Chapter 3

FDI in Malaysia

3.1 Background

Foreign investment activities in Malaysia date back to the period of European colonial rule. Malaysia was opened to international trade and investment by the countries that colonised her. As early as the 1920s, there was already substantial British investment in the country. This British investment was heavily concentrated in resource-based activities such as the plantation and mining sectors, which together accounted for over 90 per cent of total investments. It increased from £33 million sterling in 1913 to £108 million by 1930 (Ariff, 1991: 100).

On the other hand, involvement by other nationals was minimal, limited to the American and French who were engaged in small-scale tin mining, and the Japanese who were in iron ore mining (Kanapathy, 1970: 3).

Not until the early post-independence period did the Malaysian government realise the danger of being dependent on the export of primary commodities or minerals. As Ho (1983: 25) pointed out, there were four major effects of over-dependence on agricultural and primary commodities:

(i) It increased the vulnerability of the economy to external fluctuation over which the government had virtually no control.

(ii) It resulted in over-concentration on agricultural and primary sectors in the 1960s to such a severe extent that almost no industrial activity took place. In the absence of industrial development, it is hard to modernise other sectors of the economy.

(iii) It led to the creation of a dualistic economic structure, and,

(iv) There were difficulties in absorbing the fast growing labour force since the agricultural sector was not able to generate sufficient employment opportunities.

In addition, over-specialisation in a few primary products for exports and dependence on food and other manufactured consumer goods on imports led to greater income inequality. This explains why during the early post-independence period Malaysian economy was worse off[1].

The above problem provided the impetus for Malaysia to diversify her economic base when it gained independence. In the process of diversifying the country's economy, the government saw industrialisation (especially the manufacturing sector) as one of the most important elements of diversification (Fong and Lim, 1984: 53; Rani and Haflah, 1990).

Goh (1973: 2-3) demonstrated that the emphasis on industrial development was based on, inter alia, the following arguments:

(i) The productivity of manpower in industry tends to be considerably higher than that in agriculture or other

economic activities.

(ii) The diversification of productive enterprise through industrial development is likely to enhance the economic stability of the country.

(iii) In the case of an economy which is largely based on agriculture, industry can help absorb the surplus manpower, thereby contributing to the solution of the unemployment problem.

(iv) When the economy is largely supported by the export of mineral resources, which are exhaustible and irreplaceable, industrial development will provide an effective second line of defence for it to fall back upon.

3.2 The Industrial Development Programme

As in most developing countries, the early stages of Malaysia's industrial growth was characterised by an inward-looking, defensive industrialisation strategy of import substitution. This provided opportunities for foreigners to set up manufacturing plants in Malaysia to take advantage of the existing local market, which was adequate to support domestic production of many types of consumer goods. Thus, we saw the expansion of import substitution industries, particularly in the food manufacturing sector, in the early seventies. This was reflected in the share of consumption goods in total imports, significantly reduced from 50.7 per cent in 1961 to 32 per cent in 1970 (Tan, 1990: 130). Aziz (1990: 69) remarked that "most of the commodities of domestic consumption that one finds today in Malaysia" can be

attributed to this "decade of import-substitution".

However, in a country with a small population, the growth of pure import-substitution industries was limited in view of the purchasing power of the relatively small domestic market. The food sector, for instance, accounted for 15.3 per cent of value-added in manufacturing in 1970, but it declined to 9.3 per cent in 1980 as the domestic market became saturated. Import-substitution then shifted to consumer durables as the domestic market for these goods rose with higher standards of living.

Moreover, import substitution industries met difficulties in absorbing the fast growing labour force as they were usually capital-intensive. The survey of manufacturing industries in West Malaysia in 1970 found that "for the whole manufacturing sector, foreign-owned firms usually account for about one third of total manufacturing employment while Malaysian-owned firms account for the remaining" (Kuwahara, Harada, and Mizuno, 1979: 63). In another example (Jomo, 1987: 116), the number of workers employed per million Malaysian ringgit of final demand for the manufacturing sector was found to be about a third of that for the agricultural sector. With the growth of capital-intensive industries at faster rates than labour-intensive ones, employment creation suffered.

To sustain the industrial expansion, the country switched to an outward-looking, aggressive strategy of export promotion in the seventies, especially in electrical and electronics industries, veneer and plywood, chemical and petroleum products, and rubber-

based industries.

The radical shift did not mean an abandonment of import substitution. Indeed, export orientation and import substitution have been pursued in a parallel fashion, but stronger emphasis has apparently been placed on the former (Afiff, 1991: 10).

In the eighties, the manufacturing scene was marked by another change -- Malaysia witnessed an ambitious heavy industrialisation programme[2] with the establishment of the Heavy Industries Corporation of Malaysia (HICOM). The term "heavy industry" has been used rather loosely in Malaysia, connoting projects with high capital intensity, long gestation period, and substantial scale economies (Ariff, 1991: 10). So far, the heavy industries in the Malaysian context include the production of the Malaysian car (Proton Saga and Perodua Kancil), small engine projects, an integrated steel plant, petrochemical plants, and a cement plant. The rationale for promoting these industries was based on large externalities and spill-over effects that include widespread learning effects (skills transfer) and the forging of linkages (both forward and backward). These linkages will, in turn, lead to widespread technological diffusion, especially to small and medium-scale industries in the country (Lim and Toh, 1992: 46).

