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# Tighter Control over Foreign Capital

by Rolf Sutter, Hamburg \*

**Foreign investors in Malaysia were greatly disquieted when the Petroleum Development (Amendment) Act, 1975, and the Industrial Coordination Act were passed by the Malaysian Parliament. Both these enactments and the re-formulated Standard Conditions for Foreign Investments are indicative of the Malaysian Government's desire for tighter control over the national resources and over the foreign enterprises.**

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**T**he Petroleum Development (Amendment) Act marks the most rigorous intervention to date in the hitherto very liberal investment climate of Malaysia. It applies to enterprises engaging in the production and distribution of mineral oils and petroleum chemicals in the widest sense and provides that the start-up and continuation of such activities require official authorization. Of particular importance is the general proviso that enterprises covered by the Act must issue Management Shares to the amount of at least 1 p.c. of the common or paid-up capital stock and sell these to the state oil company, Petronas. The Management Shares must be given the same voting rights as the ordinary shares but carry 500 votes each for decisions on the appointment of directors or other staff. In this way the Malaysian Government can assure itself of a substantial measure of control and influence without a large capital outlay.

The Industrial Coordination Act, 1975, extends the requirement of official authorization which had previously been confined to enterprises which applied for state assistance under the Investment Incentive Act to all native or foreign firms engaging in production.<sup>1</sup> Enterprises which have commenced production under previous legislation without such a licence must apply for this official authorization within a year from the promulgation of the new law. A licence will also have to be obtained in future for any extension of the production programme of an existing enterprise. The grant of a licence is conditional upon the submission by the firm in question of acceptable proposals showing how it intends to conform to the objectives of the New Economic Policy. The main aim here is to ensure greater Malaysian capital and personal participation in the enterprises. By 1990 70 p.c. of the national assets are to be Malaysian-owned, and 30 p.c. — the minimum prescribed already in the Standard Conditions for

Foreign Investments<sup>2</sup> — are to be held by Malaysians. As regards personnel it is stipulated that Malaysians must be represented in the individual enterprises at the higher qualification levels in proportion to their numbers in the total population in the region in which the plant is located.

## Cardinal Points of Malaysian Economic Policy

Beside these central stipulations the new laws and regulations contain quite a number of other provisions designed to extend the control over foreign enterprises. At the same time however the Government emphasizes that a further increase of foreign investment is essential for continuing economic development.<sup>3</sup> This dichotomy seems, at a first glance at least, to be contradictory. To understand it and to be able to judge it, one must give a little more thought to the problems of the country, on the one hand, and the role played by the foreign enterprises in the Malaysian economy, on the other.

Malaysia is facing two grave problems in its domestic policy — the persistent racial tension between Malaysians and Chinese and the operations of the guerillas who have become again more active since 1974. Against the economic background of these two problems four tasks emerge as cardinal points of Malaysian economic policy:

☐ With an unemployment rate which even in boom periods failed to fall below the 7 p.c. mark the need is for the creation of many additional jobs.<sup>4</sup>

☐ Diversification of the export structure is essential in order to avoid conditions of great instability. The five principal export commodities of Malaysia — rubber, tin, timber, palm oil, and mineral oil —

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<sup>1</sup> Cf. Industry's Division, Ministry of Trade and Industry, Brief on the Industrial Coordination Act, 1975, Kuala Lumpur 1975.

<sup>2</sup> Cf. (no author's name) Malaysia strebt stärkere Investitionskontrolle an (Malaysia aims at tighter investment control), Nachrichten für Außenhandel, June 25, 1975.

<sup>3</sup> Cf. Dato Hamzah Abu Samah, Minister of Trade and Industry, Industrial Development and Opportunities for Investment, Speech to an international investment seminar in Kuala Lumpur, October 8, 1975.

