III. Case Studies

Malaysian development has seen three major types of rent-management, namely:

(1) Rent-management by the state; which can be desirable if state officials are value-maximizers who learn rapidly from their mistakes.

(2) Rent-management by state-initiated (public) enterprise, i.e. also led by the State, but the State's institutional structure allows costs and benefits to be internalized and losers do not have the power to politically resist the state.

(3) Rent-management by privately-controlled enterprise via politically influential business elites, i.e. rent-seeking by influencing the State, whereby political demands for transfers can be met with a stable set of redistributions.

This section discusses the above-mentioned rent-management via specific case studies focusing on the various types of rents and their implications.

Learning-Based Rent in Palm Oil Refining

The palm oil refining industry is probably the most successful story of Malaysian resource-based industrialization. With a current estimated annual refining capacity of about 8 to 9 million tones (of Crude Palm Oil (CPO) and crude palm kernel oil (CPKO)), exports of processed palm oil (PPO) grew at an annual compounded rate of about 25 percent over the past two decades, and accounts for 60 percent of the world's refined palm oil products and about 10 percent of the major refined oils and fats. As one of the most technologically advanced palm oil refining industries in the world, this industry has come long way from the 1974 production capacity of 90,000 tones of CPO, less than 10 percent of world CPO production.

Before1974, very few efforts were in place to encourage refining and fractionation activities for CPO and CPKO for export (Jaya Gopal 1999). In 1978, refining and fractionation of CPO for export was considered to have limited potential (Jaya Gopal 1999). However, in line with the state's adoption of export-oriented industrialization from the late 1960s, the government introduced various new policies and incentives to promote investment in such industries, mainly by encouraging resource-based industrialization, i.e. industrial processing of domestically produced raw materials (e.g. palm oil, rubber, timber, and petroleum).

Hence, the international competitiveness achieved by the industry can be mainly credited to the introduction of learning-based rents by the state in creating an environment where the (private) financial profitability of investments (to the industry) would be high. This was mainly done via export duty exemptions for higher value-added (processed) palm-oil products, other tax incentives to encourage resource-based activities to promote the industry's growth, legislation for the creation of institutions (to assist the industry in R&D, training, and marketing), and regulatory policies.

Duty Exemptions for Higher Value-added (Processed) Palm-Oil Products

The duty exemption structure was introduced to reduce the domestic prices (further from world prices) of crude and less-processed palm oil, while maintaining prices nearer to world prices of more processed palm oil products, hence encouraging greater investments in palm oil processing by increasing domestic margins down the processing chain, with net transfers of oil of processing subsidies from CPO producers to domestic refiners (Jaya Gopal 1999). **Table 7** details the development of the duty exemptions scale for the refined palm oil exports.

Table 7: Development of Duty Exemptions for Higher Value-added Processed Palm-Oil Products

Year	Duty Exemptions Scale
1968	All PPO product exports free of duty (PPO products were thus exported at or near world prices), while a heavy duty was imposed on CPO exports (ensuring CPO prices were well below world prices)
1976	Formulation of a graduated export duty scale to encourage more than the first stage of CPO processing (with refiners guaranteed bigger profits(more rents) for processing CPO and exporting PPO products)
1978	Introduction of a more complex export duty formula (to better encourage more processing): - High export duties were imposed on CPO and a little less on PPO based on their respective average export prices - Varying levels of export duty exemption for five categories of processed palm oil products, decreasing to nil for the fully refined and fractionated products category

Source: Jaya Gopal 1999

Other Tax Incentives

Table 8 details the development of various tax incentives, mainly in the form of tax relieves and allowances for investments and exports to promote palm oil refining industry.

Table 8: Development of Various Tax Incentives

Period	Tax Incentives
1970s	Introduction of pioneer status, investment tax credits, export allowances, overseas promotion, training, R&D incentives, and pre- and post-shipment export credit refinancing assistance programs.
1980s	Streaming of various tax incentives: - Only the export duty exemptions on refined and fractionated palm oil and palm kernel oil products and tax deductions for overseas promotion, training, and R&D remained, - Investment tax incentives were only applied for activities further downstream, such as manufacturing specialty fat products and oleo-chemicals.
1990s	Continuation of the 1980s' structure - Export credit refinancing for assistance programs were expanded - Other remaining ones were continued.

Source: Jaya Gopal 1999

Legislation for Creation of Institutions

Table 9 shows the various laws for the creation of institutions (to assist the industry in R&D, training, and market promotion) were already initiated from the late 1970s.