The promotion of heavy industrialisation in Malaysia has received plenty of criticism about high production costs, market gluts, heavy debts (which are largely with foreign credit), poorly conceived policy, poor integration into the national economy, and excess capacity. Nevertheless, it will not be easy for these

industries to withdraw since large amounts of capital have already been sunk into them. Even though some of these projects are announced to be making "profits", Ariff (1991: 11) says "it provides no vindication for the heavy industrialisation policy due to heavy protection by the government"[3].

The current phase of industrialisation since 1987 has seen the growth of second round export-oriented industrialisation (EOI). The upsurge in EOI involved mainly investments from East Asian countries, due to international realignments after the Plaza Accord 1985, resulting in the effective massive depreciation of the ringgit, which has lowered production, especially labour costs. Deregulation and relaxation of government investment policy may also have contributed to the rapid influx of manufacturing investment, growth, exports, and employment.

3.3 Investment Incentive Programmes in Attracting Foreign Investment

Like many other developing countries, Malaysia felt that the pace of industrialisation could be greatly accelerated through an investment incentive programme. Malaysia generally welcomes foreign investments. She has fairly liberal policies towards FDI, as well as generous tax and other incentives as instruments of industrial policy to promote investments in the country.

The first policy measure taken for the stimulation of industrial development in the Federation of Malaya[4] was tax incentives. Their origin can be traced to the Report of the Industrial

Development Working Party delivered to the Malayan government in 1957 after a World Bank mission had in 1955 made some rather general recommendations for industrialisation[5]. The underlying rationale was that the cost of tax exemption was small compared to the gains from increased investment, and tax concessions were more attractive to profit-oriented investors than capital allowances (Hoffmann and Tan, 1980: 35). In addition to this, tax incentives are considered (i) valuable as an indirect stimulus to investment as they publicise and enhance the country's investment climate, and (ii) to reflect the favourable disposition of the government towards private foreign investment. As a result, they help to induce both domestic and foreign investors to undertake activities which they would not have undertaken otherwise. The incentive programmes introduced in Malaysia are described in the following section in chronological sequence.

3.3.1 Pioneer Industries Ordinance of 1958

Malaysia's first effort to stimulate industrial investment through incentive measures was the Pioneer Industries Ordinance of 1958. This Ordinance was recommended by the Industrial Development Working Party. Under the Ordinance, firms were granted a two-year income tax exemption (at that time, company tax was 40 per cent) to any new manufacturing establishment granted "pioneer" status. The exemption period was extended to (i) three years with capital investment of more than RM100,000 but less than RM250,000, and (ii) five years for capital

expenditure exceeding RM250,000.

Under this scheme, the objective of the government was to encourage the establishment of as many manufacturing companies and industries as possible. This was supported by the fact that under the Ordinance, there was no limit on the number of pioneer certificates granted to one industry. Nonetheless, where it was viable to have only one firm, preference was given to the applicant with the highest amount of local capital (Fong and Lim, 1984: 58).

The 1958 Ordinance was amended by the Pioneer Industries Act of 1965[6]. It is interesting to note the differences in the promotional privileges offered under the two Acts. Under the new Act, the amount required for one additional year was fixed between RM250,000 and RM500,000, for two additional years between RM500,000 and RM1 million, and for five years, it exceeded RM1 million. In the 1958 Ordinance and the 1965 Act, firms were allowed to carry losses incurred during the tax relief period into the post-relief period.

With the advent of the new tariffs and incentives many companies got involved in Malaysia's import substitution programme. Initially, the British were the leading investors, followed by Malaysian and Singapore capital. However, by the end of the 1960s, the US had become a prominent investor, comparable in size to UK investment commitments. Japan and Hong Kong companies were also beginning to make their presence felt (see Table 3.1).

Table 3.1: Ownership of Pioneer Companies, 1962 and 1969 (in RM million)

Country	1962	1969
Malaysia (West)	13.0	67.8
Singapore	19.6	86.5
UK	16.0	79.8
US	3.6	67.5
Japan	1.3	38.4
Hong Kong	4.3	33.5
Others	11.2	39.0
Total	69.0	413.4

Source: Jesudasson, 1988: 57.

According to indicators, such as manufacturing share of GDP, an increase from 8.5 per cent in 1960 to 13.5 per cent in 1970 was observed. But only 23,000 jobs were created under the pioneer programme owing to the relatively capital-intensive investment. Thus, it failed to narrow the gap between the 3 per cent growth in the labour force and the 2.5 per cent growth in job creation (Jesudasson, 1988: 58).

3.3.2 The Investment Incentive Act of 1968

A new industrial investment act, namely the Investment Incentive Act, was promulgated in 1968 and further amended in 1972 and 1974. This new act was introduced as Malaysia made a policy shift away from import substitution towards export orientation. The radical shift was highly supported as the domestic market became saturated by the late sixties. This phenomenon reflected the fact that further expansion was not viable unless there were more overseas market ventures.

