The Great FDI Debate: Substance Or Subterfuge?
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The recently released UNCTAD World Investment Report (WIR) 2010 has ignited a heated but nonetheless welcome policy debate about Malaysia's foreign direct investment (FDI) performance and economic policies.

For those who have not been following the debate, two issues are involved. The first is the much steeper-than-expected fall in FDI inflow in 2009, while the second is the sizeable outflow of FDI from Malaysia.

Given the near global economic collapse in late 2008, the fall in FDI was not entirely unexpected. But while global FDI dipped by 37%, Malaysia's FDI fell by a whopping 81% from the previous year – from US$7.3 billion in 2008 to US$1.4 billion in 2009.

The second issue is a related but different one, namely, there was a FDI outflow from Malaysia to tune of US$8.04 billion, resulting in the country experiencing a negative FDI flow on a net basis.

Should we be concerned about these two issues? If so, how should we react? One thing is certain: We cannot understand, let along resolve, anything solely in macro and abstract terms. We need to examine the facts in detail but also holistically if we are to come to grips with the problem and propose solutions.

To begin, we must recognize that FDI flows can fluctuate wildly from year to year. In 2001, for example, Malaysia only managed to get US$0.5 billion but in 2002, FDI shot up by 540% to US$3.2 billion! Other countries have had similar experiences. Singapore's FDI inflow declined by 70% in 2008 but rebounded back by 54% in 2009.

Given the sharp year-to-year volatility, it is better to look at FDI over a longer period. When we do so, we see that FDI inflows to Malaysia have increased although not as robustly as other countries. From 2000 to 2009, the country's FDI inflows grew by 4.2% annually, while other countries in the region increased by double digits.

What about FDI outflow? Is it evidence that investors have lost confidence in Malaysia? Not necessarily. The US is ranked as the second most competitive economy in the world in 2009 by the World Economic Forum yet, in the same year, it had net FDI flows of US$118.2 billion. Japan and South Korea are in a similar situation.

FDI outflow can be due to many reasons and both strong and weak economies can be capital exporters. In Malaysia's case, two forces are at work. One is the excess savings over investment. So why is investment lower than the funds available? The government has been wrestling with this issue since the Asian Financial Crisis but more in a moment.

A second force is that Malaysian companies are aggressively seeking higher returns from abroad. Our industries are maturing and our companies have the ability to invest abroad. We are known in the Middle East, South Asia and Southeast Asia for our investment and expertise in petroleum, palm oil, telecommunications, banking and infrastructure.

Logically, we should not want to stop Malaysian companies from doing business abroad. Quite to the contrary, we should be encouraging them. This leaves, however, the issue of raising the lethargic rate of private investment. These problems have emerged over decades but we cannot take as long to remedy them.

The government is fully aware of the structural impediments and has begun to initiate changes. For example, since last year many foreign equity restrictions and quotas have been removed or relaxed and 27 services sub-sectors have been liberalized.

Many measures and funds have been given to promote innovation, R&D and technology development and acquisition. Education reforms, improving teachers' skills, expanding vocational and technical training, easier importation of skilled foreign workers and brain gain programs are among the measures to address the issue of skilled manpower.

The government transformation programme (GTP) aims to improve public sector delivery. A long overdue decision has been taken to corporatize and empower the Malaysian Industrial (now Investment) Development Authority because Malaysia needs to move faster in the highly competitive world of FDI.

The government also realizes that more need to be done which is exactly why it seeks a New Economic Model (NEM) for Malaysia. The first report on the NEM has addressed the FDI inflow problem critically, but I think, productively. It discusses challenges such as the lack of skilled workers, the low level of technological capacity, burdensome bureaucracy, fledging small-and medium scale enterprises, corruption, and lack of personal security.

The global FDI environment will remain challenging as advanced countries wrestle with their growth, deficit and debt problems. It is imperative that we do not resist change and merely insist on the status quo. But it is equally imperative that we do not initiate counter-productive change. The present economic and government transformation reforms must be taken seriously if we want to be an attractive investment centre and to return to being an economic dynamo.

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