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“Malaysia’s Experience with Foreign Direct Investment”

Foreign Direct Investment is now touted as the most important contribution to economic growth, particularly for developing countries.

2. There is no doubt that it plays a big role but it will only do so if it is carefully managed.

3. Malaysia has had a lot of experience with FDI. Indeed long before FDI became a favorite word with economists Malaysia was already welcoming foreign investments.

4. Unlike most newly independent countries which tended to be socialistic and inward looking, Malaysia not only did not nationalise foreign holdings upon attaining independence but instead invited foreigners to participate more in its economy.

5. As a British colony, we had become host to the colonial entrepreneurs. They developed the huge rubber estates, set up huge tin mines, and their trading houses imported and exported all the needs and products of the Malay states or Malaya.

6. The distributive trade was monopolised by Chinese immigrants. The Indians were brought in to work in the rubber estates and to hold minor posts in the Government.

7. The Malays were largely in the rural areas, planting rice and fishing. A few were trained as administrators and were in the civil service.

8. The policy of dividing and ruling is quite obvious. The overall situation at independence was not conducive to economic development. Indeed the situation

was ripe for racial conflicts and political instability. To make matters worse, the Chinese had started a Communist insurrection, and guerilla forces were attacking the British colonial Government and did not stop when independence was achieved.

9. But the Malays decided not to grab power for themselves alone. They opted to share power with the Chinese and Indians. And instead of nationalising the British and other European-owned estates, mines and businesses, they opted to leave them in the hands of these foreigners. Apart from import duties on certain foreign products, trade was free and largely unregulated.

10. This policy of the new independent Government reassured the foreign investors and business people. The reason for this Malaysian Government's policy was because of the realisation that we had no expertise in business and nationalising would result in business failures. Instead the Government opened up new estates and mines and got some of the experienced Europeans to help manage them and to teach Malaysians the intricacies of management.

11. But estates and mines did not create enough jobs for Malaysia's growing population. Only the manufacturing industries could do this. And so in the 1960's it was decided that Malaysia should industrialise. Since we had no industrial technology and know-how, no capital, no management expertise and no knowledge of the world market, we decided to invite foreign investors to set up industries.

12. Our friendly treatment of foreign businesses after independence paid off. Foreign investors regarded Malaysia as a good country to invest in. We had political stability, low cost of living and willing workers. But in addition we decided to provide tax incentives in the form of tax holidays for up to 10 years. At first we thought we could participate and get a share in the new industries. But it became obvious that the investors wanted to own 100 % of their business. We decided they could own 100 % if the industries were export oriented. Sales within the country would attract import duties, as if the products were imported.

13. Having created the right environment and incentives, we had to aggressively promote foreign investments in our country. Every year teams from the Ministry of Trade, headed by the Minister would go to the capital exporting countries to promote the industrial free trade zones or estates that we had created. It helps to have current investors participate in these promotion teams, to tell about their experiences in Malaysia.

14. As FDI in developing countries were not common in the early days, selling the idea was difficult. Besides our country was not known to the world at that time. The fact that most developing countries were politically unstable and new Governments have a habit of changing the rules did not make attracting foreign investments easy. It took time for investors to realise that Malaysia was stable

and we do not change the rules on investments with each change in the leadership of Government. When they realise the stability and consistency of Malaysian policies and practices the number of investors increased.

15. Additionally they discovered that Malaysian workers were very skillful and diligent. They and their trade unions were not militant. There were very few strikes and industries were very productive.

16. The Government is truly investor friendly. Government Ministers are approachable and they hold regular dialogue sessions with foreign investors. Grouses aired during the dialogues or at other times receive the attention of the Minister responsible. Frequently the Cabinet is notified and action taken. Before the Annual Budget is presented the business community is invited to dialogue and to present memoranda on the tax structure and to propose changes. The Government is not bound to accept all suggestions but frequently the Government would accede to the requests of the business community.

17. The Government did not promote FDI in order to collect taxes for its coffers. The primary objective was to create jobs for Malaysia's workforce. Accordingly the focus of FDI was on labour intensive industries. So successful was the strategy that Malaysia created more jobs than there are workers in Malaysia. Today more than a million foreign workers have found jobs in Malaysia.

