CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1. Summary

Recent trends have indicated that private investment, particularly FDI to developing countries is rapidly replacing official aid in the 1990s. As FDI is a driving force in a country's economic growth, there has been intense competition for FDI inflows. The developed countries continued to receive the bulk of FDI inflows, while among developing economies, China is the largest recipient. Other major FDI recipients include Malaysia, Singapore, Brazil and Mexico.

The objective of the study is to analyse Malaysia's competitiveness in attracting FDI inflows for the manufacturing sector vis-à-vis other developing countries. Focus is on the developing economies, including the four NICs of Singapore, Taiwan, Hong Kong and Korea based on the consideration that the competition for FDI inflow is among the developing economies themselves. This is because the developed countries as major sources of FDI will channel it to the developed countries. Hence, the intense competition among the developing countries for the remaining FDI share meant for the developing economies.

The study examined the various theories of FDI to determine the factors or determinants of FDI, specifically in the Malaysian context. Of particular relevance is Dunning's OLI (owner specific assets, locational assets and internalisation) framework, in which investors will combine their firm specific assets with the location specific assets of a particular country through the internalisation process. Thus countries compete for FDI through improving on their location specific assets, such as investment incentives and infrastructure.

The paper also examined the concept of competitiveness by WEF and IMD. The study went on to establish that a nation's international competitiveness as indicated by the rankings of the Lausanne-based WEF in its Global

Competitiveness Report 1997 and the Geneva-based IMD in its World Competitiveness Yearbook 1997, has a bearing on its ability to attract FDI inflows.

Data for this study is obtained from secondary sources. The study recognises the limitations of using MIDA's data on approved projects and proposed investment as not all approved projects may be implemented. However, the data on approved projects and proposed investment indicate investors' intentions to invest. Data on FDI inflow by country and region is obtained from World Bank and UNCTAD reports. Although there may be inaccuracies in FDI data due to errors and differences in reporting, the data indicates trends and directions. Data on ranking and international competitiveness is sourced from WEF and IMD reports. In addition to using hard data, both WEF and IMD have also included a perception study called the Executive Survey which sought respondents' opinions on various factors which contributed to a nation's overall global competitiveness.

5.2. Conclusions

The study examined Malaysia's international competitiveness vis-à-vis other developing countries. The study also ran a regression analysis on ten variables which can influence FDI inflow (dependent variable). The ten factors are GDP, GDP growth, exports, political system, corporate taxes, investment incentives, infrastructure, improper practices and transparency. The factors GDP, GDP growth and exports are hard or statistical data, while the remaining factors are soft data obtained from IMD's Executive Survey. After analysing the data, the study arrived at the following conclusions:

- Malaysia is ranked favourably by WEF and IMD. In 1997, WEF ranked Malaysia at position 9 out of 53 countries, while IMD ranked it at number 17 out of 46 countries. Malaysia ranks high after Singapore and Hong Kong, when compared to the other developing economies in IMD's list of competitive economies.

- A nation's ranking in international competitiveness is instrumental in its ability to attract FDI inflows. The higher the ranking, the larger is the FDI inflow. Due to Malaysia's ranking which is higher than its Asean member countries of Indonesia, Thailand, the Philippines and Vietnam, it has managed to attract larger FDI inflows. The exception is Singapore which is able to attract even larger FDI inflow due to its higher ranking. However, there are other factors attracting FDI Inflows, such as the size of the market as evidenced in China's case, where despite its lower ranking, it remains the largest FDI recipient among developing countries since 1992.
- The regression analysis using the "enter" approach of all ten variables on FDI inflow indicated that the predictor variables account for 70.3 percent of the variation in FDI (dependent variable). There were only two significant variables, that is GDP (a proxy for market size) and the factor "control" (regarding restrictions or freedom in acquiring domestic companies).
- The stepwise regression analysis identified only two significant variables, GDP and "control". The variable GDP accounted for a significant 55.2 percent of the variation in FDI, while the variable "control" explained 13.4 percent of the variation in FDI. The explanatory power of the model is close to 70 percent, meaning that 30 percent of the variation in FDI is accounted by other variables not in the model.
- The findings of the regression analysis have implications on the Malaysian economy's competition for FDI. Due to its small domestic market and relatively smaller GDP, Malaysia cannot attract FDI on the basis of market size unlike populous nations like China, Brazil, Indonesia and Mexico. Malaysia has to compete as a platform for exports, and in this case, overall competitiveness does matter.
- The factor "control" is found to be significant. This finding has implications on the government policy of equity and allocation of equity conditions imposed on foreign investors.

