3.1	3.8	2.6	3.9	2.1	2.8	1.6
Fabricated prod.	3.0	4.3	2.8	3.8	3.7	4.0	4.3	4.3
Machinery prod.	2.0	2.9	2.5	2.8	3.2	2.6	4.4	3.5
Electrical & electronic prod.	15.1	17.2	16.1	19.7	18.6	23.3	26.1	27.7
Transport equip.	4.3	4.1	2.9	2.9	4.7	2.3	4.6	3.2
Scientific measur.	0.6	1.2	0.8	1.2	1.1	1.4	1.2	1.8
Other manufact.	0.8	1.7	0.9	2.1	1.0	2.1	1.4	2.0
Total (RM '000)	1211.5	47.6	1331.7	51.0	2059.2	69.8	3509.9	103.4

Source: Malaysia, Industrial Survey Construction, Manufacturing, Mining and Store Quarrying, Department of Statistics, 1985-1989.

Malaysia, Annual Survey of Manufacturing Industries, Department of Statistics, 1992.

Although the role of FDI has been highly recognised since Independence, its role has been enhanced since the mid-1980s. Foreign capital has played a crucial role in the economic recovery not only in Malaysia but also in Thailand, Indonesia and the Philippines. The slowdown of economic growth in Malaysia and Indonesia was due to the falling prices of oil and commodities which were their principal export items. The economic slump created unemployment. This situation forced the government of ASEAN countries (except for Singapore and Brunei) to extend incentives, to relax investment laws and regulations, and to promote active investment so as to attract FDI into their respective country. Foreign investment was seen as a convenient way to alleviate the said problems.

In this same period , the world economic recovery and the appreciation of the Yen have pushed the companies in Japan to relocate their facilities in cheaper locations to maintain their export competitiveness under the traditional domestic production system. Four ASEAN countries (Malaysia, Thailand, Indonesia and Philippines) meet their needs. Meanwhile, industries in South Korea, Hong Kong, Taiwan and Singapore were facing higher production costs[3] and thus felt the need to follow suit to remain competitive. As a result, there has been a massive increase in investments from these countries, mainly in the export-oriented manufacturing sector moving all over ASEAN countries looking for the most economic location for production.

ASEAN countries have emerged as production bases on the strength not only of low labour cost, but also because of the improvement in legal arrangements for accepting foreign capital, relative progress in infrastructure and a certain degree of manufacturing basis promoted by industrialisation since the 1960s. For instance, in Malaysia, the average annual growth rate of the inflow of FDI in approved projects by Malaysian Industrial Development Authority (MIDA) was almost 70 per cent a year over the period from 1985 to 1991. The inflow on the approved basis more than doubled from 1987 to 1988 and from 1989 to 1990, while it decreased by 9.5 per cent from 1990 to 1991. This massive inflow was partly due to the high appreciation of the currencies of the East Asian countries since the Plaza Accord in 1985, and partly explained by the relaxation of foreign equity ratio regulations and the favourable incentives given by Promotion of Investment Act 1986 (Yokoyama, 1992).

1.5. Background of the Problem

Given the structural changes that were taking place in the Malaysian economy, the greatest accelerator of this economic transition was the rapid expansion of FDI. In other words, Malaysia relied heavily on FDI, particularly from the multinational corporations, to accelerate its industrialisation programme.

One of the problems that Malaysia is facing now in the development of certain foreign-owned companies is due to the

present situation of the profits of parent companies being below company expectations. For instance, large companies such as Matsushita Electric Industries, Sharp, Toshiba and Sony are experiencing difficulties. These companies cut back capital expenditure and personnel to restore profit (Salih, Ho and Chua, 1992: 6). For small and medium-sized firms capital investment is stagnant. Thus, the question is whether they will continue to invest like before?

The European Community is no exception. Germany is in a recession. It is staggering under the burden of the 1990 unification plan. Recent estimates suggest that transfer from West Germany to the East in 1991 amounted to 6.5 per cent of its GDP. About two-thirds of this came from West Germany's external surplus. In this scenario, the lion's share of West German capital leaked out to East Germany at the expense of the rest of the world.