<sup>4</sup> Cf. Bank Negara Malaysia, Annual Report and Statement of Accounts 1974, Kuala Lumpur 1975, p. 111.

accounted in the past 15 years for between 75.5 and 80.5 p.c. of total exports. Their combined share in 1974 (75.5 p.c.) was only 1 p.c. lower than it had been 10 years earlier.<sup>5</sup>

□ The reduction of the big differential between the industrially developed and the purely rural regions: the gross domestic pro-capita product varied in the 11 West Malaysian states in 1965 between extremes of M\$ 370 and M\$ 1,490.<sup>6</sup> More recent information indicates a further widening of this differential.<sup>7</sup>

□ Redistribution of the national wealth to the benefit of the Malaysians: although accounting for about 53 p.c. of Malaysia's total population, they owned only 1.9 p.c. of the capital of all limited companies in 1970; the Chinese owned 22.5 p.c. while well over 60 p.c. was in foreign hands.<sup>8</sup>

It is important for a solution of these problems that they can be tackled in conditions of rapid economic growth. In Malaysia this prerequisite has been created. Real economic growth has proceeded since 1970 at annual rates between 5 and 10 p.c. The per-capita GNP of about US\$ 700 in 1974<sup>9</sup> was surpassed in Asia only by Japan, Singapore and Hongkong. The influx of foreign capital under the stimulus of the very favourable investment climate in Malaysia probably made a fairly significant contribution to this development.

### Amount and Origin of Foreign Capital

An accurate assessment of the magnitude of the foreign investments and their origin is possible only insofar as they have gone into pioneer enterprises — i.e. enterprises which are accorded a special priority and promotion rating. Only the investments in these are regularly recorded by the Federal Industrial Development Authority (FIDA) while the amount of foreign capital expended on projects which enjoy no or different forms of state assistance can be only partially ascertained. The investments of the pioneer enterprises certainly accounted for the bulk of all investment in the past few years. In 1974 M\$ 327.4 mn were invested in pioneering projects, including M\$ 127.7 mn from abroad.<sup>10</sup> The total capital invested in pioneering enterprises thereby rose to M\$ 1,370 mn of which

foreigners — who in 1973 provided for the first time less than 50 p.c. — had contributed M\$ 604.3 mn. No less than one-quarter of this capital sum originated from Singapore. Expatriate Chinese and to some extent also non-resident enterprises are probably the main sources of capital for these investments from Singapore, as for those from Hongkong.

Great Britain, the former colonial power, plays traditionally a leading role in Malaysia which became an independent member of the Commonwealth as late as 1957. Japanese firms are however seen to develop their engagement in Malaysia with far greater energy. At the end of March 1974 the Japanese were leading the US and British firms in regard to the number of companies in which they held interests. The five mentioned countries accounted for over 85 p.c. of all foreign investments in pioneering enterprises. So they had already done in 1970.

European countries other than Great Britain play a relatively minor role in respect to pioneer projects. The amount of the investments in 1974 and the information concerning licences for new projects suggest however increasing interest on the part of European firms, especially from the Federal Republic of Germany and Switzerland.<sup>11</sup> This is a development which is being welcomed by the Malaysian Government; one of its reasons for this is that it wishes to limit or lessen the country's one-sided dependence on a few sources of foreign capital.

### Creation of Additional Jobs

In spite of the relatively rapid growth of the economy Malaysia has been unable to provide enough job opportunities. The unemployment rate — 6.1 p.c. in 1965 — had by 1970 risen to over 7 p.c.<sup>12</sup> and it is not expected that a more favourable picture will emerge for 1975. Of the 600,000 new jobs which were planned for this quinquennium the agricultural sector and manufacturing industry were each expected to provide well over 160,000 although in 1970 52.6 p.c. of all employed persons had still been engaged in agriculture while manufacturing industry accounted for no more than 9.6 p.c.<sup>13</sup> These figures illustrate the central part assigned to this sector of the economy in solving the employment problems.

The manufacturing industry actually managed to create 19,000 new jobs in 1970 and as many as

<sup>5</sup> Cf. Bank Negara Malaysia, Quarterly Economic Bulletin, March/June 1975, Vol. 8, No. 1/2, p. 70.

<sup>6</sup> Cf. David Lim, Economic Growth and Development in West Malaysia 1947/1970, Kuala Lumpur 1973, p. 139.

<sup>7</sup> Cf. The Treasury of Malaysia, Economic Report 1974–1975, Kuala Lumpur 1974, p. 84 ff.

<sup>8</sup> Cf. Mid-Term Review of the Second Malaysia Plan 1971–1975, Kuala Lumpur 1973, p. 83, Tables 4–7.

<sup>9</sup> Cf. The Treasury of Malaysia, Economic Report 1974–1975, *ibid.* p. 4 and p. 98.

<sup>10</sup> Calculated from: Federal Industrial Development Authority (FIDA), Annual Report 1974, (place of publication not indicated) 1975, p. 126, Table IV.

