

CHAPTER IV

PROMOTIONAL FACTORS

Industrial development in the Federation of Malaya does not come about by itself. The very process of industrialisation is a major project that entails a lot of money. It cannot be carried out solely on the initiative of the private enterprises. Merely setting up industries, not to mention expansion in the industrial sector, cannot be easily achieved. To ensure that industrialisation can proceed, the base must be established; resources and facilities such as social overhead capital (roads, communication system and power) upon which industrial development is dependent upon must also be set up and private enterprises must be fetted, at least in the early stages. These are the work of those concerned with encouraging industrial development, because social overhead capital and regards shown to the private enterprises can only be done by them. The building of social overhead capital and the things done to attract investors to participate in industries, are promotional factors. In other words, promotional factors or incentives must be given to promote industrial development.

Giving incentives^{also} will not automatically ensure that industrial expansion can take place. It cannot be carried out in a vacuum, even with incentives given. There must be an environment - a medium - through which expansion can take place. And the environment must be maintained in a form conducive to industrial development.

This chapter will discuss the various promotional factors that have played (and can play) in promoting industrial expansion in the Federation. In the next chapter, we shall discuss the factors found in the environment that are responsible for the industrial development that the Federation has experienced.

That incentives, whether in the form of protection or assistance, are important in stimulating growth in the rate of industrialisation, are recognised by the government of this country. To start on anything is a very difficult task due mainly to the tendency of stickiness of social valuation and acceptance. If private enterprises, whether they are foreign or local, are expected to participate in setting up industries, they must have confidence that they can succeed in their ventures. It is the task of the government to see that everything is done to ensure that these ventures can be successful (either the giving of protection or assistance, or some other things). Early success can, to a very large extent, determine the success of industrialisation in the future.

While the government is taking special interest and positive steps to influence the rate and pattern of industrial development in Malaya, it is the stated policy that business enterprises shall be carried out by private enterprises, without any undue interference by the government. Direct investment only comes about in projects which do not offer sufficient attraction to private enterprises but nevertheless vital to the industrial progress of the country. Whatever measures taken by the government are indirect, in the form of incentives (financial and non - financial) given to local industries which may either use local or foreign capital. The industrial development that Malaya has experienced is due mainly to the giving of such promotional inducements to local industries, and to potential investors.

A. Financial Inducements:

Pioneer Status:

A principal financial inducement for businessmen to invest in industries in this country was the setting up of the Pioneer Industry (Relief from Income Tax) Ordinance in 1958. Under this, the government grants " tax free

holidays" to pioneer companies¹ for a period of 2 - 5 years depending on the capital invested.² Besides this, losses may be taken into consideration after 'holidays' cease, and firms can also treat all their existing assets as new for depreciation. This is to help industries establish themselves until they are able, without jeopardising their financial positions, to make tax payments (in the Federation, the companys' tax is 40% of profits obtained). Many investors, to take advantage of this inducement, have set up firms in the hope of getting pioneer status. Up to June 1963, 99 companies have been granted pioneer status.

The granting of pioneer status to firms that are qualified to get it (only those firms that are producing new products are considered), so as to allow them relief from tax, have no doubt contribute greatly to the industrial development. Without this incentive, many firms might not be able to establish themselves, because the initial running costs are exceptionally high.

This financial inducement can continue to play a part in promoting industrial expansion, but modifications must be made and the inducement made more flexible. At present consideration of granting pioneer status to companies is not made in clear precision. Some firms granted pioneer status are subsidiaries to other companies. that are not given pioneer status. By making a subsidiary company a pioneer company, the parent company is running away with taxes. Moreover, granting of this inducement is too easy with little consideration given to minium standards and also to small capital basis - only 100,000 dollars and above. Heavy and more capital intensive industries should be encouraged more than the smaller ones, to act as a base for industrial dev -

¹ preference is given to industries using local capital, but industries using foreign capital are entitled to this privilege too.