Table 9: Development of Legislation for the Creation of Institutions

Period	Institutions
Late-1970s	Establishment of the Palm Oil Research Institute (PORIM) to conduct research on all palm-oil related activities (including processing) Establishment of the technical and Palm Oil Registration and Licensing Authority (PORLA) to conduct market promotion of processed palm oil products, with the collaboration of PORIM and the Ministry of Primary Industries
Mid-1980s	Establishment of the Malaysian Palm Oil Promotion Council (MPOPC) to conduct worldwide consumer-oriented promotion campaigns to assist the industry counter the US soybean lobby campaign against palm oil

Source: Jaya Gopal 1999

Regulatory Elements in the Policy Environment

Table 10 summarizes regulatory elements in the policy environment developed since the mid-1970s, to control and monitor investments and capacities within the industry (to ensure an adequate supply of crude palm oil for refiners).

Table 10: Development of Regulatory Elements

Period	Regulatory Elements
1975	Issue of Manufacturing Licenses under the Industrial Coordination Act - Conditions for (approved) maximum capacity and export limits - Quota for local content/material utilization, employment, location, and equity structure
1986	More relaxed conditions for: - (approved) maximum capacity and export limits - Issue of new licenses for refining and fractionation plants
Late-1980s	Strengthening and coordination of above policies due to: - Excess capacity to supply CPO - Decline in capacity utilization rates

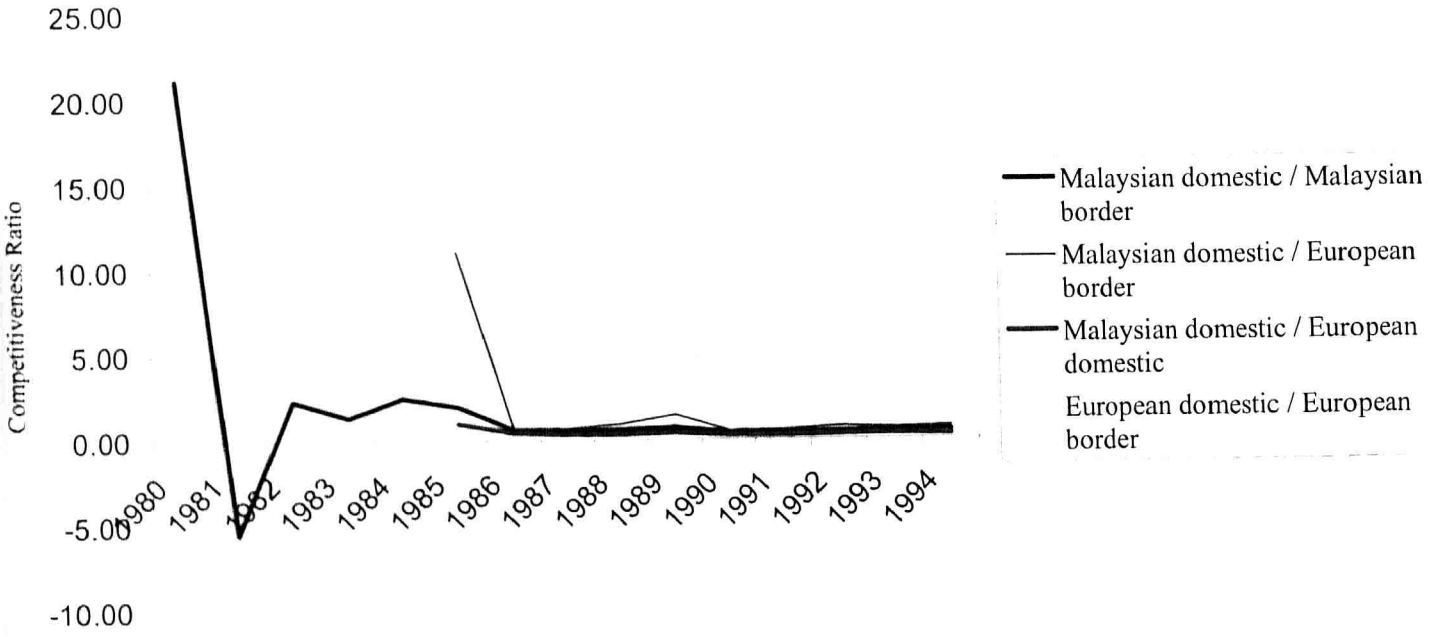
Source: Jaya Gopal 1999

With the introduction of these learning-based rents, the competitiveness of the industry has improved dramatically, based on measurement of competitiveness ratios (for refining and fractionation of palm oil). **Appendix 1** details the methods used for calculating the competitiveness ratio formula.