Towards the end of the "decade of import-substitution" the government saw a gradual slackening in the tempo of consumer goods industrial activities. In its efforts to inject further stimulus into the industrial sector, the government introduced two measures that were expected to have far-reaching consequences. They were the introduction of Investment Incentive Act of 1968 and the setting up of the Federal Industrial Development Authority (FIDA). The Act, which was replaced the 1958 Ordinance, was a much more sophisticated piece of legislation.

Under the 1958 Ordinance, manufacturing companies were not encouraged to utilise local raw materials and labour in their production. To rectify the internal problems, tax incentives were provided not only for pioneer industries but also to encourage non-pioneer companies; the dispersal of industries from traditional areas; and the utilisation of an increased Malaysian content in manufactured products. The Act also catered for capital-intensive industries which had a long gestation before profits were made. For the first time fiscal incentives for export-oriented companies were introduced (for details, see Appendix 2).

To facilitate the transition from import substitution to an export-oriented industrialisation strategy, the government established the Federal (now Malaysian) Industrial Development Authority in 1965. With the establishment of FIDA, it took over the functions of promoting industries and administering incentives within the Ministry of Trade and Industry. In October

1988, MIDA announced its introduction of the so-called "one-stop agency" -- the Centre on Investment (COI), to better serve foreign investors by circumventing time-consuming procedures. MIDA became the sole agency responsible for all such official procedures, and applications were to be approved within two months so that foreign investors could start business as soon as possible.

3.3.3 Industrial Coordination Act of 1975

Further adjustments were made to the investment incentives in 1975 when the Industrial Coordination Act (ICA) was introduced. The main feature of the Act was the requirement of obtaining a licence for all manufacturing unless exempted. This was to enable the government to regulate equity shares of private enterprises, including industries belonging to foreign companies, conforming with the New Economic Policy (NEP). Prior to the NEP, there was almost no regulation of foreign ownership, and wholly or majority foreign-owned companies were to be found in any industry. With the introduction of NEP, the foreign-equity share was expected to be reduced to 30 per cent by 1990[7].

The NEP was introduced after the racial riots in May 1969. The tragedy happened due to the economic imbalance between the three ethnic groups, i.e. Malay, Chinese, and Indian, in terms of income, employment, and ownership of wealth. In other words, post-1975 industrialisation was governed by policy instruments which focused on certain socio-economic objectives. Jesudasson

(1988: 167) argues that "... the leaders were more interested in using multinationals to help realize their political goals than to intensify industrial development".

With the introduction of ICA 1975, there were only 471 applications for manufacturing projects (that is, new as well as expansion projects) in 1975, a decrease of 25 per cent from 1974 (FIDA Annual Report, 1975: 108). This situation continued into 1976 with a 16 per cent decline in applications compared to 1975 (FIDA Annual Report, 1976: 159). On 30 April 1977 (Far Eastern Economic Review, 6 May, 1977: 38-42), the government announced a number of amendments to the ICA. Among some of the salient changes were:

(i) Excluding firms with less than RM250,000 in shareholders' funds and fewer than twenty-five workers from the Act.

(ii) Freeing firms with less than RM500,000 in fixed investment from the equity condition.

At the beginning of the 1980s, the world economy was in recession, sparked by the second oil crisis of 1979. To overcome these world changes, the government introduced a counter-cyclical fiscal intervention policy which was aimed at encouraging more Bumiputra participation in business and industrial activities. As a result of this massive intervention, the government faced financial burdens with the debt service ratio increasing from 2.3 per cent in 1980 to 22.3 per cent in 1985. At about the same

time, over-supply of primary commodities depressed commodity prices in the world market, which in turn led to the first negative growth of GDP in Malaysia in 1985.

In order to improve the year-long recession in 1985 and 1986, various measures and deregulation to the existing guidelines pertaining to investment in the manufacturing sector were formulated. For instance, in 1985, the government made some amendments to the ICA of 1975. Following the amendments, only manufacturing companies with shareholders' funds of RM2.5 million and above (from the existing RM250,000) or those who engaged 75 (from the existing 25) or more full-time workers need to apply for the licence. In addition, no approval is required for companies which plan to undertake expansion in order to export 80 per cent or more of their products (companies are only required to inform the Ministry of International Trade and Industry (MITI) and MIDA of the details). Similar conditions and procedures are applicable for a company which undertakes diversification for export (MIDA, 1993b: 3-4).

3.3.4 Promotion of Investment Act 1986

The changing comparative advantage of Malaysia resulting from structural transformation in its economy has prompted the government to review its fiscal incentives pertaining to FDI.

In October 1986, the Promotion of Investment Act was promulgated to succeed the Investment Incentives Act and to encourage private sector investment, especially foreign direct investment, to boost

the economy. The Act was amended in 1991. This shows a distinct shift towards manufacturing activities that are capital-intensive and technology-intensive and have higher value-added content.

The various types of investment incentives available under the Act are:

(i) Pioneer status incentive

(ii) Investment tax allowance (ITA)

(iii) Abatement of adjusted income

(iv) Export allowance

(v) Double deduction for promotion of exports

In the past, companies which were granted pioneer status were given income tax exemption of 65 per cent and a 3 per cent development tax for 5 years. From 1 November, 1991, pioneer enterprises are granted complete tax exemption of 70 per cent and a 2 per cent development tax during the tax relief period (development tax was abolished in 1993). To reduce protection and promote competition, no extension of the pioneer period will be granted.