² \$250,000 and above - 5 years; \$100,000 to \$250,000 - 3 years and less \$ 100,000 - 2 years.

elopment. This may also cut down the difficulties of considering small units which have no potential contribution to national income and employment. Bigger and more capital base industries have greater chance to succeed and they can help create confidence in the business world and thus help change social attitudes towards the functions of business.

But as it stands now, a question may be asked. Is it adviseable to attract new firms only producing products never produced before in Malaya, while there are no such inducements for the expansion of existing industries? Industrial development is not only the setting up of new firms. Horizontal and vertical expansion or integration should accompany the establishments of new firms. Of course, in the early stages of industrial development, new firms must be given every encouragement to be set up, but existing firms must not be neglected!

Industrial Finance:

Capital is essential for the setting up and expansion of industries. Local capital is limited in its flow, yet local investment is encouraged. To facilitate the acquisition of local capital so that industries may be set up and later to acquire capital for further expansion, a Malayan Industrial Development Finance Ltd. (M.I.D.F.L.), sponsored by the government and comprising the principal Exchange

Branches, the Colonial Development Corporation and Commonwealth Development Finance Company, was set up in March 1960¹. This is the only organisation with the sole purpose of providing long term capital for Malayan industrialists. It also offers equity, preference and debenture participation and act as underwriting and issuing house.

This move has been in the right direction and it has encouraged the setting up of many industries. Interested

¹ For a detailed account of how the Company works and grants loans, refer to "Capital for Industry".
Published by the M.I.D.F.L.

investors are always hindered because of the lack of capital. With the setting up of this institution, many firms which formerly could not be set up due to insufficient capital and many firms which are prevented from expansion due also to the same cause, can obtain capital for their ventures. But it cannot be professed that in this direction the company is very effective. Being a public company with a capital of \$50 million, it is not surprising that the main thought of the company is only to invest in very successful and large ventures or in business that have a very good chance of success. What is left over is for the smaller and newer establishments. As such there is discrimination against those which may in most cases ^{be} more in need of financial assistance from this source (because of the difficulties of obtaining funds from some other sources). Thus, in 1962, out of 77 applications, only 17 loans were granted.

Besides giving financial aid, the M.I.D.F.L. also helps the industrialists in another way. It is prepared to discuss with potential clients on capital requirements, capital structure and suitable means of obtaining new capital.

As a financial institution to help industrialists and therefore to promote industrial development, it is going to be of more importance in the future. As such the institution itself needs to expand. At present, the Company is negotiating with the World Bank for a loan which can increase its present capital to \$ 250 million. Maybe then, it can provide capital assistance to more industries.

B Inducements to Foreign Capital.

The financing of industrial development in a country should come as far as possible from local sources, but if local sources are not forthcoming, then foreign capital is welcomed. In the Federation, local capital is limited and slow moving (there is only one financial institution where loans can be obtained and although there are many commercial banks, these

are conservative in their lending habits). Therefore Malaya has depended on a great deal of foreign capital for her industrial development. If Malaya wants her industrial development to go on, then more need may have to be made of foreign capital unless local capital is made available.

Foreign capital just does not come into Malaya, unless there are securities for foreign investors. In other words, it must be induced to come in. The reason why Malaya has been able to make use of foreign capital for her industrial development is because the government has granted many other inducements in the form mainly of protection to foreign investors, besides the incentives given to local industries either using foreign or domestic capital. The other inducements can be briefly stated.

(a) private foreign capital is given securities and fair treatment. The government is always willing to negotiate assurances on foreign investment with other governments to prevent against expropriations. Malaya has already signed an agreement to that effect with America.

(b) the Federation government is willing to pay compensation to investors in the event of nationalisation of their companies. Agreements with U.S. and West Germany have been made to prove the sincerity of the government.