While the industry was unprofitable and uncompetitive, with a competitiveness ratio of more than 200 percent (of 'world' gross margins) during its early years, Malaysia border prices managed to achieve the highest level of international competitiveness, with a competitiveness ratio of less than 60 percent in the 1990s. **Figure 1** depicts the competitiveness of Malaysian palm oil refiners from

1980 to 1994, while **Table 11** and **Appendix 2** detail the historical and structural transformation of the industry respectively.

Figure 1: Malaysian Palm Oil Refiners' Competitiveness, 1980-1994
*(Data in **Attachment 1**)*



Source: Jaya Gopal 1995

Table 11: Historical Development of The Palm Oil Refining Industry

Period	Development
1977-1983	First Phase - Reduction in gross domestic margins achieved when increase in refining capacity greatly exceeded increase in CPO supply - Excess profits in refining and fractionation activities were eliminated, while export duty's impact in reducing gross domestic margins slowly declined during the early 1980s
1980-1988	Second Phase - Reduction in gross domestic margins was largely achieved via technical, organizational, and structural changes within the industry - Export duty had no impact at all on gross domestic margins

Source: Jaya Gopal 1999

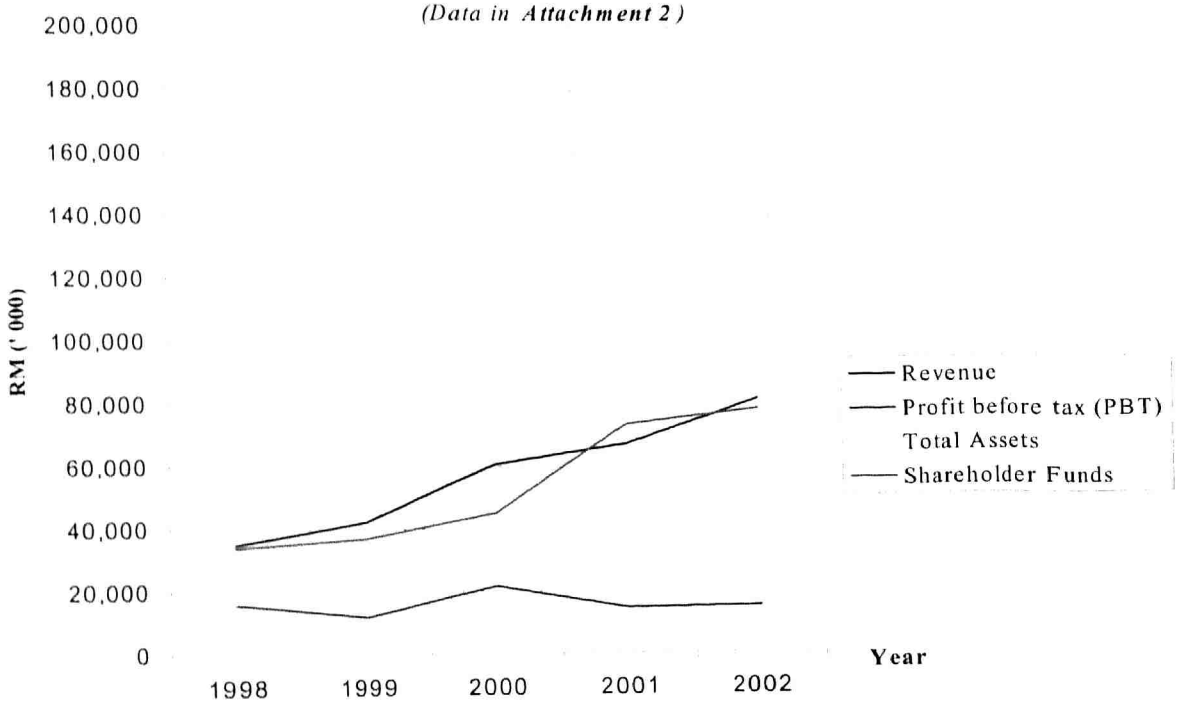
Through a market intervention introducing various learning-based rents, the Malaysian government developed the industry to become internationally competitive (Jaya Gopal 1999). Without such interventions, the refining industry would never have developed to be able to compete internationally.