18. Some Malaysians worried that the foreign investors would dominate the economy and the politics of the country. As we all know this happened to the Banana Republics of Central America. But this did not happen in Malaysia because the number of investors was big and the Government does not depend on them for its revenue. The industries were also varied and in any industry, the electronic industry for example, there would be numerous manufacturers from many different countries. Because the different countries of the investors have different attitudes and policies their investors are not likely to act together. Their fragmentation ensures the absence of any political agenda on their part. In all the years since Malaysia received foreign investments there has been no attempt at meddling in local affairs. In fact the foreign investors are very dependent on Government in terms of policies and perks that they have not tried to antagonise the Government or the country in any way. Our independence has remained intact despite having large foreign investments by a large number of investors for more than 40 years. Even when we are critical of the policies of the countries from where the investors come, they have not reacted adversely.

19. Lately we have to compete with China and its very low cost labour for FDI. We also face the possibility of some investors pulling out of Malaysia to go to China. We have no choice but to offer better terms and to help the investors in whatever way we can. By carefully studying the advantages offered by China and

those offered by us, we are able to highlight Malaysia's comparative advantages and so convince the investors to stay put.

20. Although Malaysia's main objective is to create jobs for our people, but there are a number of spillovers from foreign-owned industries. From being merely an exporter of raw materials like rubber, tin, palm oil and petroleum, Malaysia is now a big exporter of manufactured goods. In 2003 total exports amounted to 100 billion USD, of which 82 percent is made up of manufactured goods. Malaysia is now the 17th biggest trading nation in the world. Because these manufactured goods are of world quality other Malaysian products manufactured by purely Malaysian companies have also gained acceptance worldwide.

21. Experience gained while working for foreign companies has improved the quality and skills of Malaysian managers and workers. They are now able to start industries on their own either in the manufacture of similar products or new purely Malaysian products. Today manufactured goods by Malaysian companies are to be found all over the world.

22. Investments by Malaysians in industries naturally bring more return for Malaysia and the Government. Apart from creating jobs, their earnings are largely spent in Malaysia. Transfer pricing indulged in by foreign investors are less likely with Malaysian owned businesses. The profits accrue to Malaysians.

23. Although the foreign investments enjoy tax holidays, their staff, foreign and local, pay Malaysian income tax. Supplies of food and raw materials benefit Malaysian companies. Now many of the foreign-owned industries source component parts locally – enabling Malaysia to go into component manufacturing. These components can also be exported, thus giving extra businesses to Malaysians.

24. Because Malaysia has gained expertise in manufacturing we are not too dependent on FDI anymore. We still want to attract them but our own investments have made up for the slowdown in the flow of FDI. This capacity of the locals is very important. As more and more countries vie for FDI, the investors will become more demanding in their requirements. In the end the benefit from FDI will become less and less.

25. Apart from investments in their own industries to take advantage of the lower costs and incentives offered by the host countries, foreign investors are also keen to invest in local stocks and shares.

26. Initially Malaysia did not allow foreign investments in Malaysian companies. Later we decided to allow foreigners to own up to 30 percent of Malaysian shares. It is really very difficult to control as the shares were bought

and sold rapidly on the stock exchange. We still maintain this quota but foreign share holdings can exceed the quota every now and again.

27. Usually when foreign investors buy shares on the stock exchange the value of the shares tends to move very rapidly and widely. This is especially so when the huge pension and other funds move in. As soon as they begin to buy the shares appreciate in value. Local investors seeing the index shoot up and aware that foreign funds were buying would follow suit and rush for the affected counters. A boom would take place as share values shoot up beyond the value of the companies' assets and returns.

28. The boom may develop into a bubble as the shares begin to appreciate wildly without any relation to the performance of the businesses. As buying pressure increases the share prices shoot up.

29. In some countries short selling is allowed. Investors buy basically non-existent shares hoping to sell when the prices go up. Other investors sell the shares at below market price, hoping to push the prices down. When the prices go below the price that they sold then they would buy at the lower price in order to deliver to their buyers who had bought at the higher prices. At this stage the selling and buying have nothing to do with the business or the shares available. Share trading has taken a life of its own. At some stage this trading in non-existent shares will collapse, as delivery of the shares bought cannot be made. This may trigger total stock market collapse and chaos in the economy.