Pertaining to Investment Tax Allowance (ITA), companies granted ITA on or after 1 November, 1991 only enjoy an allowance of 60 per cent of qualifying capital expenditure (this is in comparison to 100 per cent previously). In addition, the maximum amount of ITA to be deducted for each assessment year is limited to 70 per cent of the company's statutory income. Any unutilised allowance may be carried forward to subsequent years of assessment.

Both the pioneer status and ITA incentives are not granted to companies which previously enjoyed special incentives for similar products or activities. However, a 100 per cent tax exemption may be given to strategic projects of national importance such as those with heavy capital investment or high technology which may generate extensive linkages in the Malaysian economy (Ariff and Danaraj, 1992: 13).

In both cases, companies will be paying tax at approximately 10 per cent during the tax relief period (MITI, 1994: 285). These incentives are granted to firms that undertake to produce promoted products or engage in promoted activities (see Appendix 3 for a list of promoted products), irrespective of the location of their business.

However, pioneer firms located in the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak (after 1 November, 1991) enjoy income tax exemption of 85 per cent of their statutory income. As for companies eligible for ITA, the rate of allowance is increased to 80 per cent and the amount of allowance exempted for each assessment year is increased to 85 per cent of the firm's statutory income. Thus, the firm will be paying tax at a rate of approximately 5 per cent (MITI, 1994: 286).

3.4 Profile of FDI Flows into Malaysia

3.4.1 Growth of FDI

Generally, FDI has played an important role in the industrial

development of Malaysia during the last two decades. FDI in the Malaysian manufacturing sector experienced 12.1 per cent and 12.5 per cent growth respectively for the period of 1961-65 and 1966. With the separation of Singapore from Malaysia in 1965, the growth rate deteriorated to 8.9 per cent in 1967 and to 8.6 per cent in 1968. Since then, manufacturing investment has picked up (Kanapathy, 1970: 5).

Table 3.2 shows total FDI in Malaysia for the 1980-92 period by approved projects. The pattern of total FDI in Malaysia for 1980 to 1993 is illustrated in Figure 3.1.

It can be observed from Figure 3.1 that there was a peak in FDI in 1982 at RM1.6 billion in total approved foreign investment (comprising both equity and loans). Subsequently, FDI reached a low in 1983 at RM629.2 million but it has been increasing steadily since then. By 1986 it had reached RM1.7 billion, which was marginally higher than the peak registered in 1982. The total proposed foreign investment increased markedly (137%) from RM2.1 billion in 1987 to RM4.9 billion in 1988. This situation further improved in 1989 and a second peak was achieved in 1990. Nonetheless, the seven-year consecutive growth in FDI slowed down to RM17.1 billion in 1991 and further decreased to RM6.3 billion in 1993.

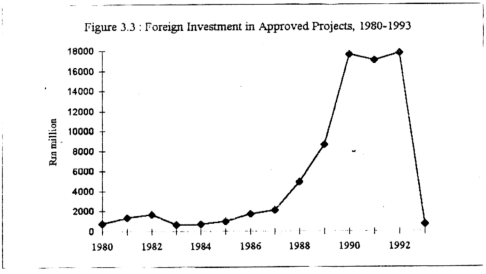
The large increase in approved FDI in the second half of the 1980s is a reflection of the liberalisation and deregulation of government policies.

Table 3.2: Foreign Investment[1] in Approved Projects 1980-93 (RM million)

1980	729.5
1981	1309.2
1982	1626.6
1983	629.2
1984	718.1
1985	959.3
1986	1687.9
1987	2060.0
1988	4878.0
1989	8652.7
1990	17629.1
1991	17055.3
1992	17772.1
1993	687.2

Source: MIDA, Statistics on the Manufacturing Sector in Malaysia, various years.

Note: [1]Foreign investment = equity + loan.



The data presented above, obtained from MIDA, include only approved investments for the manufacturing sector. These data, can be misleading as there would be a sizeable discrepancy between investment projects approved by MIDA and those actually implemented by the applicants. It is not uncommon for an approved project to be abandoned, postponed, or trimmed down in the face

of changing international, home or host country circumstances. According to MITI (1994: 222), of the total investment projects (both local and foreign) approved during 1980-93, 55.5 per cent were in operation, 2.7 per cent were setting up their plants, and 20.8 per cent were in the initial stages of implementation as at 31 December 1993. Thus 21.0 per cent of the approved projects had not been implemented (see Table 3.3). Despite the aforementioned weaknesses, the figures provided by MIDA are still widely used since it is difficult for Malaysian researchers to obtain data from all home country sources. Furthermore, data compilation from home countries are often too aggregated. Similarly, data provided by the International Monetary Fund are available only at a highly aggregated level (Ariff, 1991: 103).