(c) foreign investment and remittances of dividends and repatriation of capital are subject only to normal exchange control within the sterling area. To ensure that this privilege is not abused, the Federation government has made agreements with Commonwealth countries for relief of double taxation, so that income will not be subject to tax both where it arises and where the recipients reside. If there is double taxation, investors from overseas may be more reluctant to participate in the industrial sector in the Federation

These inducements given by the Federation government explain the attractiveness for the foreign investors to come and invest here. There is very little reason to doubt the

important role that foreign capital has contributed to the industrial development of the Federation. This is borne out by the fact that out of the nominal capital of \$634,970,000 of the 99 pioneer companies (at end of June 1963), 73% represents foreign capital. Besides being used as the base for industrialisation, capital from overseas contribute to industrial expansion by serving two other purposes. It (a) provides technological skill and managerial experience, because come together with foreign capital and (b) acts as pioneering and stimulating process by mobilising local capital.

Though foreign capital has played a great part in affecting industrial development in this country, its future role must not be taken for granted. From the viewpoint of development, there is no doubt that foreign capital will be welcomed and for that matter capital from whatever sources. A question stands out clear. Do we have to depend on as large an extent on foreign capital in the future as we are at present ? Depending too much on capital may prove a costly affair due to the increasing outflow of capital from within. Even at present 6 - 7% of the Federation net national income is flowing out to overseas investors. Only a small % at the same time comes back in the form of net capital inflow. In other words, there is a net capital outflow.¹ If the net outflow can be retained in the country, many development projects, whether industrial projects or otherwise, can be undertaken. The answer to the above question will depend greatly on the speed at which mobilisation of domestic capital can be undertaken and made available.

In the meantime, however, foreign capital must not be neglected. It has played a great part in helping the

¹ For this reason, Puthuchery in his book, "Ownership and Control in Malayan Economy " (printed by the Singapore Eastern University Press) has likened the inducements to foreign investors as " holding the door of a bird cage open in the expectations that more birds will fly in than out" pg.169.

industrial development in this country and it will continue to play an important role. What inducements which have been given to the foreign investors must in most respects be retained, but the government must try to counteract the problems of outflow of capital. And this is important. Otherwise the statement made by Puthuchery is very pertinent. The government can do this to a great extent, by devising measures to reduce the outflow and channel them into internal investments, some to the industrial sector. It can be done through measures like widening opportunities for investment and strengthening the government investment opportunity. The M.I.D.F.L. is such a measure. Furthermore, foreign capital must be at all costs be prevented from flooding the industrial base which may lead to foreign domination in industries. While measures are taken to induce foreign capital to come in, all out efforts must be taken to acquire more domestic capital.

C Non-Financial Inducements:

Protection from Imports :

Before the advent of any great extend of manufacturing industries being set up in the Federation, there had already been an influx of imported goods. Thus when industrialisation started in Malaya, there was already stiff competition to be faced. Newly established manufacturing enterprises could not hope to overcome the competition. With such keep competition prevalent, and also because of the small internal market, overseas investors would have been very reluctant to build factories in the Federation; they could supply the Federation from outside bases. These had been recognised and when the industrial development programme was set up, protection from imports was given to ensure that the industries established here could be successful. (With keep competition, many newly set up industries in most cases, can have little chance of success). The protection given were in the forms of tariff protection, remission of duties on raw

materials and capital goods when necessary, and anti-dumping ordinances. The success of industrialisation and its early development are due, to not an unimportant part, on these preventive measures. These measures are still being used at present and they are likely to be used in the future, until industrialisation has reached the self-sustaining stage and the industries can face external competition much better.

The imposition of tariffs is undertaken by the Tariff Advisory Committee¹, which also deals with the remission of duties of raw materials and machinery for manufacturing purposes, imported by local manufacturers. The purpose of this remission is to cut down production costs and to compensate for the relative paucity of raw materials and capital goods in the Federation. Tariff protection is very essential for successful industrialisation for the home market. Many formerly agricultural countries became industrialised behind a tariff barrier. Malaya in her search for industrialisation should be of no exception.