30. Another danger is the dumping of shares after they have appreciated to a high price. Large foreign funds are not really interested in the companies and their performance. They are not interested in the dividends as these would not give them the returns they need to serve the objective of the funds.

31. Huge pension funds usually need high returns of up to 8 percent at least. There is no way they can get 8 percent return from the inflated share prices they had paid. But capital gains can give them this return and more. They would therefore aggressively buy the shares so that the prices rise steeply. At a certain stage they would sell off practically all their shares to achieve profit from their capital gains.

32. The effect of their dumping is to depress the share prices greatly. Others including the local investors would be left holding shares which are priced much below the prices they had bought. As the value of their holdings fall below the value of their collaterals with the banks, demands would be made by the banks for them to top up. As huge numbers of investors fail to top up, there would be an increase in the number of non-performing loans in the books of the banks. The borrowers can face bankruptcy.

33. The general effect of the dumping of shares by large foreign funds can be a total collapse of the stock market and economic recession. Billions of dollars in market capitalisation would be lost. The whole country can go into recession from which recovery would be very difficult.

34. During the currency crisis in Malaysia, shares held by foreign institutions were dumped unceremoniously. The stock market index plunged from more than 1000 to below 300. Billions of Ringgit in market capitalisation were lost, banks were saddled with a high percentage of non-performing loans, businesses and investors went bankrupt.

35. It was to overcome this that Malaysia stopped the expatriation of funds from the disposal of shares by foreigners. Immediately the stock market recovered and the index shot up from 262 to 800 plus. After one year of this regime the foreign investors were allowed to divest and repatriate their money. They were very happy because had they divested when the index was below 300 they would have incurred losses. Disposing their shares after the index rose more than one and a half times gave them a solid profit. After they left the stock index fell again but not as low as when they were dumping shares before the clamp on fund repatriation.

36. It must be admitted that these big investors do the same in their own countries, buying shares, pushing up the prices and then dumping in order to realise capital gains. Local investors in Malaysia can do the same but their funds are limited. Today the Government has instituted limits to buying or selling so that rapid movements in share prices could be halted for a brief period.

37. The biggest problem was caused by the rapid and deep devaluation of the Malaysian currency caused by the foreign currency traders. When currency depreciates then the value of foreign investments in shares in terms of their own currency or U.S. Dollar also gets devalued. This is because foreigners have to buy local currency in order to invest. Obviously when the currency depreciates the value of their holdings in terms of their currency would also depreciate. To avoid losing the foreign investors would cash out in anticipation of further devaluation of the currency. But by selling off their shares they depress the price of the shares further. Now they stand to lose not only from the currency devaluation but also the fall in the prices of the shares they had bought. Fearing further currency devaluation and falls in the share prices they would sell the remaining shares that they were holding. This of course pushed the share prices further down and also the exchange rate of the currency.

38. By then the economy would be in a state of collapse. The International Monetary Fund would offer to lend money but with the condition that the country opens up and allows foreigners to enter the country freely to buy the near bankrupt companies or banks.

39. Malaysia rejected the IMF offer as this would mean foreigners would move in to literally take over the economy. But many countries were forced to accept IMF loans and conditions. The result was that foreign investors moved in and bought local banks and businesses at fire sale prices, benefiting from the devaluation of the local currency and the fall in the share prices of local businesses. Recovery for the affected country becomes extremely difficult as it has to find enough local currency in order to buy the foreign currency at inflated prices simply to pay off IMF debts. In the meantime most of the best local banks and businesses would be owned by foreigners.

40. With globalisation and the removal of trade and investment barriers, it is likely that many countries would stand to lose.

41 Malaysia has benefited from Foreign Direct Investments. But this is due to the country's control and regulation of foreign investments. Without these controls Foreign Investment may not be so beneficial to the country.

42 A totally unfettered and unregulated F.D.I. may help a country desirous of growing its economy. But it is important that host countries understand the danger they may be exposed to.
