〈研究論文〉

FTZ Development for Export-oriented Industrialisation in Penang, Malaysia: The Role of Government in Supporting TNCs and Local SMEs

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Free trade zones (FTZs), or export processing zones (EPZs), have been conceived as a linchpin of the export-oriented industrialisation of Malaysian electronics industry. Actually, it was not until the establishment of the first FTZ at Bayan Lepas on Penang Island in 1971 that the export-oriented industrialisation substantially started in Malaysia. Penang's FTZs have attracted a number of Transnational Corporations (TNCs) from the US, Europe, Japan and the Newly Industrialising Economies. They propelled the rapid industrial development of the Penang as well as its neighbouring states, in which electronics industries have played a central role. In such a historical context, it is reasonable to assume that Penang's electronics industrialisation has been deeply linked with its FTZs development (Rasiah 1993). In this regard, it is important to note that FTZ development does not necessarily lead to an overall development in the territory. To continue the trend of the successful attraction of FDI, growing attention has been paid to the development of local enterprises, or small and medium-sized enterprises (SMEs), in the industrialisation process, as local development with TNCs is critically determined by the incorporation of local firms in global networks in which the role of government is decisively important. Based on this view, this study examines the Malaysian industrial policies on FDI and SMEs in the light of Penang's FTZ development.

Ⅰ. FTZs for Export-oriented Industrialisation

1. What is a FTZ?

FTZ is often used interchangeably with other similar words such as export processing zone (EPZ), free zone (FZ), and special economic zone (SEZ). The following argument uses the word "FTZ", as does Malaysian government. FTZ is defined as an industrial estate specialised in processing duty-free goods for export. In short, an FTZ is trade enclave which is privileged to import raw materials, process them, and then export to the world market. A FTZ is geographically, physically or legally separated from other principal custom territories. In a FTZ, investors are offered a variety of incentives such as duty free imports, tax holidays and sometimes liberal labour and environmental regulations. The intermediate goods and materials are imported with duty free, while the goods produced there are normally not allowed to be sold in the domestic market. Excellent infrastructure facilities such as well-designed factory space, efficient transportation, telecommunications, stable supplies of electricity and water and waste

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disposal facilities are normally available in FTZs. The provision of such facilities is funded directly by government or through public or private development corporations.

FTZs have appeared as one of the important strategic tools mainly for developing countries since the 1960s to attract foreign direct investment (FDI) for export-oriented industrialisation. The success of some of the early FTZs such as the Shannon FTZ in Ireland in 1959, the first FTZ, Taiwan's Kaoshiung EPZ in 1966 and South Korea's Masan in 1970 stimulated the policy-makers' interest in leveraging FTZs for export oriented industrialisation. In general, the principal and direct objectives of establishing FTZs are to induce domestic and, particularly, foreign direct investments, increase exports to earn foreign exchange earnings, to generate employment opportunities, and stimulate regional economic development. Technology transfer including both production and management skills and linkage creation with local economy are also expected in FTZs activities; however, these are often considered as the secondary or indirect objectives and can come to the fore after the principal objectives are successfully achieved.

Nowadays, FTZs have become an important export base for developing countries. Major exports from FTZs include electronics, garments, telecommunications equipment, auto parts and other related items. These products are principally labour intensive and, at the same time, their assembly requires repetitive, tedious, and often dangerous works which may not be suitable for automation. For firms in developed countries, they often transplant labour-intensive segments of production to FTZs in developing countries in order to take advantage of low cost labour. For developing countries, on the other hand, FTZs are used as a means to diversify their economic activities away from the traditional agriculture towards export-oriented manufacturing. Actually, Haywood (2004) reports that, according to the data at changes in level of exports from 1993 to 1996 in countries exporting to the United States and Europe, developing countries with FTZs achieved an increase in exports of 72%. On the other hand, those without zones were only with 1%. Clearly, FTZs are powerful vehicle for developing countries anxious to promote export-oriented industrialization.

Paradoxically, FTZs are far from "free." They are regulated environments in which the regulations are different from those in the rest of the national economy. In most cases, the rules are more liberal, though ironically in many cases FTZs environments are effectively more controlled and often need to follow the rules of law more strictly than the rest of the economy. For example, while many industrial zones have no duty charged on imports and/or exports, the flow of items are tightly monitored and controlled by customs in order to prevent smuggling into the ordinary customs territory.