Despite the World Bank report that FDI in Malaysia had increased to US$4.4 billion in 1993, as compared to US$4.1 billion in 1992, the recent manufacturing report (Malaysia Industry and International Trade 1993) showed a sharp decline in approved investment in the manufacturing sector. It fell by 66.2 per cent from RM17.77 billion in 1992 to RM6.01 billion in 1993. This is mainly attributed to the sharp decline from traditional major investor sources, namely Japan, Taiwan and U.S. Though the FDI inflow from China, Denmark, Hong Kong, and Singapore have increased markedly, their share is, however, far behind the

former.

The 1993 scenario seems to suggest that the rapid influx of FDI into Malaysia is over. Taiwanese manufacturing investment, for instance, is the largest foreign investor in 1990 with RM6.3 billion investment. Nonetheless, Taiwan occupied fifth place with RM1.5 billion investment in 1992.

On the other hand, statistics showed that Taiwanese FDI in China rose from US$1 billion in 1990 to US$3 billion in 1992. Likewise, Taiwanese investment in Vietnam increased from US$410 million to US$500 million over the same period (Business Times, 26 May, 1993). This evidence shows that Malaysia and China, and Malaysia and Vietnam appear to be moving in opposite directions vis-a-vis FDI. When one country receives a higher level of FDI in a particular year the other gets less. This suggests that the two sets of countries are competing for the same sources of foreign investment.

In the past, the drop in competitiveness of the unskilled, labour-intensive industries led the industrialised countries, viz. Japan, South Korea, Hong Kong, and Taiwan to relocate their sun-set industries to resource-rich, politically and economically stable developing countries such as ASEAN in general and Malaysia in particular. The success of Malaysia in attracting foreign investment in the past was due, to some extent, to the uncertain political climate in China. As the political climate in China improves, and her "open door" policy becomes attractive, investors from Japan, Taiwan and Hong Kong are likely to be

attracted to the continent given the ample cheap labour resources and huge potential markets available there.

By contrast, after several years of rapid growth in the recent past, tighter labour supply (skilled as well as unskilled labour), rising wages (on average above 15 per cent per annum), and other growth constraints in infrastructure have emerged in the Malaysian economy. With manufacturing costs rising and labour shortages becoming more acute in Malaysia, Vietnam has become one of the hottest markets for new FDI. By the end of 1992, FDI in Vietnam reached US$4.1 billion (Sin Chew Jit Poh, 26 February, 1994). The prominent investors are Taiwan, Hong Kong, France, Australia, and the Netherlands. Apart from her cheap and abundant labour force, with the lifting of the US embargo on Vietnam there are no longer restraints on economic growth.

Today's global investment environment is unfavourable for Malaysia compared to the situation in the mid-80s. Thus, Malaysia's worry is understandable. She fears that she might lose her competitive edge to the late-comers in the global race for FDI, since the latter are able to provide cheaper labour and larger markets. The resurgence of economic regionalisation is adding another new dimension to the global financial system and international trade and investment flows. The formation of North American Free Trade Area (NAFTA) and the European Single Market in 1992 may lead to more inward-looking tendencies of the member countries. From EC investors' point of view, Spain in particular and Mediterranean countries in general, provide almost optimal

conditions for investment (Wagner, 1989: 36). In addition, there is a possibility of diversion of Japanese and NIEs' investment to these regions to overcome the problem of trade frictions in the near future. For instance, the head of Sony in Europe, speaking about his company's plan to invest more than a hundred million dollars in Europe, said: "If we followed just the economics of manufacturing, we would ship the lot from South-East Asia" (UNCTC, 1990: 30). In another example, companies from Taiwan and Korea are actively planning for joint ventures and mergers with European companies (UNCTC, 1990: 31).

The above discussion suggests that Malaysia needs to improve its investment competitiveness now that global trends point towards a possible reduction in total world investment funds and the sharing of this smaller pool of funds among more contenders. If Malaysia wants to remain competitive and attractive, then the government should decide on the options it must take to remain dynamic in the growing Pacific-rim.

On the domestic front, FDI will be much needed to drive the economy towards the aspirations of Vision 2020. As pointed out by Ariff (1991: 134) "it is hard to imagine Malaysia maturing into the Newly Industrialising Economies (NIEs) status without foreign participation in the industrialisation process".

Thus, it is necessary to examine some of the factors that influence the level of investment at any specific point in time. An understanding of these factors is essential if policies are to be framed to achieve a desired level of investment.