<sup>11</sup> According to FIDA information, German firms by April 30, 1974 made applications and received licences for projects involving investments of M\$ 17 mn. The corresponding investments by Swiss firms amounted to M\$ 48 approximately.

<sup>12</sup> Cf. Second Malaysia Plan 1971–1975, *ibid.*, p. 102.

<sup>13</sup> Cf. Mid-Term Review of the Second Malaysia Plan 1971–1975, *ibid.*, p. 30.

36,000 in 1973. The 1974 figure was probably a little lower: the Government put it at about 30,000.<sup>14</sup> What contribution the foreign enterprises have made to these results can only be estimated for the pioneer enterprises which provided more than 50 p.c. of the new job opportunities in manufacturing industry.

Assuming that the foreign enterprises have participated in the creation of new jobs in proportion to their share of the annual investments<sup>15</sup>, about one-third of the job opportunities in pioneer enterprises since 1970 are due to foreign capital. Since about 60 p.c. of the capital of all limited companies in Malaysia, including those which do not enjoy pioneer status, is foreign-owned, it may be concluded that the foreign capital is making a substantial contribution to the solution of the job procurement problem. No allowance is made in this assessment for the positive or negative repercussions on employment from linkage effects and structural changes in production and competition due to the activities of foreign enterprises. These indirect effects on employment of the foreign investments cannot be judged with any certainty.

#### Export-intensive Investment Projects

Malaysia's five major export commodities — rubber, tin, timber, palm oil, and mineral oil — provided well over three-quarters of all export earnings throughout the past ten years. As these commodities are however subject to very wide world market fluctuations, the export sector suffers from extreme instability. Owing to the high ratio of exports to total production (1974: 49 p.c.) this has a strong impact on private investment and on the gross national product.<sup>16</sup> Stabilization of Malaysia's export earnings — and this means diversification of exports — is therefore of great importance for the growth process.

<sup>14</sup> Cf. FIDA, Annual Report 1972, p. 57; 1973, p. 61; 1974, p. 85f.

<sup>15</sup> In fact this is probably not the case. It may be assumed that the capital-to-labour factor employment ratio is higher for the foreign enterprises as a whole than for native enterprises; cf. David L i m, *ibid.*, p. 154ff.

Tax concessions are for this reason extended to export-oriented investment projects with pioneer status if more than half their output is marketed abroad, and in cases of extreme export orientation up to 100 p.c. of the capital may be in foreign hands.

These promotional measures have probably helped to raise the contribution which the industrial exports make to Malaysia's total export trade from about 5 p.c. in 1965 to over 12 p.c. in 1974<sup>17</sup>. The proportion of the output of the pioneer enterprises which is intended for the foreign market has risen quite noticeably over recent years.<sup>18</sup> About one-third of the investment projects authorized by FIDA in 1973 and in 1974 were export-oriented. The key sectors for projects of this kind — the electrical, electronics and textile industries — were fields in which production operations have been moved out of industrial countries, chiefly for reasons of cost.

#### Foreign Investments and Regional Policy

No detailed information is available about the distribution of the foreign investment projects over the various regions of Malaysia. As however about 50 p.c. of all capital invested in pioneer enterprises by the end of 1973 has come from abroad, the successes in regional diversification during recent years must to some extent have been sustained by foreign enterprises. In 1971 43.1 p.c. of all authorized projects were located outside the areas which have been classified as industrially developed. In the following years the rate rose continuously; in 1974 it reached 63.2 p.c.<sup>19</sup> The regional distribution of the job opportunities and investments anticipated under these projects shows an even more favourable picture. In 1974 the industrially less developed areas attracted 77 p.c. and 80 p.c. of these, respectively.

<sup>16</sup> Cf. the same author, *ibid.*, p. 30.

<sup>17</sup> Cf. The Treasury of Malaysia, Economic Report 1974–1975, *ibid.*, p. XIX.

<sup>18</sup> Cf. FIDA, Annual Report 1971, p. 51; 1972, p. 59; 1973, p. 63; 1974 p. 95.

<sup>19</sup> Cf. FIDA, Malaysia Industrial Digest, Vol. 8, No. 1, First Quarter 1975, p. 8.

## KONJUNKTUR VON MORGEN

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These results are also indicative of intensive efforts by the Malaysian Government which, on the one hand, created infrastructural preconditions for the location of industries in previously less accessible regions by setting up industrial estates — of which there are by now 43 spread over the country — and, on the other, provided for possible tax exemption of projects in development areas for up to 10 years.

