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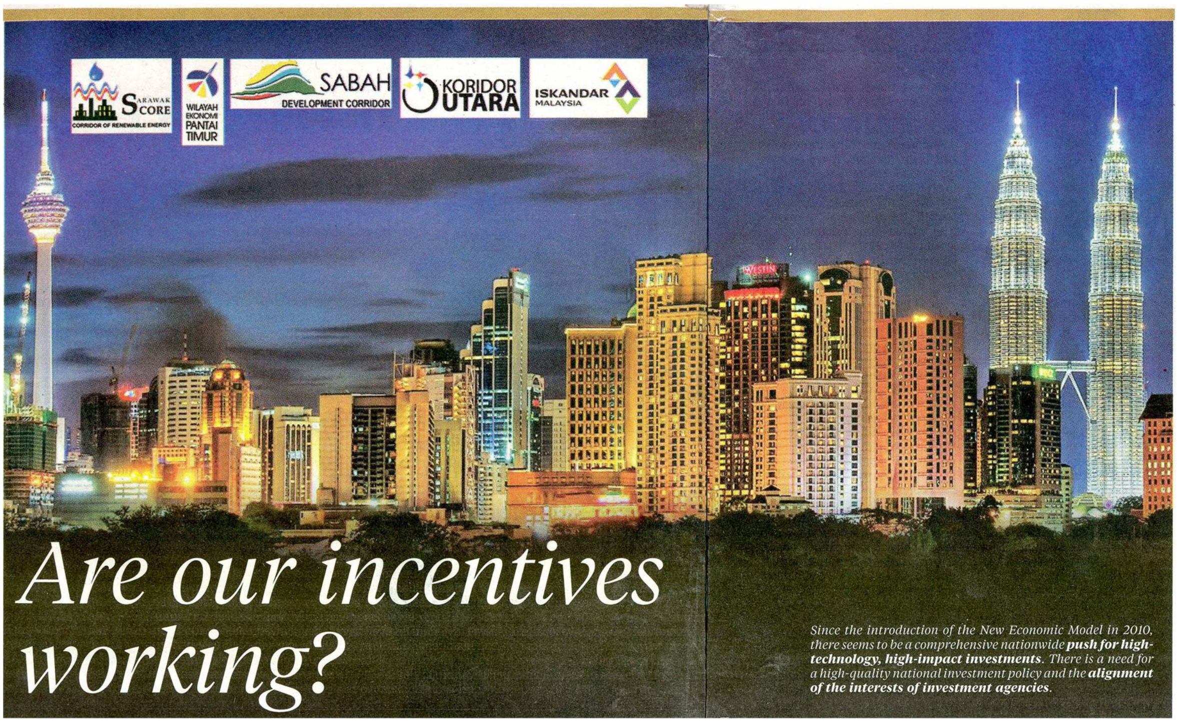

By Firdaos Rosli

COMPETITIVE: *High-quality investment requires high-quality policies*

MANY countries, including Malaysia, have been actively employing investment incentives as a means to encourage foreign direct investment (FDI) inflow into the country. These incentives come in various forms - fiscal (tax holidays) or monetary (loans and subsidies), and sometimes, a combination of both. Pray tell, is there a country that does not offer such incentives in attracting FDI today?

The fact remains, though, that the government incurs loss of potential revenue through investment incentives. It is difficult to assess their effectiveness, especially when there is no guarantee that technology and managerial skills transfer occur as a result of FDI. Undeniably, as investment incentives often favour foreign firms, can we also conclude that they disincentivise domestic investment?

Malaysia introduced investment incentives when its import-substitution strategy reached its limits of industrial enlargement. The government realised that the domestic market was too small to grow and thereupon introduced export-orientation policies to reinvigorate manufacturing growth, starting with Incentives Act 1968 and Free Trade Zones Act 1971. Multinational companies, particularly Japanese-owned ones, responded positively, as they not only reduced business costs, but also risks by investing in Malaysia.

The Malaysian Industrial (now Investment) Development Authority, or Mida, was the first and only government agency mandated to coordinate investment promotion and provide incentives to foreign firms. However, since the mid-1990s, Mida’s role in investment promotion is increasingly shared by other government agencies with similar functions, such as the Multimedia Development Corporation, Biotech Corp, Halal Development Corporation and five economic corridors throughout the country. Obviously, these agencies carry different organisational interest and objectives, despite having a similar mandate.

Presumably, the more salespeople you employ, the more potential revenue could be generated due to the increase of customer touchpoints. But perhaps, this is not so in our case.

Firstly, the law of diminishing returns is evident in areas as fundamental as investment promotion, notably when these agencies do not share a common information/data and communication platform, activities and investment monitoring mechanism. This is compound by the fact that the promotional activities of these agencies crowd out the private sector's voice in promoting the country. Secondly, Malaysia's investment agencies are unable to enhance its competitive advantage any further, as other countries, particularly neighbouring one, are offering similar incentives as well.

Malaysia has always been playing second fiddle for FDI in the Asean region. For the period between 1980 and 1995, Malaysia attracted US$34.69 billion (RM125 billion) worth on investment – more than double that of third-placing Thailand's FDI, which amounted to US$16.89 billion. However, the following decade was different for both countries, in which they switched places for the first time. For the period between 2000 and 2011, Thailand recorded FDI inflows of US$101.63 billion, while Malaysia secured only US$80.46 billion worth of FDI.

At this point, the competition for FDI became feistier. The government saw the need to turn the tide by institutionalising new investment promotion agencies (IPAs) that could boost FDI inflow at a speedier rate. Such a strategy would require IPAs to be more in tune with the needs of the private sector by carrying out more industry- and location-specific objectives. They aim to not only attract high-quality investments, but also favour foreign firms with high technology capabilities by offering them customised incentives.

Sadly, despite being "closer" to the industry, Malaysia's IPAs continue to offer "generic" incentives to attract FDI. Generic incentives in this context mean that they are identical to competing foreign IPAs and, ironically, the domestic ones, as well. This opens up a new dilemma - incentive competition exists among government agencies instead of competing with the IPAs of other countries.

Let the truth be known that attracting high-quality investment requires high-quality policies. Generic incentives are incomplete because they offer no complementary role in increasing investor confidence and protection in the country. Malaysia cannot expect to attract high-quality investments in a market where foreign firms can afford to shop for the most generous incentive at a click of the mouse. Worse still, they can even use it as a bargaining chip to secure nontransparent customised incentives with the IPAs of their choice.

Since the introduction of the New Economic Model in 2010, there seems to be a comprehensive nationwide push for high-technology, high-impact investments. Malaysia cannot depend solely on Mida or the International Trade and Industry Ministry to develop a high-quality investment policy. Attracting investment requires a nexus of high-quality policies, involving education, labour, wage, technology, trade, competition, environment, intellectual property rights and, more importantly, immigration. Developing such national policies must first be tackled by aligning the interests of relevant investment agencies, and this can only be done at the highest level.

Today, foreign firms have the upper hand in choosing the most attractive investment destination. Countries are no longer able to choose foreign firms that they desire. Incentives that are too relaxed and generous are indeed a race to the bottom, as the "winner" often exposes the country to a situation where the barrier to entry and exit is virtually zero.

China is reviewing its national investment policy as we speak. Shall Malaysia play second fiddle to that yet again?

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