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'NEP not to blame for decline in FDIs'

By Muhammed Abdul Khalid

ONCE in a while, the debate on the New Economic Policy (NEP) resurfaces, and majority would argue that the policy is the source of all problems facing this nation. The latest came from Tan Sri Ramon Navaratnam's "Time not on our side as we stride forward to Vision 2020" (The Star, May 31), in which he argued that the NEP is one of the main reasons for the decline in foreign direct investments (FDIs) into Malaysia.

Sad to say that Tan Sri Ramon's argument is empirically incorrect as most of the foreign companies that have set up operations in Malaysia are no longer constrained by the NEP's equity shareholding requirement since the past several years.

For instance, since 1998, Malaysia has completely liberalised its manufacturing sector by allowing 100 per cent equity ownership without any conditions imposed. In fact, export-oriented companies have been allowed to be fully owned since 1986. Similarly, the services sector which accounts for nearly 60 per cent of Malaysia's gross domestic product (GDP) is partially liberalised following the liberalisation of 27 service sub-sectors in 2009, with no equity conditions imposed. High tech industries, in particular companies that are established in the Multimedia Super Corridor (MSC) are also allowed to be fully owned by foreign investors.

All these points imply two things. First, contrary to his argument, Malaysia has loosened its Bumi requirements several years ago and second, despite not having such requirements, FDI inflows remained subdued in the past several years, suggesting that other factors than the NEP could in fact be the real reasons behind such a dismal FDI performance.

Arguably, what matters most for foreign investors are not NEP related requirements but rather the political stability, policy consistency, excellent infrastructure, generous tax and non-tax incentives, prospects of commendable returns on investment as well as, cheap and educated labour force that a country can provide.

Furthermore, had the NEP really constrained FDI inflows, Malaysia would not have seen the influx of foreign investments towards the late 1980s and in the 1990s, up to the crisis year when the requirements under the affirmative action were rigorously enforced. On the contrary, net FDI inflows into Malaysia were not only positive but also among the highest in the region.

This is evidenced from the FDI-to-GDP ratio which doubled to 6.6 per cent during 1991-1996 from just 3.3 per cent during1970-1984, with a record high of 23 per cent registered in 1992. The level of private investments was so high in the mid-1990s that its ratio to GDP surged to over 40 per cent, causing the country's savings-investment gap to turn negative as implied by the yawning current account deficits during that period.

Nothing could explain that period of investment boom other than the right cocktail of favourable economic and political factors. Besides, during the period of 1990-1999, Malaysia's FDI flows climbed at a much faster rate compared with that of other Asean countries, with an average annual growth rate of 19.5 per cent for FDI inward stock, higher than the Philippines' 14.2 per cent, Thailand's 10.8 per cent and Singapore's 11.3 per cent.

Admittedly, FDI inflows into Malaysia have subsided post-Asian crisis and have been on a declining trend, especially since 2007. Such a trend is due to a confluence of factors - key among them is the rising labour cost.

Prior to this, Malaysia's attractiveness to foreign investors was largely explained by its cheap labour force, which is no longer the case in recent years. Even our down south neighbouring country, Singapore, also saw its share of FDI to GDP drop by half to 9.2 per cent in 2009 from 19.1 per cent in 2006, despite being perceived as a more liberalised economy.

Thailand faced the same problem, with its share of FDI to GDP declining by half to merely 2.3 per cent over the same period. Nevertheless, other regional countries, namely Vietnam, Cambodia and Indonesia are still offering a combination of factors favoured by foreign investors - cheap labour, abundant land and huge domestic market - things that Malaysia does not offer anymore.

The most critical of all, these three countries offer incentives for labour intensive industries which Malaysia correctly no longer promotes. United Nations Conference on Trade and Development (UNCTAD), in its 2009 report, stated that foreign investors placed market growth as the topmost priority when it comes to deciding on an investment destination, followed by the availability of cheap labour, and, in some cases, access to natural resources.

It is also found that while government effectiveness, regulatory quality, rule of law, and corruption are important considerations, these are not their main concerns. This explains the huge investment inflows into India and China, and even Vietnam, despite being ranked much lower than Malaysia in the World Bank's Ease of Doing Business Index where Malaysia was ranked 21 out of 183 economies versus Vietnam's 78th position, China's 79th and India's 134th.

If we decompose the FDI components, one can see that the declining trend in net FDIs into Malaysia is largely attributed to outflows of funds, partly due the repatriation of dividends and earnings by existing investors as well as increasing Malaysian investments overseas (usually termed as reverse investments), mainly due to cross border acquisitions especially in the area of telecommunications and banking.

This is reflected in the amount categorised as Direct Investment Abroad (DIA) which continued to chart an upward trend since the beginning of the millennium, increasing from a mere 0.3 per cent of GDP in 2001 to 5.6 per cent of GDP in 2010. As a result, the net international investment position (IIP) posted a positive balance in the past two years, reflecting an increase in the amount of assets held overseas by Malaysian companies. This positive development, however, was reflected in the FDI account as negative numbers.

Blaming the NEP for the decline in FDI inflows into Malaysia is factually incorrect. Being critical of a government policy or NEP is one thing but being objective in doing so is another.

Admittedly, there is still room for improvements, and we do need to deal with our weaknesses in luring foreign investments as correctly pointed by Tan Sri Ramon, but let's do it objectively.

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