In the Federation tariffs have been imposed and they have led to industrial development. In fact, the Reuff Mission² in its report has stated that one of the most important reasons responsible for the " recent spurt in manufacturing industry which has occurred mainly in the Federation of Malaya " (pg.30) is the imposition of tariffs. It, therefore, is surprising that although the government recognises the need for tariff protection as a selective instrument of progress that is imperative to industrial development (there is no doubt that government has made use of this tariff imposition), the present tariff structure is still weak and inadequate.

¹ (henceforth to be known as the Tariff Advisory Board). The duty is to advise the Ministry on the amount of tariff protection to be given to local industries (either using local or foreign capital), each industry being decided on its own merit.

² or the International Bank for Reconstruction and Development. The report is on " the Economic Aspects of Malaysia". 1963.

The existing tariffs are not high enough, only between 15-25% (seldom exceeding 25%). Many manufacturers, furthermore, have no tariff protection. A quarter of the pioneer companies, for example, have no tariff protection. These inadequacies arise because of the fear that tariff imposition can have economic and political implications. It raises the standard of living through the increase in prices, but the people concerned with the manufacturing sector will not be so greatly affected by the rising prices. However, rising prices is detrimental to the people outside the industrial sector and therefore usually outside urban areas. This can give rise to communal conflicts and political upheaval. These fears need not necessarily arise, since the tariffs are levied gradually and not at once. This will not bring a sudden jump in the standard of living of the people. Slow rising standard of living due to the gradual imposition of tariffs may be what is need for industrial development in particular (it depends on a great extent on the internal purchasing power, especially so when the market for the products produced is internal such as is the case of Malaya), and economic growth of the country in general. Besides these fears there is ground of conflict between the Treasury (which get about 30% of the total federal and state reven in 1957 from import duties) and the Industrial Development Board.

If such fears have no substantial ground and cooperation and co-ordination between the Treasury and the Industrial Development Board can be achieved (the former may loose some revenue due to the imposition of tariffs, but once industrial ~~expa~~ expansion takes place on a large scale, revenue may again increase; revenue from company tax, income tax etc.), there is every reason for increasing the existing tariffs that have already been levied and to extend the imposition of tariffs ^{protection} to more industries. Given such considerations, many more investors may be more willing to set up industries in the Federation, since they can hope to have ^{adequate} tariff protection against competition from imported goods. Of course, this will lead to further industrial development.

Fair competition can be overcome to a large extent by tariff protection, but unfair competition caused by dumped goods cannot be overcome by tariffs. Hence to protect local industries from such unfair competition by overseas manufacturers, anti-dumping legislation has been introduced in the country by the Customs (Dumping and Subsidies) Ordinance in 1959. By this legislation, it provides for the imposition of additional duties, besides normal import duties on dumped imported goods, if the imports are likely to endanger or retard the establishment of industries in the country. This like tariff protection, is a very important measure for the protection of local industries against competition.

Provision of Industrial Sites:

Tariff protection and anti-dumping acts are not the only non-financial incentives that are given to promote industrial development in the Federation. The provision of industrial sites at low cost, with access to roads, water and electric power, for potential investors is yet another effective inducement. If potential investors, either local or foreign investors, can be certain of a site where their industries can be built up, they are much more tempted to invest in industries. Such provision means the sparing of costs otherwise incurred in preliminary survey, red tape, fuss and delay and the delay of getting immediate land title (this facility is not always available in Asia land tenure systems).

Mainly to dispense with such problems so that investors are more ready to set up industries, the Federation government has set up the Industrial Site Development Trust Fund of \$7.5 million, with the task of providing and developing industrial sites. This also allows the state governments which are left to set up their own industrial sites in their respective states, to apply for loans. Petaling Jaya (in Selangor) was the first industrial site to be set up in 1960, with 201 lots. It has proved very successful. The site has

has been virtually filled up with industries.. The Tasek industrial site, the Sungei Mah Mandin industrial site and one in Johore are further sites that have been established and the chances are great that they will follow the same pattern as experienced by Petaling Jaya.