- There is a positive correlation between economic growth rates and FDI inflows. Countries like China, Singapore and Malaysia with significantly higher growths in GDP per capita in 1996 have been able to attract larger FDI inflows than countries with lower real GDP per capita growth rates.
- Larger FDI inflows are positively correlated with higher host country exports of goods. Countries like Malaysia and Singapore which have small domestic markets have to compete for FDI as offshore bases for exports. Hence the high exports expressed as a percentage of GDP. Higher FDI inflows are in turn associated with higher host country exports.
- Malaysia ranked more favourably than most of the developing countries, including China, Indonesia, Philippines and Thailand on the factors political system, corporate taxes, investment incentives and transparency. However, Malaysia ranked low on the factor "control", obtaining a rank of 44 out of 46 countries. The nation also did not rank favourably on the factor "improper practices, with a rank of 26.
- Although the factors political system, corporate taxes, investment incentives, improper practices and transparency were found to be not significant in determining FDI inflow, it is pertinent to note that these factors contribute to the overall competitiveness of nations.
- Malaysia has provided a conducive environment to attract FDI inflows in terms of its political stability and "tangible" measures like generous incentives and infrastructure facilities. However despite Malaysia's higher ranking on the "immeasurable" or "soft" measures such as transparency and improper practices (bribery and corruption), compared to China, Indonesia, Philippines and Thailand, there is still room for improvement. If the country wants to improve its competitiveness, greater efforts will have to be made regarding these soft issues and the enforcement of intellectual property rights which are increasingly becoming important in the rapidly globalised business environment. For example, Singapore and the United States provide a transparent and graft-free environment for trade and business. As a result, the governments of Singapore and the United States enjoy high credibility

with the business community, which translates into larger FDI inflows. Nations which wish to improve their international competitiveness, including Malaysia can perhaps look into the experiences of Singapore and the United States.

- Due to the current regional economic uncertainties which have resulted in the erosion of investors' confidence in the region, including Malaysia, and the emergence of other developing economies in Latin America (Brazil, Argentina and Mexico) and in Central and Eastern Europe (Poland) as choice FDI locations, FDI inflows to Asean countries are expected to shrink.

5.3. Policy Recommendations

The findings of the regression analysis indicated the significance of the factors GDP and "control" in explaining close to 70 percent of the variation in FDI. The variable GDP (a proxy for market size) accounted for a significant 55.2 percent of the variation in FDI, while the variable "control" accounted for 13.4 percent. It is thus evident that the Malaysian economy cannot attract FDI on the basis of her market size, and has to compete for FDI as a platform for exports. The significance of the factor "control" has implications on the government policy of imposing equity conditions on foreign investors.

The issue of international competitiveness is important in competing for FDI as a platform for exports. Investors are likely to be more concerned about the overall competitiveness of the country they are considering. They tend to seek low-cost production sites, countries with political stability and a conducive business environment with generous incentives, low corporate taxes, open investment regulations, low corruption and transparency in government policies.

In the context of the current economic uncertainties affecting the region and the expected slowdown in FDI inflows to Asean, it is anticipated that there will be intensified competition for FDI from neighbouring countries in this region, and other developing countries in Latin America and Central Europe. In addition, the regional economic uncertainty may enhance the competitiveness of other developing economies as choice locations for FDI inflows.