Natural Resource Rent in Petronas

The Petroleum Development Act of 1974, which ensured that the central government captured most oil rents, was executed via the National Petroleum Corporation, also known as Petroliam Nasional Bhd (Petronas). As the only Malaysian corporation that is listed under the Fortune Global 500 list (ranked at number 204 in Year 2003), Petronas is by far the most profitable corporation in Malaysia. In lieu of this, the utilization of Petronas funds is always under scrutiny, especially when the funds are granted for salvaging 'sticky' situations.

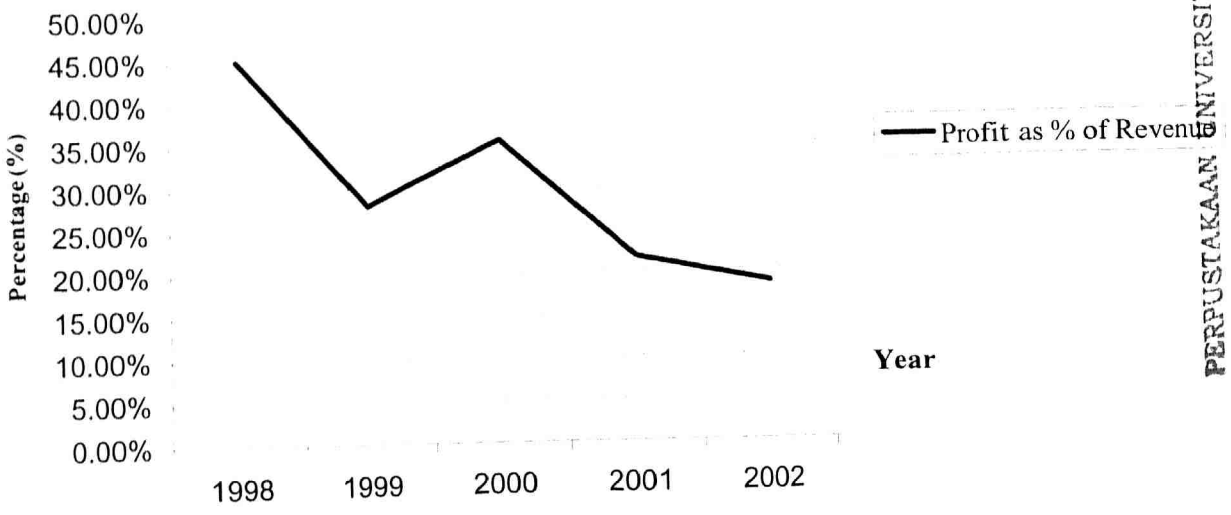
Going by Petronas summary balance sheet, it could be seen that if the 1998 figure is taken as the mean revenue for the whole 22-year period (of Petronas tenure), the total revenue collected by Petronas should be in excess of RM700 billion. **Figure 2** shows the Petronas financial performance in terms of revenue, profit before tax, total assets, and shareholder funds for the period from 1998 to 2002, while **Figure 3** shows the overall trend in profit before tax as a percentage of revenue of the above.

Figure 2: Petronas Financial Performance, 1998-2002
*(Data in **Attachment 2**)*



Source: Petronas Annual Financial Reports

Figure 3: Petronas Profit Before Tax (PBT) as % of Revenue, 1998-2002
*(Data in **Attachment 2**)*



Source: Petronas Annual Financial Reports

Since the profit-before tax as a percentage of revenue has overall declined throughout this period, it appears that costs have been on the rise, which raises the question on whether this is due to the increase in costs of production, or expenses incurred for mega-projects, purchases/bailout of loss-making companies, or other unspecified reasons.

Unexplained terminologies also suggest the validity of these claims, for example the use of the term 'minority interests'. Since the tax rate for petroleum-related revenues is already known, evidently 'minority interests' have been swallowing an increasing proportion of the pre-tax profits. In addition, further explanations are also in due for the terms 'reserves', 'cash in hand', and nevertheless, 'cash in hand plus assets'.

It is not an easy route to show, let alone to prove how Petronas funds have been utilized in 'sticky' situations. Among factors to be considered include the cost structure and revenue proportion of the domestic and international oil and gas production, and other oil and gas activities. While the grand total of these domestic and international activities will reflect the total income of Petronas core activities, the difference between the total income and the consolidated pre-tax profits should reflect the 'first cut' of the funds utilized for other purposes.

