Seeking World Capital and Promoting Domestic Investment

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Capital is almost inevitable these days. As countries in the world are trying to grapple with uncertainties and unfavourable circumstances shrouding their economies, many are faced with deteriorating foreign direct investments and thus, capital. This is made worse by the recent horrendous devastation on America's World Trade Centre, dubbed the nerve of the world's financial system/activities. Traditional suppliers of international capital are currently in a slump. Growth prospects in the US seems marginal, while Japan and Germany are still suffering. Besides the depressed price of assets, Japan is also facing a liquidity trap. Japanese firms, regardless of size, suffered sharply lower profit margins due to the worldwide slump of a wide range of their products resulting from the global economic slowdown. To restore profitability, these companies cut back capital expenditure and personnel. Foreign investment by Japanese companies reached a peak at the turn of the decade but has since plunged. Portfolio investment by Japanese pension funds and insurance companies have also come to a halt. Even some huge Japanese banks have closed down and those which survived have scaled down lending to foreigners and are bringing back capital to strengthen its balance sheets back home. This is in stark contrast to the traditional Japanese role of being a capital exporter.

Another major supplier of world capital, the European Community (EC), is in no better shape compared to Japan. Germany, the locomotive of the EC, has staggered under the burden of the 1990 unification plan. It is perceived that the initial approximation of the costs of unification was grossly underestimated. Unification of the two Germanys is a long-term problem and it is expected to take about 20 years to achieve. Recent estimates suggest that annual transfers from the West to the East in past years amounted to 4-5 per cent of its GDP. Other EC countries are not doing well either. France's economy is still trotting along, suffering under the high interest rate regime.

Malaysia's concern about current developments of the world capital market stems from the fact that we have relied heavily in the past on foreign direct investment (FDI), particularly from the multinational corporations (MNCs) to accelerate its industrialisation programme. Now that the parents of many of these foreign-owned companies are suffering financially, this raises doubts regarding the capacity of these firms to continue to invest overseas. These are legitimate concerns, given the

prevailing uncertainties in the world economy. Although many analysts expect major changes for capital flows in the world financial system in the new millenium, nonetheless, individual country circumstances will feature prominently in shaping the outcome. In most cases, it is expected that new capital needs will have to be met from domestic resources to compensate for dwindling external sources.

Competition for jobs, markets and capital is increasingly intensified. Most companies realise that downsizing and laying off redundant workers would not be enough to gain real competitiveness. In this new age of information technology (IT), many have jumped on the IT bandwagon to retool and invest in more efficient technologies and equipment.

Should the worldwide investment situation be stepped up, capital will tend to flow to the more productive companies with higher returns, incurring the lowest risks possible. The cost-cutting currently undertaken by the corporate sector will improve the competitiveness of the industrial countries. Against a backdrop of rising competition for dwindling global capital, Malaysia needs to adjust and address some pertinent issues related to FDIs and other sources of investment in order to stay competitive and sustain growth in the reformed international market. China, which absorbed 60 per cent of FDIs into Asia in 1999, will be a major threat to regional economies, including Malaysia. Notwithstanding this, Malaysia is less worried as its domestic financial system is relatively sound with sufficient liquidity for the next few years. While many countries are struggling to overcome their economic woes and improve the inflow of their FDIs, Malaysia, through its financial resources, thanks to its high savings rate, should undertake necessary measures to strengthen domestic investments so as to mitigate the adverse effects of the slow inflow of FDIs on industries, especially the small- and medium-scale industries (SMIs).

In the face of uncertainties about FDIs, it is important for the government to promote greater local initiative to take up the expected slack of foreign investment. There is, thus, a need to look at the investment policy in a more strategic manner and devise competitive policies and incentive packages to promote local investment.

In this regard, the issue of poor linkages between foreign and local firms, as pointed out by the Second Industrial Master Plan (IMP2), needs to be addressed. Indeed, the government has taken positive steps towards promoting the development of SMIs. Such industries are still dominated by small, backyard firms using outdated technology and poor plant layout. Special industrial zones are allocated to SMIs to allow easy access to the government delivery system.

Another lingering issue is the low level of technology transfer from the foreign firms to their local counterparts. Although the number of technical agreements signed by the foreign investors has increased, technology transfer through FDIs still leaves much to be desired. The low linkages between the foreign and local firms, and the high import-content of most of the foreign firms reflect the low valued-added nature of foreign investment. The low domestic value-added, in turn, implies the low level of technology transfer from the foreign firms. In this respect, while the government should ensure a high level of technology absorptive capacity within the domestic labour force, foreign investors must be encouraged to participate more actively in the effective transfer of technology to the locals.

Fiscal incentives, though not a deciding factor in plant location, are often treated as compensation for disincentives. Malaysia has offered generous and wide-ranging tax incentives in the past to attract foreign investment. Although such incentives have been regularly reviewed and adjusted as per prevailing market conditions, similar attractions are being offered by other countries as well. While the selectivity of the government in the desired type of investment should be continued, the shift towards higher value-added and high-tech industries should also be accelerated even further, given the threat of declining competitiveness.

However, the withdrawal of certain incentives should be accompanied by the dismantling of the disincentives to ensure that the country remains competitive for foreign investors. This is particularly important in the face of global competition for capital and the need to attract more foreign investment into the country to drive economic growth.

Although FDIs may not be as forthcoming as desired, local industries should not view this as a deterrent to them, but rather, as a challenge as to how they can upgrade productivity and product quality so as to compete with foreign firms and on the international arena. On their own initiative, local industries could improve their R&D activities to attain higher, if not advanced, technology, and upgrade modern machinery and production processes. With the right resolve, these are challenges well within our country's reach.