By their very nature, FTZs are bound to configurate "enclaves" isolated to a large degree from the rest of the economy. FTZs are practically distinct from the ordinary customs territory; therefore, domestic sales of goods produced in zones are treated as imports, just as if those goods had been produced overseas. At the same time, zone firms can enjoy using duty-free imports from foreign countries as well as other zone firms. This institutional setting discourages the firms to source raw materials and components locally, particularly if the transport costs of sourced items are relatively low. As a result, the backward linkages from zone firms to local input suppliers are normally limited and minimised. Moreover, the fact that the goods produced in zones are almost all destined for export, mostly to developed economies, requests that the quality of raw materials and components sourced by zone firms must meet the international quality standard. Such a high quality normally cannot be attained with local firms' capability, although only limited types of marginal items such as corrugated boxes and plastic bags are purchasable locally. Without any inducement, FTZ firms may have little interest in raising local content and quality of local items through technology assistance because they can purchase raw materials and components in requisite quality from overseas with duty-free international prices. Thus, there is a valid reason to believe that "enclave" nature of FTZs leads to zone firms to create weak and meagre linkages with local economies and suppliers. Along with the issues of employment and income generation, policy-makers are also concerned to create healthy industrial linkages within FTZs, because it may help to maximise spillovers from FTZ firms to local economy. This is one of the most important viewpoints to evaluate the performance of FTZ activities in developing countries.

2. FTZ Analysis and Evaluation

The economic pay-off of FTZs has been a controversial issue among economists and policy-makers. Traditionally, the FTZ performance is examined by using a cost-benefit framework (Warr 1989, Johansson 1994, Jayanthakumaran 2003). Cost-benefit analysis is useful to examine the balance between economic loss and gains induced by FTZs activities. Economic theory usually argues that FTZs are welfare-reducing for the host economy due to a distorted free market mechanism; however, a catalytic effect of FTZs often provides counter evidence in which a rapid expansion of export results in booming of local economy. On the other hand, FTZs provide TNCs tax incentives such as Pioneer Status, Investment Tax Allowance, and Reinvestment Allowance, which incur opportunity costs in the form of government revenue. In addition, the potential costs include import tariff breaks, administrative and maintenance costs of FTZs, and the net costs of government-funded infrastructure facilities offered to FTZ firms. On the other hand, the net benefits appear directly as a form of increased employment. Foreign exchange earnings and increased purchase of local materials and inputs also contribute to the local economy (Warr 1987). The evaluation is made usually by using the net present value criteria. However, the cost-benefit framework receives criticism, as it fails to take into account dynamic and multifaceted nature of FTZ development such as clustering and spillovers effects induced by the interaction between TNCs and the host economy.

Instead of using the traditional cost-benefit framework, this study proposes to use the FTZ lifecycle approach to analyse the performance of FTZ development. It is widely acknowledged that a successful FTZ changes itself dynamically, undergoing several distinct economic processes. The original model of this approach is proposed by Basile and Germidis (1984). Several studies follow this concept (Schrank 2001, Omar and Stoever 2008), focusing on the dynamic nature of FTZs in order to analyse how FTZs need to evolve over time according to the host economy modernises and liberalises. The approach aims to identify the elements supporting FTZ development, in which FTZ development process is broken down into four or five phases. However, my study will make use of this approach from a slightly different angle. For the purpose of the present study, FTZ development as lifecycle provides a powerful lens through which to evaluate the government policies for FTZ-based industrialisation. Obviously, every different stage of FTZ development may call for a different set of objectives to which a different set of policies should be prepared and implemented. For example, employment creation may be one of the prime goals immediately when a FTZ is established; however, if successful, at a later stage, major policy goals may shift to, for example, nurturing higher value-added activities such as research and development. Thus, government is expected to appropriately offer a set of economic policies suitably according to the different stages of FTZ development. I examine what policies were planned and implemented at what timing and what condition it was in Penang FTZs. This study applies FTZ lifecycle model to examine Malaysian government policies from such a point of view.

