

New Initiatives towards Achieving an Industrialized Economy

George Leong

INTRODUCTION

The manufacturing sector has grown creditably since Malaysia embarked on active industrialization in the late 1960s. One of the key determinants of Malaysia's successful industrial and economic growth has been the country's quick response in introducing new initiatives to keep pace with the changing domestic as well as global environment. The Government has been constantly reviewing the industrialization strategies and programs although the objectives of industrialization have basically remained unchanged, of which are to diversify our economic base and increase our national income, to generate employment opportunities and to bring about an equitable distribution of wealth.

PAST INITIATIVES

Prior to independence, Malaysia was largely an exporter of primary goods, of which rubber and tin alone accounted for about 80 percent of the country's export earnings. During this period, there was little manufacturing and the contribution of this sector to the Gross Domestic Product (GDP) was only 8 percent. The manufacturing sector was characterized by small establishments, a relatively unskilled labor force and low capitalization.

Following independence, the Government began to accord the manufacturing sector increasing importance. The Government's strategies at that time, as reflected in the first two Five-Year Malaya Plan (1956-1965), were that it would confine itself to the creation of a favorable climate for private investment, achieved largely through the provision of an extensive infrastructure in the form of industrial estates, power and telecommunication facilities and the provision of tax incentives provided under the Pioneer Industries (Relief from Income

Tax) Ordinance 1958. The private sector was left to assume the initiative and responsibility for determining the pattern of industrial development. This resulted in the growth of import substitution industries which produced non-durable consumer goods to replace those which were previously imported such as food manufacturing and textiles.

However, towards the late 1960s, the steady worsening of the country's terms of trade made it even more necessary to pay greater attention to the development of the manufacturing sector. It also became apparent that the limited domestic market was reaching saturation and the country was facing a growing unemployment problem. Continuing to rely on an import - substitution strategy would have meant that the manufacturing sector's growth would be limited to that of the domestic demand for such products. Thus, in 1968, the Investment Incentives Act was introduced to encourage the development of not only import-substitution but also export - oriented and labor - intensive industries. It was also during this period, particularly during the early 1970s that the Government emphasized the importance of Direct Foreign Investments (DFIs) in manufacturing, especially in export-oriented and labor-intensive industries. To encourage such industries, Free Trade Zones (FTZs) were established and foreign investments were attracted into the country, particularly into export-oriented industries such as the electrical, electronics and textiles. At the same time, the Government provided some measure of tariff protection for those industries which supplied the domestic market.

The effective implementation of these strategies led to the rapid growth of the manufacturing sector in the 1970s, that is during the period of the Second Malaysia Plan (1971 - 1975) and the Third Malaysia Plan (1976 - 1980). It was the fastest growing sector of the economy, averaging a growth rate in output of about 12.0 percent per annum. Its share of the Gross Domestic Product increased from 13.4 percent in 1970 to 20 percent in 1980. Manufacturing employment grew at a rate of 8.3 percent. Industries that flourished in the 70s were food manufacturing, wood products, electronics and electrical and textiles.

In the mid-1980s, the adverse global environment took its toll on the growth of the manufacturing sector. During the period of the Fourth Malaysia Plan (1981-1985) the manufacturing sector grew at a rate of only 4.9 percent per annum. In 1985, the last year of the Fourth Malaysia Plan, the manufacturing sector experienced a decline in output of 3.3 percent.

Industrial development during the early 1980s was guided by an export-led growth strategy. Despite the provision of the export incentives, the sector was still inclined towards production for the domestic market. This was largely due to the overall incentives system being relatively more attractive to import-substitution activities. Certain selected heavy industries were also established during this period to expand the industrial base and foster greater linkages within the industry.

In view of the lack of a coherently integrated plan to develop the manufacturing sector, the Government undertook to formulate a ten-year Industrial Master Plan during 1983 – 1985. The Industrial Master Plan would recommend strategies and programs as well as set targets for the development of the manufacturing sector for the years 1981 – 1990.