3.4.2 Sources of FDI

Table 3.4 shows that FDI inflows into Malaysia are increasingly dominated by countries of the Asia-Pacific region, especially Taiwan and Japan. The US was one of the traditional important investors. However, the presence of US FDI dwindled, while Taiwanese firms have been making dramatic inroads into Malaysia since 1987. The share of foreign investment from the Asia-Pacific countries increased steadily from 71.9 per cent in 1982 to 78.6 per cent in 1989 before surging further to 87 per cent in 1991. On the other hand, investment share from EC countries declined significantly from 15.3 per cent in 1982 to only 7.8 per cent in 1993.

Table 3.3: Progress of Implementation of Approved Manufacturing Projects (1980-1993) as at 31st Dec, 1993

Status of Implementation	Number of Projects	% of Total Number of Projects
Projects Implemented		
(i) In Production	5064	55.5
(ii) Machinery Installation or Factory Construction	243	2.7
Subtotal	5307	58.2
Projects in Initial Stage of Implementation		
(i) Site Acquired	210	2.3
(ii) Active Planning or Negotiation	1694	18.5
Subtotal	1904	20.8
Projects not Implemented		
(i) No Action Taken	174	1.9
(ii) Temporarily Shelved or Abandoned	883	9.7
(iii) Withdrawn	862	9.4
Subtotal	1919	21.0
Total	9130	100.0

Source: MITI, Malaysia International Trade and Industry Report 1994: 222.

Among the Asia-Pacific countries, the Japan's share peaked at 31.1 per cent in 1989 and then declined steadily to 15.1 per cent in 1992. However, its share increased to 26.4 per cent in 1993. Taiwan, on the other hand, always a distant second to Japanese investment, topped the list of investors in 1990. Its negligible share of 0.3 per cent in 1982 increased to 11.8 per cent in 1987 and 36 per cent in 1990, compared with 23.9 per cent for Japan. Its position dropped, however, in 1992 to fifth with 8.4 per cent

of total investment share. But it ranked in the top three in 1993's total FDI inflows into Malaysia.

Table 3.4: Foreign Investment[1] in Approved Projects by Sources 1982-92 (percentage)

	1982	1985	1987	1989	1990	1991	1992	1993
Australia	9.3	2.7	6.1	0.3	0.3	2.4	12.0	0.8
Canada	0.8	0.2	2.4	0.2	0.5	0.4	0.1	0.1
China	0.0	0.0	0.4	0.1	0.1	2.3	0.1	1.8
Hong Kong	0.6	2.9	4.3	4.1	2.1	3.5	0.4	1.5
Indonesia	6.0	1.3	0.1	1.2	6.1	7.3	2.7	3.9
Japan	34.0	27.6	34.7	31.1	23.9	21.7	15.1	26.4
Korea	0.1	2.6	0.2	2.2	3.7	10.7	0.6	1.8
New Zealand	0.1	0.1	0.0	0.0	0.1	0.4	0.0	0[a]
Phillippines	5.8	0.1	0.0	0.0	0.2	0.0	0.1	0.0
Singapore	1.3	10.4	12.5	10.6	5.1	6.5	2.5	8.3
Taiwan	0.3	3.3	11.8	25.0	36.0	21.2	8.4	14.2
Thailand	5.7	0.1	0.2	0.1	0.0	0.1	0.0	0.2
US	7.8	11.7	7.9	3.7	3.2	10.5	18.6	28.0
Asia-Pacific	71.9	63.0	80.6	78.6	81.3	87.0	60.6	87.1
UK	10.9	2.8	3.7	8.8	4.9	3.2	7.3	0.7
Netherlands	0.1	0.0	0.0	0.7	0.2	0.0	0.8	1.1
Germany	3.1	0.8	1.4	3.6	0.7	1.1	0.4	1.0
France	0.0	1.8	3.2	0.1	0.1	0.2	22.9	0.5
Italy	0.3	1.4	0.6	0.5	0.1	0.2	0.0	0.2
Belgium	0.8	0.1	0.6	0.8	0.2	0.3	0.0	-
Denmark	0.0	0.1	0.8	0.0	0.1	1.1	0.1	3.8
Ireland	0.0	0.0	0.0	0.1	0.0	0.0	4.2	-
Greece	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-
Luxembourg	0.0	0.0	0.0	0.0	0.0	0.1	0.0	-
Spain	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5
EC	15.3	7.0	10.3	14.6	6.4	6.2	35.8	7.8
Others	12.8	30.0	9.0	6.9	12.3	6.8	3.7	5.1
Total (RM million)	1626.6	959.6	2059.9	8652.8	17629.2	17055.3	17772.1	628.7

Source: MIDA, Statistics on the Manufacturing Sector in Malaysia, various years.

Note: [a] Expansion of capacities or manufacture of additional products not involving additional capital.

[1] Same as Table 3.2.

A few other countries have also become more and more important foreign investors in Malaysia in recent years. The prominent countries are the United States, Korea, Indonesia, and China. The United States has staged a comeback with its share increasing from 3.2 per cent in 1990 to 10.5 per cent in 1991 and 18.6 per cent in 1992. The United States emerged as the largest investor in Malaysia with a proposed capital investment of RM1.76 billion in 1993 (28 per cent of total investment share).