Ⅱ．FTZs Development in Penang

1．Establishment of FTZs

In Malaysia, the FTZs were introduced as a part of the export-oriented strategy which started around the late 1960s. Interestingly, unlike zones in other Asian countries, the FTZs in Malaysia were established in a rather decentralised manner, promoted by local or federal bodies which sought to promote the regional economic development at a state level. The need for establishing FTZs was most serious in Penang, due to its unique status as an island state. During the British colonial period, Penang was flourishing greatly, enjoying a special privilege as an entrepot centre for commodity exports from northern Malaya and was also a port of immigration for Chinese and Indian workers destined for the mines and rubber plantations. Following independence, and until the end of the 1960s, Penang remained a free port nominally; however, substantially this privilege had been gradually diluted. Coupled with the rise of other growth centres in Peninsular Malaysia, the end of Penang's free port status resulted in the scaling down of commercial activities and loss of jobs. The local economy seriously stagnated and, the rate of unemployment in Penang was nearly double that for the national average. A public-funded institution explains the then-situation as follows.

> The early part of the country's independence shifted the focus of economic and administrative developments to the Kelang Valley region, in particular Kuala Lumpur. Various other political developments, especially the period of confrontation with Indonesia following the establishment of Malaysia, also contributed to the decline of the State as a trading centre. This shift of the centre to the Kelang Valley culminating in the revocation of Penang's free port status in 1969 and the high unemployment rates of around 9%† during that period resulted in significant political changes in the State [⋯]. (ISIS and PDC 1991, 1-1)

Given the problems encountered by Penang, traditional sectors such as agriculture, fisheries, and trade were considered too small and slow in growth

† The figure rises around 15% when underemployment is taken into consideration.

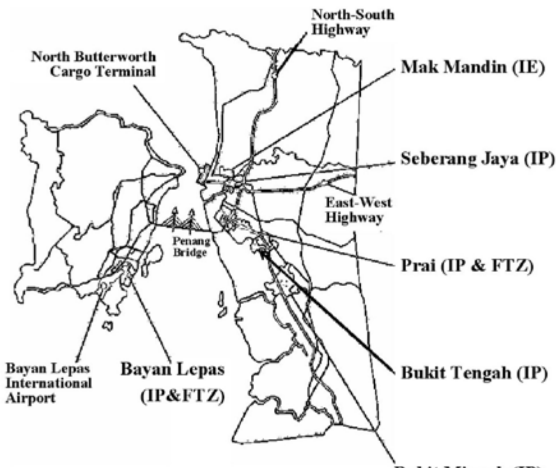
to absorb unemployment. The manufacturing and general service sectors, e.g., tourism, were identified as the main engines of economic growth. Then, a radical and ambitious plan was proposed to promote a massive and aggressive industrial development of Penang.

It was not long before steps were taken to give a strong push to the economy. The Penang Master Plan Study was undertaken in 1969 by U.S-based consultancy Messrs. R. Robert Nathan and Associates. The Study called for the linking of the State's economy with the rest of the world mainly through greater foreign linkages and ties with TNCs. At that time, FTZs in Taiwan and Korea showed a gradual sign of successful export-oriented industrialisation. Penang decided to follow this strategy: the development objective began with the establishment of the FTZ which was the first in Malaysia, and was expected to induce the rapid entry of a number of electronics firms, particularly in semiconductor packaging. In fact, FTZs played an integral role of the Master Plan for development of the state.

To achieve these objectives, in 1971, the Penang Development Corporation (PDC) was established by the State Legislative Assembly explicitly with a view to promoting the regional development through the expansion of export-oriented labour-intensive manufacturing. The PDC played a central role in establishing the first FTZ in January 1972 at Bayan Lepas in the south-eastern corner of Penang Island. Greatly thanks to the active promotion of PDC, the initial start of Penang FTZ strategy was successful: twelve major TNCs, namely AMD, Clarion, Fairchild Semiconductor, and Intel as well as several textile companies, were established in the first year, or in advance, of 1972. Due to an ideal location for electronics off-shore production with its proximity to the Penang International Airport, the Bayan Lepas FTZ started as the first electronics cluster in Malaysia. The FTZ was extended later in three further phases, followed by the establishment of two additional zones in the mainland at Prai and Prai Wharf, suitable for industries producing heavy or bulky items such as metal and plastics. Later in 1985, the 13.5km Penang Bridge was opened to link Penang Island to the mainland, facilitating efficient land transportation and logistics among FTZs within Penang (See Fig.1).