Despite the slow down in manufacturing growth during the period of the formulation of the Industrial Master Plan the Government recognized the tremendous growth potential of the manufacturing industry in Malaysia. However, there was a need for more aggressive strategies and programs to develop the manufacturing sector. The Industrial Master Plan (IMP) was therefore launched. It recommended that there should be an outward oriented industrialization strategy based on the intensive development of resource-based industries for export and the diversification and upgrading of non-resource based industries for export. The strategy was to be supported by technology and manpower development, improved incentive systems, infrastructure development and the modernization and rationalization of the industrial sector. The Industrial Master Plan targeted the growth of the manufacturing sector during the ten-year period at 8.8 percent per annum.

INITIATIVES TAKEN DURING 1986 AND 1987

In response to the global environment and in line with the recommendation of the IMP, the Government undertook a number of measures to accelerate the growth of the manufacturing sector following the slow down in the mid-1980s. The more important measures undertaken were as follows:

1. *New Tax Incentives for the Manufacturing Sector* The Promotion of Investments Act, 1986 which replaced the Investment Incentives

Act 1968 came into force on 1st January 1986. Under this Act, a package of new incentives was provided particularly to encourage greater exports of manufactured goods. The Abatement of Adjusted Income for export incentive was introduced.

The Pioneer Status incentive was also modified whereby companies granted Pioneer Status would enjoy five years of tax relief irrespective of the size of the capital investment. To encourage expansion and reinvestment, pioneer companies manufacturing specified products would also be eligible for a further 5 year tax relief period on meeting certain additional requirements such as having achieved a total capital investment of at least M\$25 million or an employment level of 500 full-time Malaysian workers.

Manpower training, which is necessary for skill improvements and increased productivity, has generally been provided mainly by the Government. Apart from shop-floor training provided by some firms, private sector's contributions in this respect had been minimal. Recognizing the importance of training and the important role of the private sector in this area, the Government introduced the double deduction incentive for approved training to encourage private sector training in the manufacturing sector in 1987.

In a move to encourage Research and Development (R and D) activities to be undertaken by the private sector, the Government increased the incentive for expenses on R & D activities from 1 1/3 to double deduction in 1986.

2. *Raising the Level of Exemption from Licensing Industri Coordination Act, 1975* As part of the overall deregulation measures undertaken by the Government to stimulate private sector investments, the requirements governing the licensing of manufacturing companies under the Industrial Coordination Act were liberalized. On 12th December, 1985 the limits exempting a company from licensing were raised from less than M\$250,000 shareholders' fund to less than M\$1.0 million and from less than 25 full-time workers to less than 50. The exemption limits were further raised on 24th October 1986 to less than M\$2.5 million shareholders funds and 75 workers.

3. *Liberalization on Guidelines on Foreign Equity Participation* To attract greater foreign investments, the policy guidelines on foreign equity participation in the manufacturing sector as well as on the employment of expatriate staff were relaxed. At a Malaysian Investment Promotion Seminar in New York on 30th September 1986, the

Honorable Prime Minister announced a set of new conditions for foreign equity participation and the employment of expatriate staff. Foreign investors, whose applications are received by Malaysian Industrial Development Authority (MIDA) during the period 1st October 1986 to 31st December 1990, are permitted to hold whatever level of equity of up to 100 percent provided that the company's products will not compete with products presently being manufactured locally for the domestic market and that the company exports at least 50 percent of its production. Also, a company with a foreign paid-up capital of US\$2.0 million would be automatically allowed five expatriate posts.

INITIATIVES TAKEN DURING 1988 AND 1989

1. *Establishment of the Center on Investments (COI) in MIDA* In 1988, as one of the measures to further enhance the investment climate in the country and to further stimulate greater private sector investments, the Government undertook a comprehensive review of the conditions and procedures for investing in Malaysia. It became clear that despite the various administrative measures taken in the past to remove bureaucratic delays and red-tape, more would have to be done in these areas particularly during the post-licensing period to expedite the setting up of the manufacturing projects. An investor still had to approach many different Government departments and agencies to obtain the necessary approvals to implement their projects. To facilitate an investor in obtaining most of the approvals required at the Federal level, the Government established the Center on Investments in MIDA on October 1st, 1988. With its establishment, an investor need only to come to MIDA to obtain most of the approvals required at the Federal level with regard to the setting up of manufacturing projects. As the Center on Investment, MIDA has now also to receive, process and convey decisions in respect of the following:

- a. Applications for customs duty exemption on machinery and equipment.
- b. Applications for Double Deduction for Approved Training in the manufacturing sector.
- c. Applications for Double Deduction for Research and Development.
- d. Applications for extension of Business Visit Pass (not exceeding 3 months) and the conversion of Business Visit Pass to

- Temporary Employment Pass (not exceeding 3 months).
- e. Applications for approval to employ women workers for the night shift.
 - f. Applications for approval for overtime work exceeding 64 hours per month.
 - g. Request for verification of tariff codes.

In addition to the above, in order to be more effective as the one stop agency for investors at the Federal level, MIDA also took over several operational functions that were prior to October 1st, 1988, undertaken by the Ministry of Trade and Industry with regard to licensing and incentives at the 'post licensing' level.

In 1989, MIDA also took over the function of the evaluation of all joint venture and technical assistance agreements.

2. Liberal of Guidelines on Foreign Equity Participation in Projects Catering for the Local Market

In 1988, the Government liberalized the guidelines on foreign equity participation in manufacturing and integrated agricultural projects which cater primarily for the local market. Foreign investors would be allowed to hold 100 percent equity in projects catering for the domestic market if they were unable to find suitable local partners for their projects. They would be allowed to hold this level of equity for five years from the date of operation subject to the following three conditions:

- a. the company has to export a minimum of 20 percent of its manufacturing output;
- b. the foreign investor must approach the Ministry of Trade and Industry if local partners are not available for the project; and
- c. for integrated agricultural projects, the approval from the respective state Government with respect to conditions pertaining to land must be obtained.

At the end of the five year period, the foreign equity would be reduced in accordance with existing guidelines on foreign ownership based on the level of exports, in other words, companies would have to restructure according to the conditions of their approval. These new guidelines were valid for projects approved or licensed between October 1st, 1986 and December 31, 1990.

3. Tax Incentives for Small-Scale Industries

Recognizing the important role which the small scale industries are expected to play in providing linkages to large scale industries as well as in manufacturing

goods which have high value-added and are competitive both in the domestic and export markets, the Government introduced in 1989, a number of new incentives for small-scale industries. These are as follows:

- a. Pioneer Status incentive for those which propose to produce products which have been gazed as being eligible for the incentive and which meet specified criteria such as supply to big industries, export and local content;
- b. An increase in the Reinvestment Allowance from 40 percent to 50 percent;
- c. Full exemption from import duty on raw materials, components, machinery and equipment;
- d. An Abatement of Adjusted Income (AAI) to those companies purchasing from small scale industries. The rate of abatement is 5 percent of the adjusted income or 5 percent of the total value of components purchased, whichever is the lower;
- e. Double Deduction on cost of training with the National Productivity Center (NPC), Standards Industrial Institutes of Research Institute of Malaysia (SIRIM), MARA Institute of Technology (ITM) and the Malaysian Agricultural and Research Development Institute (MARDI).

The above incentives would be given only to those small scale manufacturing companies having shareholders' funds of M\$500,000 or less, incorporated in Malaysia under the Companies Act 1965, resident in Malaysia and having a minimum of 70 percent Malaysian equity. New initiatives were taken recently to further assist the development of small and medium scale industries. The Honorable Minister of Finance announced in the 1990 Budget the establishment of an Industrial Technical Assistance fund for small and medium scale industries. The Fund will provide grants on a matching basis to specific industries to help in feasibility studies and research and development. In certain instances, it may provide loans on a commercial basis. The Fund will have an initial contribution by the Government of M\$50 million and is expected to be operational in early 1990.

4. New Tax Incentives for the Manufacturing Sector New initiatives were also taken in the 1990 Budget to encourage the establishment of rattan and wood-based industries both of which are resource-based industries. The 1990 Budget provided additional tax incentives for rattan and wood-based industries. The incentives are as follows:

- a. The manufacture of rattan and wood-based furniture and furniture components will be eligible for an extension of Pioneer Status for an additional 5 years without having to comply with the present criteria on capital and employment.
- b. Companies which produce rattan and wood-based furniture components will be eligible for Pioneer Status if they export at least 60 percent (presently 80 percent) of their production and if at least 51 percent of the equity is owned by Malaysians.