It is suggested that Malaysia focus on measures to improve its international competitiveness in order to attract FDI. This is because international competitiveness is important to foreign investors looking for locations as platforms for exports. The following recommendations are thus suggested:

- To improve the nation's business environment as an offshore location for exports. Malaysia already ranks favourably on corporate taxes and investment incentives. In the light of such incentives being often viewed as compensation for disincentives (Ariff,1991), any further enhancement on such incentives may appear redundant. A more appropriate policy measure will necessarily involve the creation of a more pro-market investment environment emphasising higher efficiency and productivity, competitive product prices and higher product quality.
- To speed up the recovery of the economy in order to restore the confidence of investors through prudent monetary and fiscal measures.
- To improve on soft issues such as improper practices (bribery and corruption), transparency and enforcement of intellectual property rights which are assuming increasing importance in today's business environment. For example, greater transparency on the part of the government in disseminating information will remove uncertainty and enhance the credibility of the government.
- To review the equity conditions imposed on foreign investments. Foreign investors need to have a fairly substantial stake before they decide to invest. Foreign presence in the country should not be viewed as a threat to the survival of domestic companies. Instead domestic companies should treat the foreign competition as a challenge to spur them in being more competitive.

- To review the interventionist approach of the government in economics, particularly in the allocation of resources to certain groups and sectors. Instead the role of the government should be a facilitative approach, that is to produce a conducive macro environment to attract FDI inflows.
- To look to the western model for their management and organisational skills, particularly lessons on how the United States and the United Kingdom survived their recession years. Malaysia has already looked east. The eastern countries of Japan and South Korea are now in economic distress. It is perhaps timely then to take the best from both the western and eastern approaches and apply them to the recovery of the economy.
- To be consistent in the implementation of its policies in order to send the right signals. The on-off policy regarding the use of foreign labour in the country is one glaring example of the government's inconsistency. At this rate, industries will not shift to capital intensive technology, as they know the government will usually accommodate their appeals for foreign labour.
- To increase the pool of skilled labour in the country. Technicians and skilled and knowledge workers are required in increasing numbers in the present digital economy. The training and retraining of workers should be a continuous effort to enable them to handle the fast-changing technology. There should be no let-up even in the current dampened economic situation. If we train now, we will have a pool of skilled workers when the economy recovers.
- To emphasise on productive activities to allocate resources. The over-investment in non-productive activities such as assets and the stock market is one of the reasons for the current economic crisis. The country needs to increase its exports by being cost-competitive and to produce quality and innovative products.
- To reduce reliance on FDI inflows as a long term strategy, and step up efforts to increase domestic investments.

5.4. Suggestions for Additional Research

This study used secondary data to analyse Malaysia's competitiveness vis-à-vis other developing economies in the context of attracting FDI inflows. It is felt that the value of this study can be enhanced if a perception study is carried out at the same time. It is thus suggested that a perception study be carried out on industries in an industrial area, for example the Shah Alam industrial area. Opinions could be solicited from the industries on their perception of the factors that contribute towards the international competitiveness of the Malaysian economy.

An analysis could then be done to see whether there are differences in the consideration of factors that constitutes a nation's competitiveness with the studies conducted by WEF and IMD. Alternatively, opinions could be sought on whether they agree to the ranking of Malaysia as determined by WEF or IMD, and how they would then rank the countries, particularly the Asean economies and China. This additional research could also analyse whether are differences in perception between local and foreign companies and between big and small companies in terms of either employment size or equity.

In view of the findings from the regression analysis indicating the significance of only two variables GDP and "control", it is suggested that further research be conducted to identify other relevant variables to improve the explanatory power of the regression model. It would be interesting to identify other relevant variables which influence FDI inflow.

5.5. Implications of the Study

This study will be useful to industries and government agencies which are concerned with the promotion of Malaysia's international competitiveness such as MITI, the Ministry of Finance and the Economic Planning Unit and to researchers who are interested in the field of FDI.