Although the amount is still small, the growth of FDI from South Korea and China is significant. In 1981, Korean investment constituted only 0.8 per cent share. Its share in total investment rose from about 2.95 per cent in 1990 to 10.6 per cent in 1991 before decreasing to 0.6 per cent in 1992. In 1993, its total approved investment was RM111.1 million (1.8 per cent of the total share).

China's investment in Malaysia, too, registered a marked increase during 1990-91. Although its share dropped to 0.05 per cent in 1992, it remains as a major investor in 1993, with RM114.9 million in approved projects.

Singapore, partly because of its special links with Malaysia and partly because of the presence of multinational corporations in Singapore relocating the manufacture of low-value added products to lower cost countries, is always a major investor in Malaysia.

Among the EC countries, historically the UK was the notable investor in Malaysia foreign investment formation. Its importance, however, is being eroded continuously by the Asian

NIEs of Hong Kong, Taiwan, and South Korea. The share of UK declined steadily from 4.0 per cent in 1988 to 3.3 per cent in 1991, but later increased to 7.3 per cent in 1992. The Netherlands, always a distance behind the UK, emerged as the largest investor in 1986 with its share reaching a high of 52.3 per cent of the total investment from EC countries. France, in a similar vein, moves up several notches to become the largest investor in Malaysia in 1992 with RM4 billion in approved projects.

Data in Table 3.4 reveal that rarely did any country have a share of more than 25 per cent of total investment in Malaysia (with the exception of Japan in 1982, 1989 and 1993; Netherlands in 1986; Taiwan in 1990; and US in 1993). This shows that there was no major reliance or dependence on a single investment source. According to the former Finance Minister, Tengku Razaleigh, "Multinationals are no longer exclusively identified with only one major industrial country. In recent years multinationals sprung up in many industrial countries as well as some developing countries ..." (Jesudasson, 1988: 182).

3.4.3 Sectoral Allocation

Foreign investments have gone into a wide spectrum of manufacturing activities, ranging from simple food manufacturing to production of sophisticated scientific and precision instruments. Nonetheless, some industries have large investment while others appear to be overlooked by foreign investors.

Notable among them are basic metal products, electronics, petroleum and coal, and chemical products, which jointly accounted for as much as 72.2 per cent of the approved FDI in 1990 (See Table 3.5). On the other hand, downstream processing and manufacture of products based on local commodities have been relatively unsuccessful in attracting FDI. For instance, food manufacturing, beverages and tobacco, furniture and fixtures, wood, and rubber products. This would suggest that the country's manufacturing is narrowly based.

Sectoral allocation of FDI in Malaysia, however, varies considerably between investing countries. Nevertheless, over the years the sources of FDI have not changed significantly, as shown in Table 3.6 and 3.7.

The sectoral pattern, in terms of fixed assets, corresponds closely to that in terms of paid-up capital, although fixed assets are considerably larger than paid-up capital in absolute terms (see Table 3.8 and 3.9).

In 1992, the most important recipients of Japanese FDI were textiles, basic metal and electronic products, accounting for 65.3 per cent of the total paid-up capital. Nearly 75.8 per cent of the Taiwanese paid-up capital in Malaysia is accounted for by three industries, namely electronics, fabricated metal, and wood and wood products. The textile, chemicals, and electronics subsectors have absorbed 66.0 per cent of FDI in terms of paid-up capital from Hong Kong.

Table 3.5: Foreign Investment[1] in Approved Projects by Industry, 1989-90 (RM million)

	1989				1990			
	Foreign Equity		Foreign Investment		Foreign Equity		Foreign Investment	
	RM m.	per cent	RM m.	per cent	RM m.	per cent	RM m.	per cent
Food Manufacturing	135.6	4.0	290.7	3.4	129.1	2.1	325.7	1.8
Beverages & Tobacco	-	-	-	-	8.4	0.1	8.4	0.0
Text. & Textile Products	230.8	6.8	511.2	5.9	312.2	5.0	874.2	5.0
Leather & Leather Products	7.2	0.2	18.5	0.2	16.5	0.3	30.5	0.2
Wood & Wood Products	331.3	9.7	1007.4	11.6	179.2	2.9	542.7	3.1
Furniture & Fixtures	62.0	1.8	129.7	1.5	62.2	0.0	127.6	0.7
Paper, Printing & Publishing	58.6	1.7	294.2	3.4	120.2	1.9	373.6	2.1
Chem. & Chemical Products	458.7	13.5	1016.4	11.7	655.6	10.5	1727.3	9.8
Petroleum & Coal	64.2	1.9	223.8	2.6	540.6	8.7	2703.1	15.3
Rubber Products	130.7	3.8	360.7	4.2	32.4	0.5	54.2	0.3
Plastic Products	97.5	2.9	215.2	2.5	174.4	2.8	426.6	2.4
Non-metallic Mineral Prod.	111.6	3.3	339.0	3.9	95.9	1.5	180.1	1.0
Basic Metal Products	154.3	4.5	440.1	5.1	1526.1	24.5	4538.7	25.7
Fabricated Metal Products	220.3	6.5	521.4	6.0	132.1	2.1	304.9	1.7
Machinery Manufacturing	60.3	1.8	143.3	1.7	363.5	5.8	1167.9	6.6
E'trical & E'tronic Prod.	1112.0	32.7	2720.8	31.4	1654.8	26.6	3773.2	21.4
Transport Equipment	61.4	1.8	136.8	1.6	104.5	1.7	279.5	1.6
Scientific & Measuring Equip.	52.7	1.5	209.9	2.4	48.5	0.8	78.9	0.4
Micellaneous	51.8	1.5	73.5	0.8	71.7	1.2	111.8	0.6
Total	3401	100.0	8653	100.0	6228	100.0	17629	100.0

Source: MIDA, Statistics on the Manufacturing Sector in Malaysia: 1988-1992.