While a proportion of the 'first cut' is utilized for socially and economically beneficial purposes, such as the investment for Engen Petroleum Limited, the incorporation of the Universiti Teknologi Petronas, and the injection of funds for Perusahaan Otomobil Nasional (Proton), the rest of the first cut can be implied to be utilized for salvaging numerous 'sticky' situations (as shown in **Table 12**), as what the population in general might agree to be waste.

Table 12: 'Sticky' Situations Salvaged by Petronas

Period	Utilization
Mid-1980s	- Construction of Menara Dayabumi - 1st bail-out of Bank Bumiputera Malaysia Bhd (BBMB/BMF)
Mid-end-1990s	- Construction of the Petronas Twin Towers and Putrajaya township
2001	- Purchase of Malaysian International Shipping Corporation (MISC) - 2nd bail-out of Bank Bumiputera Malaysia Bhd (BBMB/BMF)

Source: Khan & Jomo 2000

Putting the mid-1980s occurrences aside, these major bailouts and mega-projects coincides with the overall trend of Petronas financial performance throughout the 1998-2002 period as shown earlier in **Figure 2** and **Figure 3**, where an increase in total revenue, total assets, and shareholder funds is met with a downward trend in profit before tax as a percentage of revenue. This raises the question on the effectiveness and efficiency of the oil and gas resources rent-management in benefiting the country's overall social and economic interest.

The Malaysian Automobile Industry

For over 40 years, the government has protected the local industry and imposed local content requirements to promote the Malaysia automotive industry. There have been two phases in the development of government policy towards the automobile industry. The first phase (1967 – 1982) encouraged local assembly and content, while the second phase (since 1983) has seen the establishment of a national car project.

First Phase (1963 – 1982): Encouraging Local Assembly and Content

Before the 1960s, automobiles were mainly imported from Europe as completely built-up units (CBU). From the late 1960s, government policy moved towards protective promotion of local automobile assembly, with local vehicle assembly using completely-knocked-down (CKD) kits. In 1963, the government developed a policy to promote an integrated automobile industry to strengthen Malaysia's industrial base, to reduce imports, save foreign exchange, create employment, develop strong forward and backward linkages with the rest of the economy, and transfer industrial technology (Jayasankaran 1993, Jomo 1994; Jomo, Felker, & Rasiah 1999).

Under the Motor Vehicle Assemblers Committee (MVAC), an inter-departmental agency set up under the Ministry of Trade and Industry, during the late 1960s, the government granted approval to six assembly plants to start operations in Malaysia, i.e. Kelang Pembena Kereta-Kereta Sdn Bhd (Fiat and Mitsubishi), Swedish Motor Assemblies Sdn Bhd (Volvo), Oriental Assemblers Sdn Bhd (Honda and Peugeot), Cycle & Carriage Bintang Bhd (Mercedes Benz), Assembly Services Sdn Bhd (Toyota and Daihatsu), and Associated Motor Industries (M) Sdn Bhd (Ford, Chrysler, and Land Rover).

In line with the Walker Report of 1970, the government targeted expansion of local content to 40 percent by weight over a ten-year period beginning in 1971. Local content rose from 10 percent in 1972 to 35 percent in 1982. By 1980, the industry had eleven assemblers, with an additional mainly five Bumiputera assemblers in 1977.

Soon after the commencement of complete automobile assembly in 1967, the volume of CBU units decreased significantly due to government protection (of automobile assembly) through high tariffs, stringent import licensing, and quantitative

restrictions. While the volume of CKD units increased rapidly due to the government protection, the excessive number of makes and models produced by the eleven assemblers for the small local market made it difficult for the local part makers to achieve economies of scale, reflected in the expensive prices and low local content (averaging only 8 per cent in 1979), with local content largely limited to tyres, batteries, paints, filters, seat-belts, and glass items. There was official dissatisfaction with the slow growth and limited Bumiputera participation in the industry, encouraging the government to consider state-led development of a 'national car'.

Second Phase (1983 – Present): Establishing the National Car Project

In October 1982, the government announced a state-initiated 'national-car' project, to become a full-fledged car manufacturer. The first national car company, Perusahaan Otomobil Nasional (Proton), was then launched in 1985 as joint-venture set up by the Heavy Industries Corporation of Malaysia (HICOM) with the Mitsubishi Motor Corporation (MMC) and Mitsubishi Corporation, with a share-holder structure of 70 per cent, 15 per cent and 15 per cent respectively.