1.6 Objectives of the Study

This study attempts to examine some crucial objectives and aspects of FDI inflow in the manaufacturing sector. One of the main objectives is to identify and explain foreign investors' decisions in the manufacturing sector. The main concern of the analysis will be to understand why foreign investors choose Malaysia as a site to set up their production. To understand the rationale behind foreign investment, factors cited as determinants of FDI in Malaysia will be analysed.

Understanding the motivation for FDI by MNCs will aid in understanding the foreign firms' contribution to the direction and speed of industrialisation and to the expansion and growth of Malaysian economy.

Complementary to the main objective stated above, this study will simultaneously examine issues such as incentives and disincentives offered by the Malaysian government to determine their importance in expediting FDI in this country. In addition, the impact of FDI upon the Malaysian economy will be highlighted.

1.7 Assumptions

In the light of the objectives stated above, the scope of the study is defined by the following assumptions:

(i) Investors in different types of investment and industry are likely to focus their attention on different sets of

critical factors in making a locational choice.

(ii) Investors from different countries do not necessarily concern themselves with the same set of factors.

(iii) As investment conditions change over time, factors that are not important to investors during one period may become critical to them in another period, and vice versa.

(iv) Decision to invest abroad is based on rational behaviour.

1.8 Significance of the Study

According to data published by the Malaysia Industrial Development Authority (MIDA), the total approved FDI stood at some RM18 billion in 1992. The increase from 1991 to 1992 was as much as RM716.8 million or 4.2 per cent. Even a moderate share of this huge pie could make a vast difference to the time period in which a small nation could hope to achieve industrialisation and economic take-off. Hence, any research that could lead to a greater understanding of the foreign investment decision process, and consequently as improvement in the efficiency and effectiveness of a foreign investment promotion strategy, should be useful to a developing country, particularly in the case of Malaysia.

1.9 Limitations of the Study

The limitations of this study are due to the following reasons:

(i) The list of firms provided by MIDA concerned investment

only until 1992; more recent data are not available.

(ii) The data provided by MIDA refer only to the secondary sector, i.e., manufacturing industries, as the authority does not compile data on primary and tertiary sectors.

(iii) Certain questions were not answered in full by respondents due to reasons of company secrecy or incomplete records.

The focus is therefore on the secondary sector, i.e., manufacturing industries where information is readily obtainable. However, it is acknowledged that the inclusion of primary and tertiary sectors would be beneficial and would contribute to a more comprehensive and meaningful study as export trends of Malaysia have changed. It has already made headway in diversifying and expanding the export of traditional products globally. However, because of the reasons stated above, the focus of the study is confined to the secondary sector.

1.10 Organisation of Remaining Chapters

Chapter 2 reviews the existing literature on the subject of foreign direct investment, particularly studies concerned with factors affecting foreign-investment decisions.

Chapter 3 provides the background scenario, describing the pattern and trend of FDI in Malaysia, and government policies on the industrialisation process since Independence.

Chapter 4 describes the research methodology used in the study and the firms included in the sample.

Chapters 5 and 6 discuss the findings from the interviews. The final chapter presents the summary, conclusion and policy recommendations.

Notes

1. There are three main reasons why it is difficult to compare FDI in different countries. Firstly, countries differ in their definition of FDI, since most depart in one way or another from the conventional meaning recommended by the International Monetary Fund (IMF) or Organisation for Economic Co-operation and Development (OECD). Secondly, countries differ in their method of data collection. Thirdly, corporate accounting practices and valuation methods differ between countries (UNCTC, 1992b: 39-40).

2. According to Chung (1990),

   (a) "labour intensive and low technology industries" are as follows: food, tobacco, textile and wearing apparel, leather and leather products, footwear, wood and wood cork products, furniture and fixtures, rubber products, plastic products, fabricated metal products (except machinery and equipment).

   (b) "Labour intensive, high-technology industries" are as follows: printing, publishing and allied industries, machinery, electrical machinery, apparatus, appliances and supplies, transport equipment, professional and scientific equipment.

(c) "Capital intensive, low-technology industries" are as follows: beverages, paper and paper products, pottery, china, and earthware, glass and glass products, other non metallic products, basic iron and steel products.

(d) "Capital intensive, high-technology-industries" are as follows: industrial chemical, other chemical products, petroleum products, and basic non ferrous metal products.

3. South Korea and Taiwan, for example, which registered substantial surplus in their current account balance, came under growing pressure to up value their currencies and to further open their markets. The tighter labour supply caused by the booming economies, coupled with the wave of democratisation that spread in 1987, pushed up wages sharply.