Note: [1] Same as Table 3.2

Table 3.8: Foreign Investment by Industry and Region as at 31st December, 1992
(RM million)

	Asia-Pacific		EC		Others	
	Paid-up Capital	Fixed Asset	Paid-up Capital	Fixed Asset	Paid-up Capital	Fixed Asset
Food Manufacturing	621.1	531.5	274.5	242.8	161.9	219.0
Beverages & Tobacco	297.1	280.8	109.3	102.0	0.3	0.8
Textile & Textile Products	675.8	928.4	56.5	69.4	52.7	121.4
Leather & Leather Products	14.1	17.8	-	-	18.5	36.5
Wood & Wood Products	285.6	600.2	15.6	10.3	8.0	0.8
Furniture & Fixtures	74.6	117.1	4.7	4.6	5.0	4.5
Paper, Printing & Publishig	103.4	272.7	4.3	8.7	0.6	0.6
Chemical & Chemical Products	428.1	749.7	140.2	368.1	9.3	13.0
Petroleum & Coal	231.6	642.0	431.5	970.1	0.7	1.2
Rubber Products	216.3	400.1	143.5	309.8	12.4	174.5
Plastic Products	273.3	408.7	1.5	1.1	0.7	5.3
Non-metallic Mineral Products	515.0	1050.4	77.3	96.1	60.3	94.6
Basic Metal Products	554.0	765.4	38.3	30.8	12.0	11.4
Fabricated Metal Products	361.8	473.7	24.0	25.6	53.2	97.5
Machinery & Manufacturing	202.6	268.3	8.4	5.4	7.0	6.0
Electrical & Electronic Products	3087.6	6473.8	244.4	481.0	103.2	205.7
Transport Equipment	294.4	407.6	65.1	99.3	50.3	115.7
Scientific & Measuring Equipment	160.5	291.5	61.6	122.7	28.9	63.2
Miscellaneous	69.1	220.9	10.8	21.2	3.2	0.3
Total	8473.1	14931.0	1714.6	2971.3	577.8	1139.5

Source: Calculated from Tables 3.6 and 3.7.

Table 3.9: Foreign Investment by Industry and Region as at 31st. December, 1992
(percentage)

	Asia-Pacific		EC		Others	
	Paid-up Capital	Fixed Asset	Paid-up Capital	Fixed Asset	Paid-up Capital	Fixed Asset
Food Manufacturing	58.7	53.5	26.0	24.4	15.3	22.1
Beverages & Tobacco	73.0	73.2	26.9	26.6	0.1	0.2
Textile & Textile Products	86.1	83.1	7.2	6.2	6.7	10.8
Leather & Leather Products	43.3	32.8	-	-	56.7	67.2
Wood & Wood Products	92.4	98.2	5.0	1.7	2.6	1.1
Furniture & Fixtures	88.5	92.8	5.5	3.6	6.0	3.6
Paper, Printing & Publishing	95.5	96.7	4.0	3.1	0.5	0.2
Chemical & Chemical Products	74.1	66.3	24.3	32.6	1.6	1.1
Petroleum & Coal	34.9	39.8	65.0	60.1	0.1	0.1
Rubber Products	58.1	45.2	38.6	35.0	3.3	19.7
Plastic Products	99.2	98.5	0.5	0.3	0.3	1.2
Non-metallic Mineral Products	78.9	84.6	11.8	7.7	9.3	7.7
Basic Metal Products	91.7	94.8	6.3	3.8	2.0	1.4
Fabricated Metal Products	82.4	79.4	5.5	4.3	12.1	16.3
Machinery & Manufacturing	92.9	95.9	3.9	1.9	3.2	2.2
Electrical & Electronic Products	89.9	90.4	7.1	6.7	3.0	2.9
Transport Equipment	71.9	65.5	15.9	16.0	12.2	18.5
Scientific & Measuring Equipment	63.9	61.1	24.5	25.7	11.6	13.2
Miscellaneous	83.2	91.1	13.0	8.8	3.8	0.1
Total	78.7	78.4	15.9	15.6	5.4	6.0

Source: Calculated from Tables 3.6 and 3.7.

In the case of US FDI, chemicals, petroleum, electronics, and paper, printing and publishing subsectors accounted for 69.6 per cent of the total. By contrast, Singaporean investments in Malaysia are actively involved in a wide range of manufacturing industries.

FDI from Japan and the Asian NIEs have one thing in common. They are mostly labour-intensive processing industries, in contrast to US investments.

Some interesting comparisons between the Asia-Pacific and the EC region are also revealed in Tables 3.8 and 3.9. The EC investments are dominant in only one industrial subsector, i.e., petroleum and coal, in terms of both paid-up capital and fixed assets in 1992.