After the establishment of FTZs, Penang's economic structure changed drastically. The share of the manufacturing sector grew from 12.7 percent to 41.0 percent of Penang's gross domestic product

Fig.1 Map of Free Trade Zones (FTZs), Industrial Estates (IEs) and Industrial Parks (IPs) in Penang



(Source) Statistics, Penang, Malaysia 1997

(GDP) in 1970 and 1980, respectively. At the same time, the manufacturing sectors contributed to generating employment opportunities in Penang. The number of employees in the manufacturing sectors increased from 31,985 in 1970 to 91,516 in 1980. Correspondingly, the share of the manufacturing sectors in total employment in the state went up from 15 percent in 1970 to 28 percent (figures are quoted from PDC 2003). Thus, Penang's manufacturing success was obvious in the 1970's and early 1980's, mainly thanks to the active contribution of PDC to inviting global companies.

It is also important to note that the international economy in the late 1960s and early 1970s was highly favourable for Penang to start export-oriented industrialisation under FTZ strategy. The FTZs in Penang were established at a time coincidentally when developed countries' TNCs, particularly U.S. semiconductor companies, needed to transfer their labour-intensive operations to Third World countries in order to take advantage of lower wage costs. Grunwald and Flamm explain the economic background at that time.

> Confronted with low-cost foreign competition, American producers followed one or the other of two paths. One was to invest heavily in capital equipment and automate the production of transistors. This was the path taken by Philco. […] The other path, pioneered by Fairchild, was to beat the Japanese by taking the labor-intensive stages of production to Far Eastern location where wages were even lower than in Japan. This was a successful strategy, quickly copied by other U.S. producers. […]
>
> After 1967,producers moved into Mexico; from 1968 on, important plants were also located in Singapore. In 1972 Malaysia became an important area for export production. (Grunwald and Flamm 1985, 69-71)

TNCs, especially the semiconductor companies, thus began converging on Malaysia, particularly on Penang, to transfer their labour intensive segments in order to utilise lower wage advantages. Without such a global trend, export-oriented strategy with FTZ in Penang should have been less successful than it actually was.

The 1969 Penang Master Plan Study pursued two principal objectives. The first was, as is mentioned above, to create employment opportunities through reinvigorating the local economy by manufacturing exports and broadening the base of economic activities. The second was to promote the development of rural areas through industrialisation and urbanisation to reduce economic imbalances among different ethnic groups within Penang. The FTZs were considered a powerful tool for these objectives, as they were expected to provide huge employment potential with income generation, as well as to serve as a means to create employment opportunities for the economically disadvantaged majority Malay community, absorbing them into the more productive manufacturing sector from agricultural and rural sectors on which they depend. In a broader context, the development of manufacturing industries was regarded as an important integrant for the central government's strategy "New Economic Policy (NEP)," which aimed to redress the "racial imbalances in the economy" as a cause of the riot of May 1969.

2. Development of FTZs in Penang

Penang's development objectives were very clear – to reduce unemployment with economic equalisation. As the Penang state government, coming into line with the central government policies, placed the priorities on employment generation, FDI were invited virtually without any precondition. Consequently, there was little or no attempt to screen and control foreign investment proposals as well as to impose performance requirements in the areas of, for example, local content or technology transfer. As a result, technology transfer and the creation of industrial linkages were less prioritised at the time of establishment of the FTZs. Actually, in the 1970s and early 1980s, forward and backward linkages were generally meagre in Penang FTZs where TNCs enjoyed the enclave advantages of FTZs with duty-free imports. This was clearly reported by Nesadurai (1991) as follows;

