Malaysia

The Malaysian economy, led by an increase in product exports mainly due to an economic recovery in the U.S. and growing local production by Japanese companies reflecting a stronger yen, continued to show strong growth in 1994, at a rate of 8.5%.

Sony Corp.'s plant in Malaysia.

For 1995, we project the growth rate to fall slightly to around 8%, resulting from a balance of the negative impact of a tightening monetary policy to alleviate fears of creeping inflation reflecting the strong economy, and the positive impact of the expected increase in local production by Japanese companies given the persistent yen strength (around ¥100/US$); strong exports supported by a moderate recovery in the Japanese economy and a strong U.K. economy; and increasing fixed-capital formation, such as on-going construction at the New International Airport and a project for building telecommunications-related infrastructure.

The Malaysian economy has grown by about 8% annually since 1988, the leading factor being industrialization financed by foreign capital which resulted in an increase in product exports (Chart 1).

Trend in foreign investment

Malaysia is graced with rich natural resources, including natural rubber, tin, oil and natural gas. Exports of these primary products have helped finance the country's economic development since its independence in 1957, and the economy achieved an annual growth of above 8% in the 1970s. However, in the mid-1980s, falling prices in crude oil and primary products slowed the economy, and in 1985 Malaysia recorded the first negative economic growth since its independence. In response, with the introduction of the Investment Promotion Act in April 1986, the government promoted industrialization led by foreign capital and announced a significant relaxation over foreign investment regulations in September of the same year. Both acts were followed by several other measures to encourage foreign investment.

Previous to the adoption of the new policies, economic development was based on The New Economic Policy, designed to develop local capital, especially ethnic Malay capital. In principle this policy gave foreign capital only a supplementary role, placing limits on foreign share holdings. However, with the introduction of drastic deregulation measures over foreign investment, originally introduced as a counter-recession policy after 1986, foreign capital has become the driving force in the industrialization of Malaysia.

Regarding infrastructure, which is indispensable in attracting foreign investment, Malaysia has been better positioned than its neighbors as it inherited a relatively sufficient infrastructure from the days of British colonial rule.

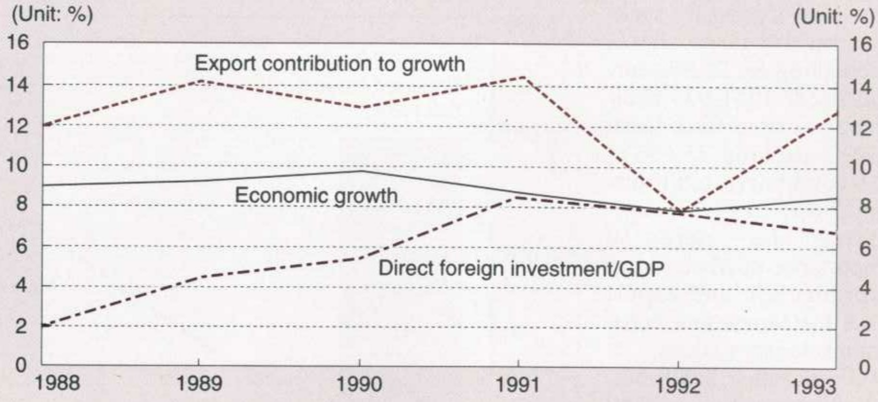
Foreign investment in Malaysian manufacturing industries (approval base, including loans) doubled year-on-year from 1988 to 1990, due to both international (weakened export competitiveness in Japan and Asian NIEs, whose currencies were sharply appreciated following the Plaza Agreement in September 1985) and domestic factors (foreign investment deregulation). However, foreign investments experienced a downturn after peaking at RM17.6 billion (ringgit) in 1990, remaining almost flat at RM17.1 billion in 1991, and apparently rising slightly to RM17.8 billion in 1992, a sharp drop of 28.1% to RM12.3 billion if a special French natural gas related investment of RM5.7 billion is omitted.

Foreign investment fell further to RM6.3 billion in 1993 due to international recessions. In 1994, foreign investment recovered sharply, exceeding the full-year figures of 1993 (the previous year) by the first nine months with RM9.6 billion, and beyond RM10 billion for the year due to expanding local production in Malaysia by Japan accompanied by a further appreciation of the yen.