### **Dominance of Foreign Capital**

By the end of 1974 247 projects had been supported by FIDA as pioneer enterprises, involving an investment volume of M\$ 1.37 bn, of which 44 p.c. originated abroad; in 1972 the foreign share had been as much as 53.5 p.c. The relative decline of the foreign investments in the pioneering sections was probably in the main due to the stricter curbs on foreign capital participation in the individual projects during recent years and to the intensification of investment activities by Malaysian interests.

An examination of the 20 industries on record for pioneer projects shows that foreign capital still predominates in nine of them<sup>20</sup> including such important areas as the electrical industry, the chemical industry, oil and coal, and the non-ferrous metal industry. Together they attracted about one-third of all native and foreign investments in pioneer enterprises. In the mineral oil sector in particular the foreign share is traditionally very large; in 1974 however it was — at 74 p.c. — 6 percentage points lower than in the preceding year. The electrical industry witnessed in contrast a foreign investment boom in 1974 when the foreign share of the pioneer investments in this industry soared from 53 p.c. to 71 p.c.

A study of the distribution of the assets of manufacturing industry at the end of 1968 shows that it is not only in the pioneer enterprises that foreign capital is of great importance.<sup>21</sup> Assets to the amount of M\$ 421 mn, about 53 p.c. of the total, were at that time foreign-owned. Figures about the ownership of the limited companies in Malaysia for 1970 also show the foreign capital with over 60 p.c. in a dominant position.<sup>22</sup> In the agricultural and mining enterprises the foreign influence (over 70 p.c. of the capital is foreign-owned) is paramount, but foreigners also own the larger part of the capital of the limited companies in manufacturing industry (60 p.c.), the distributive trade (63.5 p.c.) and banking and insurance (52 p.c.).

In the light of this distribution of investments and assets it cannot come as too much of a surprise that the regulations on investments in Malaysia reflect also certain nationalization tendencies, the

more so as the Government is faced with increased domestic political pressure, especially on the issue of distribution.

On the other hand, there is some evidence in support of the view — which has been adopted by the Malaysian Government — that the foreign capital has made, and can still make, an important contribution to the achievement of the objectives for growth, employment, external economic relations and regional policy. It has led the Malaysian Government to undertake a balancing act between intensive efforts to attract and encourage foreign investments and the endeavour to strengthen native capital participation and control.

### **The New Laws in Practice**

The reaction of the investors has in part been vehement; Exxon for instance has stopped investing in Malaysia, and the other seven oil companies operating in the country also show great reluctance to invest.<sup>23</sup> This is a threat to the ambitious Malaysian plans, more particularly in the oil sector. It is therefore doubtful whether the Petroleum Development (Amendment) Act will ever be applied in its present form.

There can be no doubt however about the Malaysian Government's determination to enforce the Industrial Coordination Act and thereby the principles of the New Economic Policy. The Government is certainly trying to allay the uncertainty felt by investors and to clarify the practical implications of its policy for individual projects.<sup>24</sup> Accordingly the permitted foreign capital participation varies between a nil rate for certain types of production in substitution for imports and 70 p.c. for special export-intensive projects.

In view of the wide differentiation between projects according to type and location and the Malaysian Government's flexible and pragmatic approach to foreign capital in the past it may be expected that investors will be allowed sufficient latitude in future negotiations so as to reach terms consonant with the particular circumstances of individual projects. Seeing that many other developing countries have resorted in part to far more restrictive practices, it may not prove as grave a circumstance as a strict comparison with the past suggests that these terms will not be the same as in previous years.

<sup>20</sup> Cf. FIDA, Annual Report 1974, *ibid.*, p. 126, Table IV.

<sup>21</sup> Cf. FIDA, Annual Report 1970, *ibid.*, p. 88.

<sup>22</sup> Cf. Mid-Term Review of the Second Malaysia Plan 1971–1975, *ibid.*, pp. 81 and 83, Tables 4–7.

<sup>23</sup> Cf. Wong S u l o n g, Oil Companies in Malaysia — an uncertain feeling, in: The Financial Times, June 3, 1975, and William P. H a r t l e y, Malaysia Scares away Foreign Capital with Rules for Redistributing Wealth, in: The Wall Street Journal, September 22, 1973.

<sup>24</sup> Cf. Dato Hamzah Abey S a m a h, *ibid.*