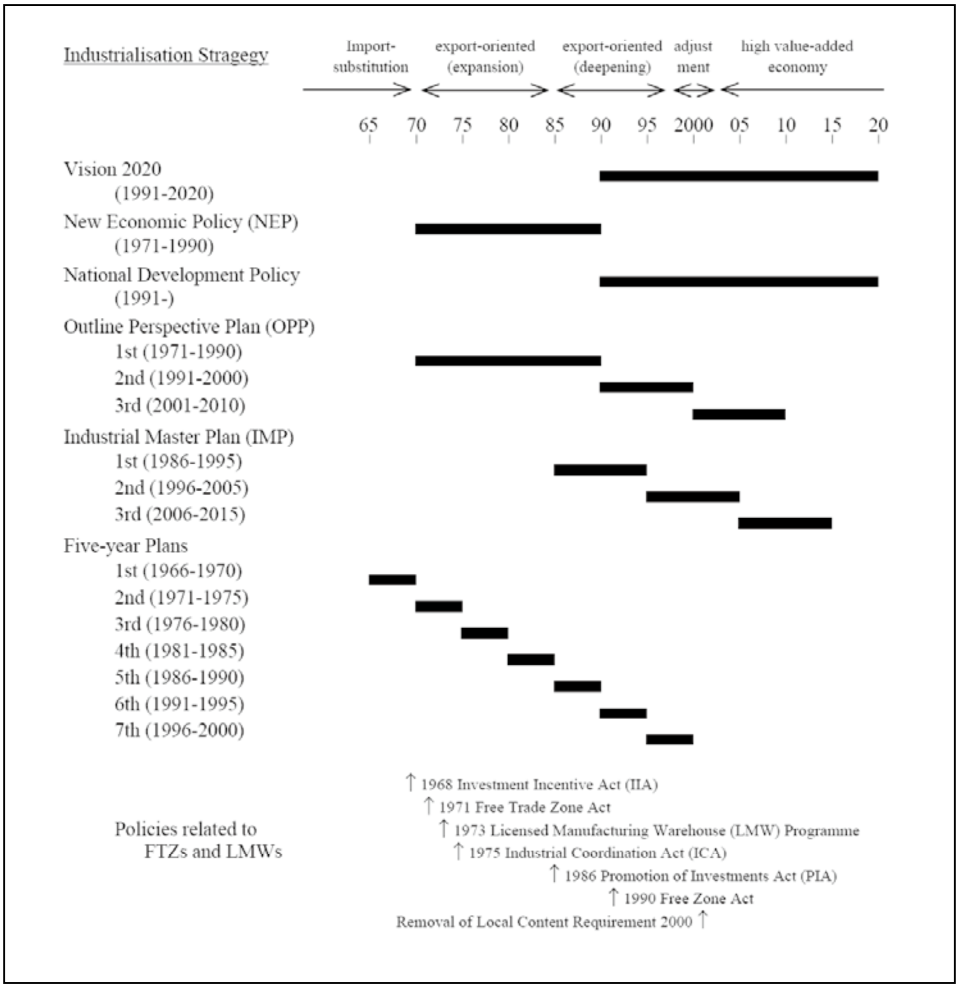
> Linkages between FTZ firms and the local economy through sourcing of raw materials and other intermediate inputs, including capital goods, were not well developed despite more than a decade of operation. Almost 90 percent of the necessary raw materials and intermediate goods required by the FTZ firms were imported. The excellent export performance of the FTZs was thus marred by the import-intensive nature of the firms. Between 1976-83, the proportion of total imports to total exports of these firms ranged from between 60 percent to 90 percent (Nesadurai 1991, 122).

It should be appreciated that the change and development in FTZs industrial structure, including linkage creation is significantly affected by a series of the central and local government development policies. Actually, Malaysian industrial policies changed drastically during its rapid industrialisation process, under which the evolution of Penang FTZs was induced. The following section examines this.

Ⅲ. Government Policies for FTZs Development in Penang

As is explained above, FDI and TNCs were leveraged as one of the major means for Malaysia to achieve the objectives of economic policies both at the national and state levels. Therefore, the policies which promote and control FDI are among the most important parts of the government's overall industrial development policies. Various policies and incentives have been introduced, developed, modified, and often abandoned, to pursue this objective. In line with this observation, the industrial development of Penang, like the other States in Malaysia, was principally guided by the socio-economic concerns which are embodied in the central government's economic policies. Undoubtedly, the development of FTZs in Malaysia is subject to overall government policies. Thus, the following parts of this section examine the impact of these policies from the viewpoint of FTZ development. For a clear understanding of this issue, it is useful to make a distinction of Malaysian industrialisation process into the five stages; (1) import-substitution, (2) the 1st export-oriented phase (expansion), (3) the 2nd export-oriented phase (deepening), (4) adjustment after the Asian financial crisis, and (5) high valued-added orientation. The time span and related policy implementation are shown in Table 1. My central concern is the periods from (2) to (3) in which FTZs were established and evolved, TNCs arrived, local suppliers emerged