Among investing countries, Japan held the top share with RM15 billion, followed by Taiwan (RM14.5 billion) and the U.S. (RM7.7 billion) in cumulative investments from 1989 to 1993. Investments from Japan and other Asian NIEs rose sharply in the late 1980s, while those from the U.S. and EU began to rise after 1990 (Chart 2).

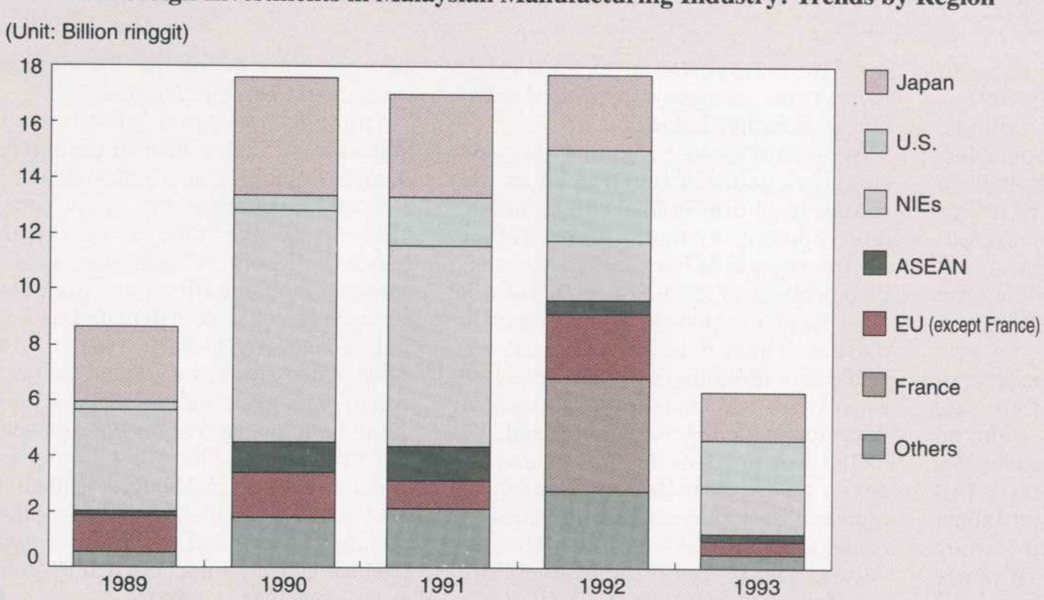
By industry, electric and electronics industries accounted for 35.5% of the total outstanding paid-up capital and fixed-assets owned by foreigners at the end of 1992, taking a huge lead over other industries.

Chart 1: Malaysia—Economic Growth, Direct Investments, Export Contribution to Growth



Source: International Financial Statistics, IMF
Notes: Direct foreign investment based on international balance of payment; Economic growth based on GDP

Chart 2: Foreign Investments in Malaysian Manufacturing Industry: Trends by Region



Source: Malaysian Industrial Development Agency (MIDA)