The provision of industrial sites has successfully attracted many manufacturers who otherwise might have been inhibited from setting up industries. Recognising the significance, the government has decided that as a long term plan, to set up a Corporation to buy land from the state government, develop it and sell it cheap to industrial investors. This will overcome the present difficulty of lack of co-ordination between the Central and state governments so far as the provision of industrial sites is concerned. Under the present system, the development of sites is left to the state governments with help from Federal loans. As such development of industrial sites have been retarded as a whole, because some state governments have not the necessarily funds, while some are afraid that no industrialists will come and make use of the industrial sites. The latter problem should not arise at all. There is no fear that industrialists will not make use of developed sites.

Perhaps there is another way in which the provision of industrial sites have contributed to industrial development. Location of industries is an important aspect of industrial expansion. With the provision of sites, the location of industries is virtually controlled. Otherwise there is a tendency for industries to be concentrated near towns where communication systems are available, and where supplies of water and electric power and other facilities are also most readily available. This obviously can lead to industrial congestion, high social costs and wastage and as a whole may retard the carrying out of the industrial development programme. These things are characteristically absent in the Federation. This is due fully to the government provision of industrial sites. This has allowed the industrial development

here to proceed uninterrupted.

Provision of Local Industrial Knowledge.

Efficient management is an indispensable and an integral part in running a business enterprise successfully. Without efficient management, there can be a waste of profits due to increasing costs leading to high prices. Increasing cost can be caused by many factors; factors such as using the wrong method of production; producing the wrong product (since there is no market analysis); lack of co-ordination; poor morale giving rise to workers' resentment which can be manifested in many forms, such as sabotage and strikes; and haphazard plant layout. High cost of production cannot by itself prevent industrial development from taking place, but it can retard the rate of development.

There can be no denying that this type of situation (lack of efficient management) exists in the Federation. As it stands now, there is not much of a market research; there are also ^{little or} no analysis of demand, no analysis of products suitable to local environment and no consideration of capital for participating industries. These things can only be carried out by efficient management. As a digression, to show the importance of efficient management in the part it plays in industrial development, it is an accepted fact that the level of management is higher in a more industrialised country than in a less industrialised country. For example, Korea which is definitely far less industrialised than Canada, has a level of management which existed in Canada 40 - 50 years back. However, the Federation government has made provision to supply its own local management. This is done by the setting up of the National Productivity Centre (it was set up in 1961) where the local people are trained in layout of factories, co-ordination, personnel, production planning and other managerial functions¹.

¹ The University of Malaya and other Technical Institutes in the various parts of Malaya are other centres for training local people in industrial knowledge.

At present, a large amount of professional management is obtained from overseas, but at a relatively high cost. Although it can be obtained from overseas easily, more local managerial skill in the industrial is highly desirable. With local management available, the need of foreign help in this direction can be dispensed with, and investors will be more willing to consider the setting up of factories here because they can be certain of obtaining easily local talent which is oriented to the local ways of live and at a relatively lower cost.

In its encouragement for industrial development, the Federation government has also set up industrial research facilities which undertake research for industrial firms which do not have their own research facilities in this country. But this is only on a small scale, although it is going to be expanded with the setting up of the Department of Scientific and Industrial Research. Statistical services are also established to facilitate the passing of information regarding industrial production and employment. Besides these, information services are also set up to create knowledge for better development of the industries. These various services, by facilitating the exchange of industrial ideas as regards to production methods which go a long way in benefiting the industries, have helped industrial development a great deal.

Provision of Services for Industries.