With the objective of producing 'national cars' for the domestic market and for export, rationalizing the automobile industry, promoting related industries, enhancing utilization of locally-made components, encouraging the upgrading of technology, engineering and technical skills, and increasing Bumiputera involvement, Proton began production in 1985 of the inaugural model, the Saga, and later expanded to Iswara, Wira, and Perdana models.

With strong support and protection from the state, Proton has managed to dominate the passenger car market by offering the most economical price, hence capturing monopoly rents from the local automobile market. Although recording

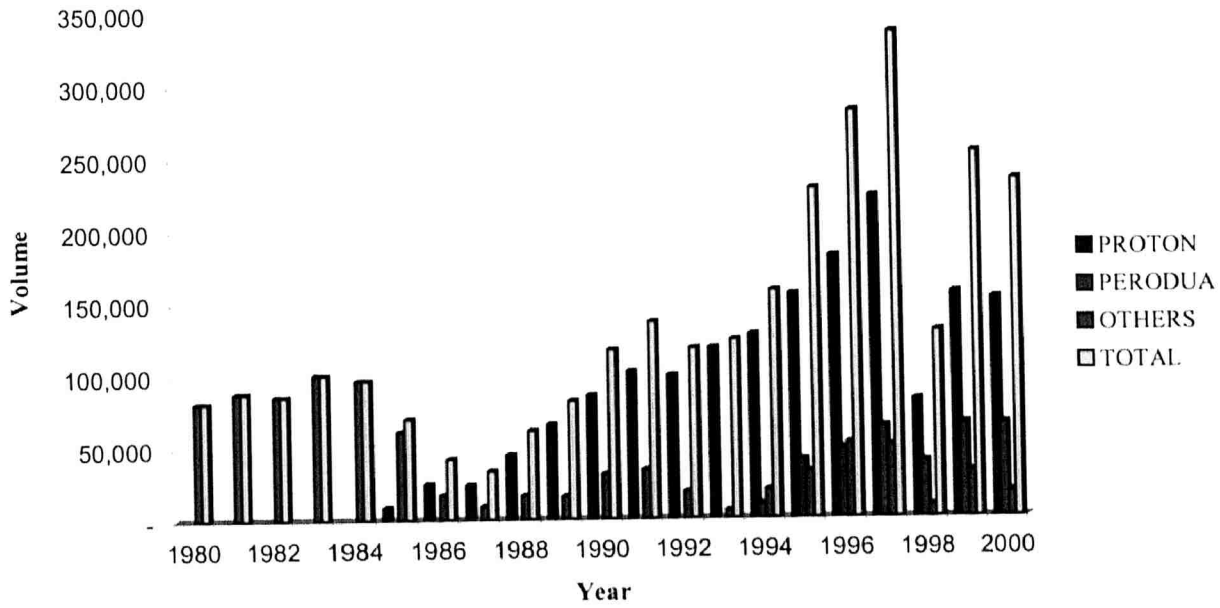
losses from 1985 to 1988 (due to the collapse in local demand due to global recession), Proton has recorded profits since 1989. By 1995, Proton had managed to capture 77 percent of the domestic passenger car market (selling 160,000 units out of the total 207,411 vehicles sold in Malaysia), and exported cars to 28 countries, accounting for 23 percent of total sales.

The state has also initiated a second Malaysian national car project named Perusahaan Otomobil Kedua (Perodua), a joint-venture agreement between Permodalan Nasional Bhd (PNB), Daihatsu Malaysia Bhd, Mitsui Company, UMW Holdings Bhd, Med-Bumikar MARA Bhd, and Daihatsu Motor Company of Japan, to produce smaller passenger cars for the local market.

Perodua also enjoys the preferential treatment by the state. Production started in 1995, with the inaugural Kancil model, and later expanded to Rusa, Kembara, Kenari, and Kelisa models. Subsequently, the establishment of Perodua transformed the structure of the local automobile market, previously monopolized by Proton, into a duopoly, when the Kancil model became the second best-selling passenger car in Malaysia, with a sales volume of 39,006 units in 1995 and 46,971 units in 1996. Meanwhile, the Rusa model, the first national multi-utility vehicle (MUV), managed to capture 10 percent of the commercial vehicle market when production began in 1996, with a sales volume of 7,400 units. The transformation of Malaysian local automobile market shares from 1980 to 2000 is depicted in **Figure 4**.

