

01/10/2003

## Domesticating the economy

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THE agenda in Budget 2004 is clear - to maximise national wealth. But one key ingredient seems to be missing - incentives for foreign direct investment (FDI) in the manufacturing sector. Instead, the country will streamline domestic investments to new levels via the development of small- and medium-scale industries (SMIs).

As manufacturing contributes to 31% of Malaysia's gross domestic product (GDP), the lack of new incentives for FDI comes as a surprise. Especially when FDI has traditionally accounted for the bulk of the country's private investments, forming at least 60% of the total.

In fact, Malaysia was among the 12 Asia-Pacific countries that registered an increase in FDI inflow last year, according to the United Nations Conference on Trade and Development's World Investment Report 2003. It states that total FDI received surged 478% to US\$3.2 billion in 2002.

Data from the Malaysian Industrial Development Authority (Mida) shows that foreign applications to invest in Malaysia amounted to RM3.5 billion in the first five months of this year - accounting for 48% of the total applications received.

A third of these applications went to the electrical and electronics industry (RM1.3 billion) while the remaining was for petroleum products and petrochemicals (RM417 million), food manufacturing (RM403 million), plastic products (RM356 million) and furniture and fixtures (RM154 million).

With these new provisions, it remains to be seen if the FDI share will increase to 60% for the full year, which has been the case for the past several years.

What is the reason for not giving any incentives for FDI this time around? As stated in true fashion by Prime Minister Datuk Seri Dr Mahathir Mohamad: 'Foreign companies in Malaysia finance their investments largely from domestic sources. As such, the inflow of foreign capital is actually smaller than perceived.

'These companies do not produce Malaysian brands, have low backward and forward linkages and utilise foreign technology. The main contribution of FDI has only been in terms of job employment. But today, since Malaysians are fully employed, it only benefits foreign workers. We must act immediately to make a quantum leap to become the nation's investor, producer and exporter.

'Today, Hitachi, Honda, Toyota (of Japan), Hyundai and Samsung (of South Korea) are well known in the world. It is therefore not impossible for Malaysian brands to be accepted globally.'

He has a point. As it is, with the incentives given to the foreign investors, they hardly pay any tax even though their revenue runs into the millions, and sometimes billions, of ringgit.

Azrul Azwar, economist at MIDF Sisma Securities Sdn Bhd, says, 'In fact, the tax benefits United States-based companies enjoy here are recovered in the US as government taxes.'

In making the private sector play a proactive role, Dr Mahathir has made his stand clear by stating that the Malaysia External Trade Development Corporation (Matrade) will be corporatised and injected with a seed capital of RM100 million, which will be used to help SMIs.

How will this be carried out? In fact, as a precursor to the latest

budget, the government had already implemented a policy shift from export-based growth to a domestic-led one in Budget 2003.

To coax investment among SMIs, the government is proposing to increase the threshold of chargeable income subjected to corporate tax (of 20%, as announced in Budget 2003) from RM100,000 to RM500,000, which would yield an additional RM322 million for reinvestment.

Another incentive for SMIs is pioneer status with tax exemption of 70% on the increased income from reinvestment - for a maximum period of five years for SMIs reinvesting in the production of machinery and equipment.

However, there are those who liken this strategy to a FDI-versus-domestic investment scenario that would see the end of the presence of multinational companies here.

To which Dr Nungsari Ahmad Radhi, executive director at World Enterprise Institute, an independent research and development body, says, 'I do not think it is an issue of one versus the other, rather it is an increased emphasis - in recognition of the decreased outlook on the inflow of FDI - on domestic investment to create new sources of economic growth.'

He says the foreign investments trickling in are not high value-added processes - the electronics and electrical FDI-based manufacturing in Malaysia adds only about 15 sen to every ringgit of the final product value. The remaining 85 sen are imported inputs.

'Given the stage we are at now, and the stage of other less developing economies such as China, Malaysia cannot compete on just labour costs,' he says.

Dr Yeah Kim Leng, general manager at RAM Consultancy Services Sdn Bhd, says that as sustaining consumption alone is not enough, the natural path would be for Malaysia to increase its share of the value chain.

'We have to look for domestically driven investments which do result in higher value-added that does not focus primarily on imports as input. In that sense, the oil & gas, commodities and some resource-based industries have done well.'

Azrul shares the sentiment, saying that Malaysia cannot be overly dependent on the cyclical nature of FDI, although it does provide ample employment opportunities.

But can this new strategy work? Nungsari feels there are no 'buts' to it. 'It has to succeed or else we will have major problems. We have this very young population where an increasing number of people are entering the labour market each year. Where are the new employment opportunities?

'There are of course problems in achieving this objective. Foremost is that it requires a healthy dose of entrepreneurial energy and culture - something we are lacking after so many decades of becoming beneficiaries of other people's enterprise. This entrepreneurial energy must be supported by the right kinds of institutions and value systems. We do not quite have that as well.'

Nungsari adds, 'Look at the banks. While they are adjusting themselves after all these merger indigestions - they don't do much risk-taking in financing new enterprises while at it - they now make healthy profits from consumer credit and mortgages! That is not banking, not the kind of banking that will support entrepreneurial enterprises.'

What is the danger of a move that focuses so heavily on domestic investment? Nungsari feels it may result in a kind of insularity, the 'we against the world' kind of mindset - that we have to produce everything ourselves.

'A particular trap is the thinking that if we are buying so much of a product, why don't we produce it ourselves - import substitution?

'The proper way to look at this is, what can we produce that we can sell to others? The whole world is the market for inputs and outputs. How do we

source the right combinations of inputs worldwide and create products to be marketed worldwide?'

So the last question that comes to mind is, will Malaysia lose out in terms of FDI, especially transfer of technology?

Azrul feels probably not. 'The policies indicate that FDI may shift to the services sector, especially in establishing operational headquarters, research and development institutes and turning Malaysia into a transport and logistics hub. There are plenty of incentives in place to spur these areas.'

Yeah says, 'This is where training and development will play an important role - in creating specialists, technologists, technicians, scientists and engineers.'

However, Nungsari feels that may be hard to accomplish at the moment as the country does not have sufficient human resources.

'We seem to yearn for creativity, innovation, risk-taking, out-of-the-box thinking and behaviour and being different, but we are so hung up on uniformity and conformity. Look at our educational institutions, and others as well. Failures are looked down upon while certain types of failures are not punished. The whole incentive mechanism must change.

'It says something about our education system, doesn't it? We are mass-producing all these IT generalists with no real skills to offer.'  
Food for thought, indeed.

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