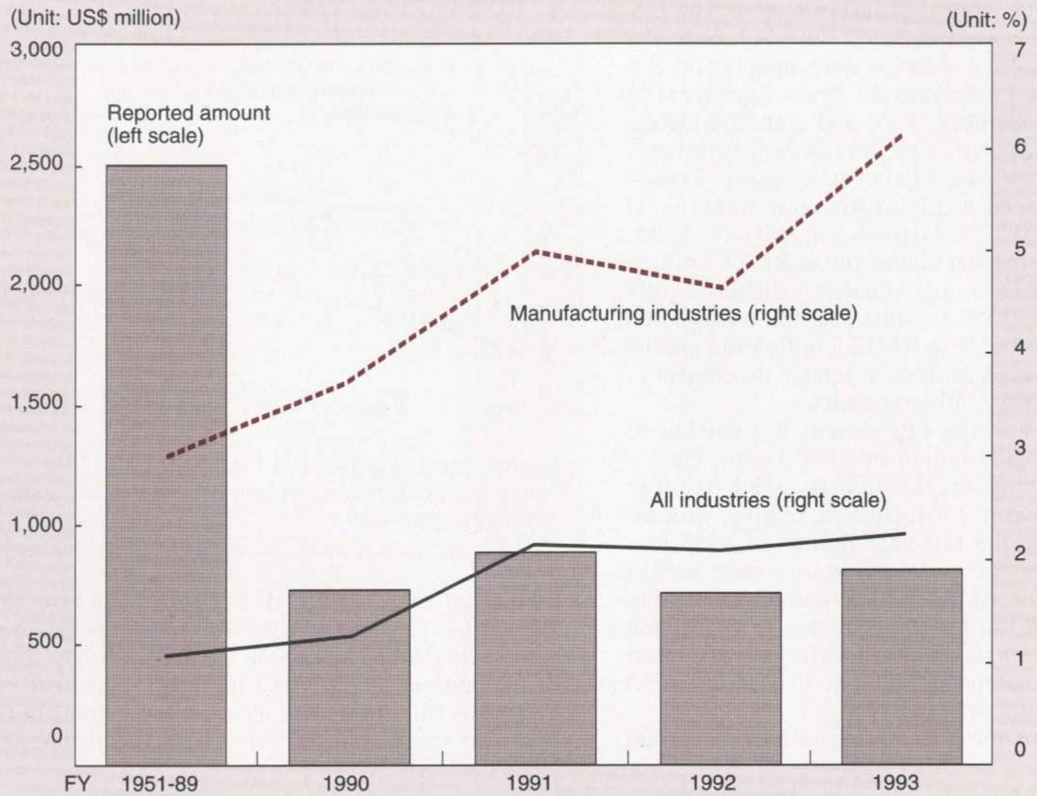
Trend in Japanese investment

Ministry of Finance statistics for direct overseas investment during the period from fiscal 1951 to 1989 place Japanese accumulated investments in Malaysia at US$2.5 billion, accounting for only 1.1% of international investments (US$238.4 billion). However, after fiscal 1990, the share continued to rise, from 1.3% in fiscal 1990, to 2.1% in fiscal 1991 and 1992, to 2.2% in fiscal 1993, ranking 10th in the overall industry base, and fourth in the manufacturing industry base (Chart 3).

Among industries, manufacturers, in particular electrical machinery makers, hold a large share, accounting for 25.8% during fiscal 1951-93. Their share has risen since fiscal 1988, reaching 31.1% of the cumulative total during fiscal 1988-93, indicating the increased importance of Malaysia as a production and export base for Japanese electrical machinery makers.

On the other hand, outstanding paid-up capital and fixed assets of foreign investors in Malaysian manufacturing companies stood at RM10.8 billion and RM19 billion, respectively, as of the end of 1992, of which Japan held 35.5% (RM3.8 billion) and 37.1% (RM7.1 billion) respectively, ranking top, followed by Singapore by a big distance.

Chart 3: Japanese Investments in Malaysia and World Share by Industry



Source: Ministry of Finance Statistics for Direct Overseas Investments

Future outlook

In the Sixth Malaysia Plan (1991-95), Malaysia aims to strengthen domestic capital as well as encourage foreign investments, setting a target of RM80 billion (40% from overseas and 60% from local capital) in investments during the period. In reality, however, domestic capital only exceeded in 1993 when foreign direct investments fell sharply, and the Malaysian economy is still largely dependent on foreign capital.

Malaysia has a relatively small population—19 million, compared to, say, about 59 million in Thailand—with an unemployment ratio currently under 3%, indicating a condition of nearly full employment. Accordingly, its labor-intensive industries have been loosing cost-competitiveness in favor of newly developing areas, such as China and Vietnam. As a result, the government is taking preferential measures in approving foreign investment to encourage investments in more capital- and technology-intensive industries.

In addition, even if domestic consumption gains in importance as the income level rises in line with economic development, bringing about higher consumption both in quantity and quality, objectively, the small population will set a limit on growth in the domestic market. Thus, it is unlikely that the Malaysian economy will completely do away with the traditional pattern of development led by foreign demand.

The bottom line is that Malaysia needs to develop its labor-intensive industrial structure to continue economic development. As current domestic capital and technological levels are insufficient to carry out this task, it is a prerequisite that overseas advanced technologies be imported. Therefore, the importance of foreign direct investment should possibly increase.

Although per-capita labor costs in Malaysia are higher than in developing countries such as China and Vietnam, in a straight comparison this is not necessarily so. If other factors, such as the standard of workers' skills and accompanying labor qualities are included, labor costs could be calculated as less. This seems particularly true in high value-added production, where the question of experience and the need for training in both quality and quantity makes a big difference. Therefore, Japanese direct investment in Malaysia is likely to be directed to upgrading and expanding existing facilities and to shifting to higher-value-added production, mainly in the electric machinery industry.

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