On the other hand, the Asia-Pacific region dominates in all other industrial groups, with the notable exception of leather and leather products[9]. Industries where the Asia-Pacific region contribute more than 90 per cent of paid-up capital and fixed assets are wood and wood products, paper, printing and publishing, plastic products, basic metal products, and machinery manufacturing.

Asia-Pacific investments are mainly concentrated in low-technology industries, while those from the EC are in high technology (see note 2, Chapter 1).

3.4.4 Importance of FDI to Capital Formation

It was noted that despite the increasing volume of FDI inflows between 1980 and 1992, foreign investment actually represented only a small fraction of domestic capital formation in Malaysia. During 1980 to 1985, FDI as a percentage of domestic capital formation fluctuated from less than 3 per cent to almost 9 per cent. The situation, however, modestly improved in the second half of the 1980s. It reached a high of 10 per cent over the annual average of 1986-1989.

The importance of FDI in relation to domestic capital formation becomes more pronounced when it is compared to private-sector investments. This is not surprising since public investment accounts for a substantial share of total domestic investment. The proportion of FDI in private sector investments averaged 9.7 and 26.6 per cent over the period of 1980-86 and 1980-92 respectively.

The ratio of FDI to domestic output (GDP), another indicator of the importance of FDI in most countries, increased from 2.8 per cent to 18.25 per cent between the periods 1980-87 and 1988-92 in Malaysia. If we take a longer view of the magnitude of FDI relative to GDP (1980-1992), the figure prevails a value of 8 per cent a year.

As a proportion of gross domestic investment, FDI has assumed a relative importance in the late 1980s. For the majority of developing countries, in purely quantitative terms, FDI is of only marginal importance in total capital formation. The inflow

of FDI, as a percentage of domestic investment (annual average, 1978-1980) for five major recipients of FDI, was as follows: Argentina, 3.0 per cent; Brazil, 2.1 per cent; Mexico, 3.3 per cent; Singapore, 3.0 per cent; and Malaysia, 2.0 per cent (Nixson, 1984: 97). According to the study of Hill and Bain (1985) FDI of nine developing market economies in Asia, the highest ratio of FDI to gross domestic investment during 1981-82 was just over 9 per cent in Singapore, followed by around 8 per cent in Hong Kong and Indonesia, and 3 per cent in Malaysia. In South Korea, Taiwan, the Philippines, and Thailand the ratios were all less than 3 per cent. Whilst in the Alburo, Bautista and Gochoco (1992) study of FDI in five ASEAN countries (excluding Brunei) over the period 1989-90, the ratio of FDI to gross domestic investment in Indonesia, Thailand and Philippines increased, with Singapore and Malaysia experiencing double digit increases.

It was pointed out that the ratio of net FDI to total resource inflow as well as the ratio to gross domestic investment tend to understate the importance of FDI, as they exclude both investments from reinvested profits and those financed by domestic borrowing.

Even if investments from retained profits and domestic borrowing were added, the proportion of FDI in total domestic capital investment in Malaysia would still be quite small. This observation should, not, however be interpreted as implying that multinational enterprises' involvement in Malaysia has been

insignificant. It is important in the sense that it is a carrier of technology and processes and investment capital, and not because it necessarily leads to a permanent expansion of capital stock. FDI has in fact contributed much to the diversification of Malaysia's industrial structure (see Chapter 1).

Notes

1. The truth is that the average income elasticity of demand for primary products is significantly lower than the average income elasticity of demand for manufactured goods in the international market. This shows that when there is an increase in the level of income, the demand for manufactured goods and non-basic food stuffs will increase more than the demand for primary commodities.
2. It is always considered as the second round of import substitution.
3. To economists, financial performance cannot be equated with economic performance. Financial performance is based on money costs and prices which may not reflect the real opportunity cost of resources, especially where they have been distorted by policy interventions.
4. The Federation comprised the area now known as West Malaysia or Peninsular Malaysia.
5. The World Bank mission emphasised tariff protection and depreciation allowance as effective incentives.
6. When Malaysia was formed in 1963, four different incentives acts existed in the four regions (Federation of Malaya,

Singapore, Sabah, and Sarawak). The attempts to harmonise these separate acts resulted in the introduction of the Pioneer Industries Act 1965.

7. Under the NEP, the guidelines on foreign equity were as follows, subject to government policies:

   (i) For projects involving the extraction and primary processing of non-renewable domestic resources, at least 70 per cent Malaysian (including 30 per cent Bumiputra) equity was required.

   (ii) For projects manufacturing substantially for export, foreign majority ownership was permitted. When justified, even 100 per cent foreign ownership was considered.

8. Prai, Prai Wharf, Bayan Lepas, Batu Berendam, Tanjung Kling, Sungei Way, Ampang Hulu Klang, Telok Panglima Garang, Johor Port Authority Industrial Land, Jelapang, Kinta, and Muara Tabuan.

9. According to 1993 MIDA statistics, Bermuda dominates foreign investment in the Malaysian leather industry, accounting for 56.7 per cent of paid-up capital and 67.2 per cent of foreign-owned fixed assets.