Another non-financial inducement that has been given by the government to promote industrial development in the country, is the provision of social overhead capital and other services. The need of social overhead capital to industrialisation cannot be overemphasised. Industries to exist need water and power to run the plants, efficient communication systems to get raw materials to the factories and to take finished goods to the consumers. In a place where there is no efficient social overhead capital, one

cannot imagine to find large scale industries there. The word 'efficient' is emphasised here, because by just having a social overhead capital is not enough. It must also be efficient in terms of its cost and production. If electric and water supply can be obtained cheaply and abundantly, this will of course benefit the industries. Efficient transportation and communication systems can also cut down costs and save time for more effective production. More often ~~not~~ than not, a place with a higher developed and efficient social overhead capital will be more attractive to investors. As a local example, the West Coast of Malaya which has a more highly developed and efficient social overhead capital, has more industries than the East Coast where the social overhead capital is not so well developed and efficient.

The government has understood the importance of social overhead capital to industrialisation and since it cannot be built up by private enterprises, the government has made provision to supply such important service so as to attract investors to set up industries. In the First Five-Year Plan, the government had spent roughly \$500 million for ^{the} transportation, communication and utilities^{sector}. But in the Second Five-Year Plan, it is proposed that about \$800 million will be invested for this purpose. This is to improve and further extend the existing social overhead capital. Table IV on page 43 shows a comparison of government investment in transportation, utilities and communication sectors.

Although no specific portion of the public investment can be determined as contributing to industrial development, it can be certainly safe to say that development in the industrial sector has taken place because of the presence of the social overhead capital. This can be said because of the importance of social overhead capital to industrialisation. Were there no social overhead capital, or there exists only an inefficient^{one}, it can be very much doubted whether^{the} industrial development that has taken place, can ever take place at all.

TABLE IV

A COMPARISON OF PUBLIC INVESTMENT IN THE
TRANSPORTATION, UTILITIES & COMMUNICATIONS
SECTORS BETWEEN THE FIRST FIVE YEAR PLAN
(1956-1960) & THE SECOND FIVE YEAR PLAN
(1961-1965), FEDERATION OF MALAYA .

Sector	Dollars in Millions	
	First 5 Yr. Plan (1956-60)	Second 5 Yr. Plan (1961-65)
<u>Transportation</u>	<u>206.5</u>	<u>362.0</u>
Roads and Bridges	95.2	190.0
Railways	71.4	65.0
Ports	37.0	55.0
Civil Aviation	2.9	52.0
<u>Utilities</u>	<u>238.6</u>	<u>402.0</u>
Electricity	142.0	254.0
Water	80.6	140.0
Sewerage	16.0	8.0
<u>Communications</u>	<u>51.6</u>	<u>72.9</u>
Telecommunications	47.4	50.0
Broadcasting	2.7	5.0
Posts	1.5	17.9
Total, the 3 sectors	496.7	836.9

Source: Figures taken from the Second Five
Year Plan (1961 - 1965), Federation
of Malaya. pg.29.

Finally, the government has helped local industries by urging governmental departments, statutory corporations and the public to buy 'Malaya-made' goods whenever possible. This may seem frivolous, but actually it is very important. The people in the Federation have been so used to buy imported goods so that they naturally tend to have an evasion for locally manufactured goods in terms of quality. Yet manufacturers here depend very much on the local consumers giving them support, depending as they do, entirely on internal market. In time to come, when the locally manufactured goods have gained the confidence of the internal customers, such 'propaganda' which has been quite effective in creating confidence of the local customers, can then be unnecessary.

The above mentioned inducements given by the Federation to local industrial establishments and potential investors, have played a great part in promoting industrial development in the country. They will and can continue to play this role as long as industrial development is still in its early stages. However, care must be taken in granting these incentives, especially the incentives that benefit the industries directly (or direct incentives); examples are tariff protection and financial aid. Excessive direct incentives can be detrimental to a sound development of an industrial economy. They may lead to harmful monopolies, inefficient management, high priced products and poor in quality. Direct incentives which are necessary to nurse industries while they are still in the infant stage, must be slowly lessened and gradually removed, when the industries can stand on their own feet. Meeting outside challenges (if it is possible) is a better way to improve and develop. Other indirect incentives, such as the provision of public utilities, managerial training institutions, which can give little or no harm to the process of development should be encouraged and expanded.