Table 1. Malaysian Development Policies & Plans and Coverage



and industrial linkages were formed and developed. Policies and economic development in the latter stages are also important to examine but, as our main focus is the early stage of FTZ development, it is rather irrelevant to this subject.

1. Policies for Import-Substitution Industrialisation (1950-1969)

In 1958, one year after the independence of Malaysia from Great Britain, the Malaysian government started to promote investments in Malaysia with the introduction of the Pioneer Industries Ordinance 1958. This was designed to provide for relief from income tax (the prevailing rate was 40%) for 2 years with (i) additional 1 year if capital investment between RM 100,000 and RM 250,000 was incurred, or (ii) additional 3 years if capital investment of more than RM 250,000 had been incurred. The Ordinance 1958 was substantially the start of the government's use of incentives to promote investments; however, it was only in the 1960s that the government seriously committed to use incentives to promote investments.

Before the mid-1960s, the incentives were used for the promotion of investments mainly in import substitution industries. At that time, industries catering for the domestic market like food and beverages, construction material, printing and publishing materials, chemicals and plastic materials etc., were the major targets for investment promotion. During this period, the government's role was largely confined to the creation of a favourable investment climate by providing infrastructure in the form of industrial estates and public utilities. Government organisational development was found in the establishment of the Federal Industrial Development Authority (FIDA) in 1967, the predecessor to the present MIDA.

Towards the late 1960s, the government found that the Ordinance 1958 (and its amended Pioneer Industry Variation Act 1965) had shortcoming as it resulted in the growth of industries for the domestic market only. As the small domestic market became saturated, the government began to realise the need to encourage exports oriented industries. Other major objectives of the government in the late 1960s were to encourage employment creation and dispersal of industries. Accordingly, a review of the incentives was undertaken which resulted in the Act being replaced by the Investment Incentive Act 1968 (IIA). Specifically, the major incentives provided by the Act included the following fiscal schemes.

(i) Pioneer Status: tax relief for 2-5 years, depending on the amount of capital investment
(ii) Investment Tax Credit: tax credit of 25-40% of the approved capital expenditure, depending on factors such as the location of the factory, whether the product was a promoted product and the local content level of the product.
(iii) Labour Unionisation Relief incentive: incentive to encourage employment creation. The incentive provided for various levels of tax exemption for companies employing more than 50 fulltime employees.
(iv) Locational Incentive: tax incentive up to 10 years for locating in less developed areas of the country, depending on the capital investment and the number of employees
(v) Export Incentive: export allowance of 5% of the value of the export, accelerated depreciation allowance of 20% if at least 20% of the production was exported, and deduction of expenses incurred overseas for export promotion
(vi) Duty Exemption: full or partial exemption of import duties on machinery and raw materials for companies manufacturing for the export market

2. Policies for Starting Export-Oriented Industrialisation (1970-1985)

In 1970, the First Outline Perspective Plan (OPP1) was launched. The OPP1 was compatible with the New Economic Policies (NEP), which was commenced one year ahead of OPP1. The OPP1 and the NEP which placed paramount importance on eradicating of poverty and restructuring of society identified the need for high growth to achieve the objectives of OPP1 and the NEP. Since the domestic market was considered too small to sustain competitive industries, emphasis was placed on export-oriented industries to provide high growth for Malaysia. The 1970s witnessed the introduction of many incentives, among which non-fiscal incentives were major tools. No major fiscal incentives were introduced in the 1970s. This was because the Investment Incentives

Act (IIA) was just introduced in 1968 and was deemed adequate for the 1970s.