To encourage the manufacture of rattan and wood-based products in Sabah and Sarawak, where such resources are presently exported in unprocessed form, additional incentives were to be granted which include a double deduction incentive on freight charges incurred by the companies.

Another new initiative is the introduction of the Industrial Adjustment Allowance (IAA) to be granted to companies which undertake rationalization of their operations. A manufacturing company which undertakes an approved industrial adjustment program may qualify for IAA of up to 100 percent of the qualifying expenditure incurred within a period of 5 years.

Industrial adjustment means any activity undertaken by any sector in the manufacturing industry to restructure by way of reorganization, reconstruction or amalgamation with the view to strengthening industrial self sufficiency, improving industrial technology, increasing productivity, enhancing the efficient use of natural resources and efficient management of manpower.

CONCLUSIONS

The initiatives taken by the Government in the recent years has helped the manufacturing sector to turn in a remarkable performance. The sector grew by 7.2 percent in 1986 and increased to 12.5 percent in 1987 and 15.3 percent in 1988. For 1989 the manufacturing sector is expected to grow by 13 percent. The sector has emerged as the leading source of the country's export earnings. In 1988, the exports of manufactured goods amounted to M\$26.9 billion or 48.5 percent of the total gross exports.

The contribution of the manufacturing sector to Gross Domestic Product has also steadily increased from 22.5 percent in 1987 surpassing that of agriculture for the first time to 25.1 percent (estimated) in 1989. It has now become apparent that the manufacturing sector possesses

tremendous potential for accelerated growth. Malaysia has become an attractive investment base for investors in view of, amongst other reasons, the conducive investment climate in Malaysia, the abundant natural resources, the excellent infrastructure and the ample supply of educated and easily trainable manpower that are available in the country.

In 1988, a record number of 732 applications for manufacturing licences under the Industrial Coordination Act was approved by the Government as compared with 333 in 1987, indicating an increase of about 120 percent. In respect of the total proposed capital investment, an unprecedented increase of about 131 percent was recorded rising from M\$3,934 million in 1987 to M\$9,093 million in 1988. The total employment proposed to be created by these projects was 136,647 compared with 59,779 in 1987. Malaysia's initiatives in promoting export-led industrialization has led to the rapid development of the manufacturing sector. Such export-led development is expected to continue in the future as data on the applications approved by the Government (Table 1) indicate that the share of export-oriented projects to the total number of approved projects has increased rapidly over the years rising from 33.9 percent in 1980 to 84.4 percent in 1988.

TABLE 1. Malaysia: Approved manufacturing projects

Year	Export-Oriented * projects		Total Manufacturing projects	
	Number	Capital Investment (\$ Million)	Number	Capital Investment (\$ Million)
1980	156 (33.9%)	844.9 (40.2%)	459 (100%)	2,102.8 (100%)
1985	147 (23.5%)	2,184.9 (38.4%)	625 (100%)	5,686.9 (100%)
1988	618 (84.4%)	7,183.2 (78.9%)	732 (100%)	9,093.9 (100%)

Source: * Malaysian Industrial Development Authority (MIDA) Annual Report. (Various issues)

* Project exporting 50 percent or more of their output

In considering future initiatives towards becoming an industrialized economy, Malaysia should continue to be guided by the Industrial Master Plan and take into account the present trend of global relocation of industries. Operations of manufacturing entities are being rationalized to optimize the advantages offered by countries the world over, so as to enhance their competitiveness in the world markets. Malaysia is strategically located to offer investors this unique opportunity. It lies in the heart of Association of Southeast Asian Nation (ASEAN), a fast growing regional grouping with a population of 280 million and a combined Gross National Product of more than US\$250 billion. Malaysia is also well located to serve the Pacific Rim countries where the potential for economic growth is greatest.

Lembaga Kemajuan Perindustrian Malaysia
Tingkat 6, Wisma Damansara
P.O. Box 10618
50710 Kuala Lumpur