Figure 4: Production of Passenger Cars in Malaysia,1980 - 2000

*(Data in **Attachment 3**)*



Source: MIDA and PROTON Corporate Profile 2001 (Abdulsomad 2003)

The government has also initiated further projects with Diversified Resources Bhd (DRB), via the PROTON-DRB Car project (producing the Tiara and Satria models), the PROTON-CITROEN car project (producing Tiara models), and the National Truck project involving HICOM, DRB, and Isuzu (producing 2-3 ton small trucks). By then, the local automobile industry consisted of final assembly, parts and components producers (manufacturers of original equipment manufacturing (OEM) and replacement equipment manufacturing (REM)), supporting industries (input providers for parts and components producers), repair services, franchised distributors, and financial agencies (UNIDO 1983, in Abdulsomad 1999).

The automobile industry has enjoyed various kinds of preferential treatment from the state, including reductions and exemptions from import duties and sales taxes, low interest rate loans (given civil servants purchasing the Saga), and technical,

financial and other assistance via a special vendor development program (for developing Bumiputera parts and components manufacturers). **Tables 13** and **14** shows the import duties and sales taxes imposed for CBU and CKD vehicles respectively:

Table 13: Import Duties and Sales Taxes on CBU Vehicles

Vehicle Type	Tariff Rate	Surtax	Sales Tax
Passenger Cars			
1,799 cc and below	140%	Nil	10%
1,800 cc and above	170%	Nil	10%
2,500 cc and above	200%	Nil	10%
Trucks and Vans	30%	Nil	10%
4 x 4 Vehicles	50%	Nil	10%

Source: MIDA (Abdulsomad 2003)

Table 14: Import Duties and Sales Taxes on CKD Vehicles

Vehicle Type	Import Duty	Excise Duty	Sales Tax
Passenger Cars			
Proton / Perodua	13%	50% of Import Duty	10%
CKD	42%	Based on Value	10%
Commercial Panel Van	-	-	10%
Dual-purpose Window Van	5%	30%	10%
4 x 4 Vehicles	-	45%	10%
Bus	-	-	10%

Source: MIDA (in Abdulsomad 2003)

Although the introduction of the national car projects had various effects on the development of the automobile industry in Malaysia including rationalization through increasing economies of scale, promotion of local content, development of

more local component firms, increased research and development (R&D) and human resource development, the industry is still not considered internationally competitive. Since its establishment, the industry has been protected by the state (via the creation of rents to protect and encourage risky and lumpy investments, especially by inexperienced local parts firms (Abdulsomad 1999).

Schumpeterian Rent in the Sapura Group of Companies

Sapura is one of the more successful stories of technological development among private Malaysian manufacturing firms. Founded in 1975 by Shamsuddin Abdul Kadir, the company managed to capitalize on the government's New Economic Policy (NEP)'s goal of promoting Bumiputera involvement in business, developing from its main core business in telecommunications, to information technology, metal-based industries, and automobile parts. In 1997, Sapura was (by chance) saved from incurring financial loss, when its initiative to takeover UMW Holdings Bhd did not materialized. Most recently, Sapura has again expanded its business portfolio to the oil and gas industry, acquiring 38.56% of the shares in Crest Petroleum Bhd on 21 April 2003 (KLSE Announcement 2003).

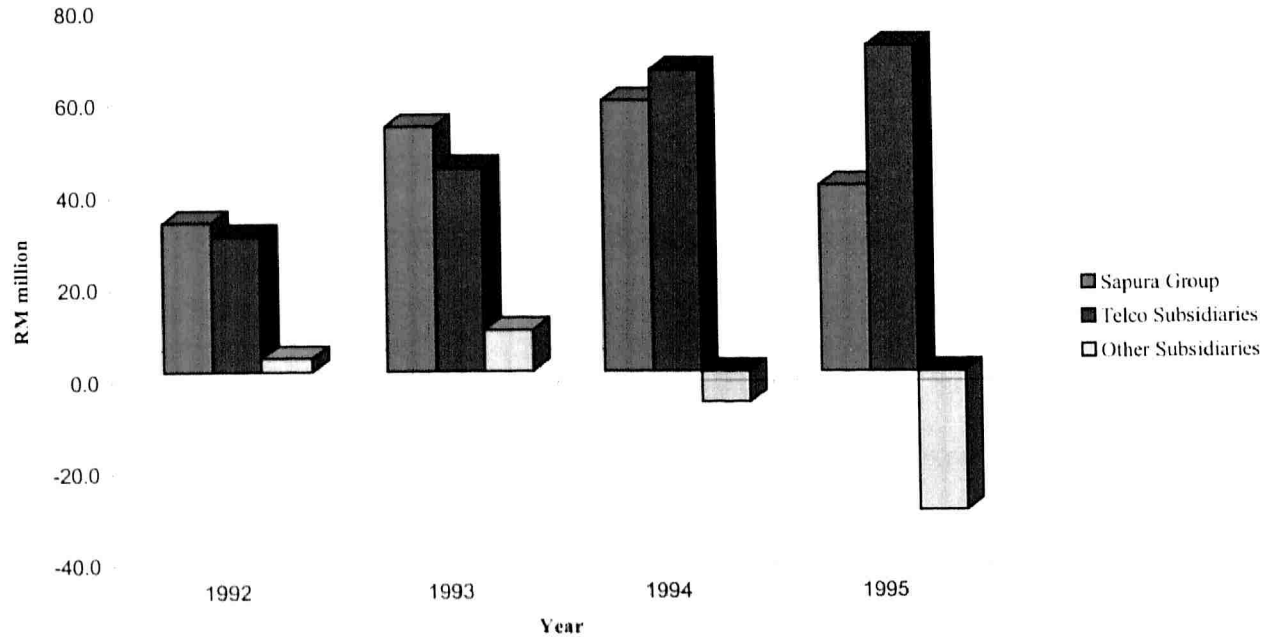
Until 1987, when Jabatan Telekom Malaysia (JTM) was corporatized as Syarikat Telekom Malaysia Bhd (STMB) and the local telecommunications market was further liberalized, Sapura was the only private company with a long-term contract with JTM for providing telephone sets and payphones in urban areas, which indirectly gave Sapura a virtual monopoly in both markets. In addition, Sapura teamed up with STMB (or Telekom Malaysia) to penetrate other developing countries' markets with strong government support, thus, gaining a competitive edge in offering a comprehensive package of services and expertise.

From a turnover of RM9.7 million (with a pre-tax profit of RM0.2 million) in 1978, Sapura Group has grown into a large conglomerate, with a turnover of RM768.7 million (and a pre-tax profit of RM40.6 million) in 1995, mainly attributable to the manufacture, installation and maintenance of payphones and telephone sets. With government intervention in limiting and eliminating competition in the payphone and telephone set markets, and a special connection to the government, Sapura has benefited significantly by securing various government tenders and contracts, and associated rents, mainly in the payphone and telephone set markets (Alavi 1999), as shown in **Figure 5** which shows Sapura's growth from its early establishment until 1995, and **Figure 6** which compares Sapura's pre-tax profits with its subsidiaries.

Figure 5: Sapura Group's Growth, 1975 - 1995
*(Data in **Attachment 4**)*

Source: Alavi 1999

Figure 6: Sapura Group's Pre-Tax Profits Breakdown, 1992 - 1995
*(Detailed data in **Attachment 5**)*



Source: Alavi 1999

Hence, the growth of Sapura has been primarily credited to its ability to secure and utilize rents created by government intervention in promoting investment for R&D activities to bring about technological change in the Schumpeterian sense, i.e. in developing technical capabilities and improving product quality and design (Alavi 1999).

The history of Sapura's R&D started in 1984, when Sapura set up its own R&D department to manufacture its own telephone, and introduced Malaysia's first home-grown phone, the S2000 series a year later in 1985. By following the apprenticeship mode of technological acquisition, Sapura's R&D efforts have mainly been concentrated on product technology, instead of process technology.

Although at about 10 percent, Sapura's R&D expenditure as a proportion of telephone sales is comparable with established multinational companies (MNCs) such

as Phillips, Matsushita, and Ericsson, its small size puts it at a disadvantage. The lack of sufficient human resource development within the company has meant that, its employment structure and employee education levels are far behind the level of its competitors in East Asia, which has adversely affected Sapura's efforts in achieving international competitiveness for its telecommunications products (Alavi 1999).

The sale of 75 percent of the shares in two of Sapura's most profitable telecommunication subsidiaries, Uniphone Sdn Bhd and Sapura Digital Sdn Bhd to Time Engineering for RM1.2 billion in 1996 raised the question on Sapura's actual objective in investing in the telecommunication industry, either to expand its R&D activities to achieve international competitiveness through technological advancement, or to shift focus from capturing the thinning Schumpeterian rents within the increasingly competitive telecommunication market to a more lucrative industry.