The government introduced regulations to facilitate the orderly and co-ordinated development of the industrial sector with the introduction of the Industrial Coordination Act 1975 (ICA). The ICA introduced the requirement for Manufacturing Licenses for companies involved in manufacturing with more than RM 250,000 shareholders' funds and/or employing more than 25 full time employees. To encourage foreign investment, under this scheme, the government allowed 100% foreign equity ownership for companies exporting more than 80% of their production. Prior to this, foreign equity ownership was restricted to 30% to increase the Bumiputera ownership.

To explain the electronics industrialisation of Penang, perhaps most important two incentive schemes were introduced in the early 1970s.

(i) Free Trade Zones (FTZs) Act in 1971. FTZs are "Export Processing Zones" (EPZs) developed by state governments, providing special preferable conditions for investing companies to facilitate the export oriented manufacturing operations. The FTZs invited companies which exported 100% of their production. In certain exceptional cases, companies exporting at least 80% of their production were also allowed to locate in the FTZs. The FTZs are deemed outside the Principal Customs Area (PCA). Goods imported into and exported from the FTZs are not liable for Malaysian customs duties. This provides a great incentives for export oriented manufacturing TNCs which seek a location with low cost labour force. Contrarily, goods made in FTZs and sold in to PCA are liable for customs duties (if applicable). Consequently, it was easy for export oriented factories to bring all their required components and raw materials to Malaysia without customs duties and with minimal of custom formalities. Bayan Lepas in Penang was the first FTZ in Malaysia.

(ii) As with the FTZ Act, Licensed Manufacturing Warehouse (LMW) scheme was introduced in 1974. This allowed firms located even within the PCA to take advantages of FTZ privileges. Manufacturing companies exporting at least 80% of their production could apply for LMW status. The LMWs were accorded similar facilities and incentives as FTZs. The LMW facility allowed factories to locate in areas other than FTZs and still enjoy the facility to import their required raw materials and components without import duties. This incentive was introduced to encourage the dispersal of export oriented industries into areas where the establishment of FTZs was not practical.

Taking advantage of policies and incentives, the government made the conscious push for FDI in the manufacturing sector especially the electrical and electronics industry and other labour intensive industries such as textile. Within twenty years or so, the manufacturing industry which used to be virtually non-existent in 1957, became a major sector, in terms of output, employment, and particularly exports, of the Malaysian economy. Yet, even in the first half of the 1980s, the resource-based industries, e.g. rubber, tin, palm oil, petroleum, etc, still made a large contribution to Malaysian economy. However, the global recession in the early 1980s hit the resource-based industries, resulted in the declining price of primary products which made Malaysia fallen into recession in the mid-1980s. In 1985, Malaysia recorded a negative GDP growth rate.

The government responded by introducing more aggressive strategies and programmes to develop the manufacturing sectors. They were expected as strategic sectors to stimulate the economy to recover from the recession and provide the potential for future high growth for the country. The government also realised the need to diversify and deepen the manufacturing base from being concentrated in labour-intensive assembling operations in a few sectors. The need to widen and upgrade the industrial sectors became apparent. This led the government to consider a fundamental review and amendment of the policies and incentives offered by the government to the industrial sectors.

3. Policies for Deepening Export-Oriented Industrialisation (1986-1997)

As a result of the review, the Government still maintained the further promotion of foreign investment as was considered crucial to pull the country out of the recession. In this regard, the Malaysian government sought a rather ambivalent two-track strategy for economic recovery, i.e. commencing heavy industry promotion and encouraging further FDI-led export-oriented industrialisation.

In 1986, the government launched the first Industrial Master Plan (IMP1), covering the period of 1986-1990, which laid the foundation for the industrial sector in Malaysia. The plan proposed to encourage the establishment and development of heavy industries and supporting industries e.g. motor vehicles, steel plants, etc. During this period, the government set up companies like the Heavy Industry Corporation of Malaysia (HICOM), Perusahaan Otomobil Nasional Bhd (PROTON), etc. These moves were partly to “deepen” the industrial sector and partly an “import substitution” move to rely less on import for heavy and sophisticated machinery and equipment. In the late 1980s, the new fiscal and non-fiscal incentives and the amendments of existing ones were introduced for heavy industrialisation.

For further development of export-oriented industries, some incentives were newly introduced or modified in the second half of the 1980s, aiming at encouraging investments, especially attracting foreign investments into the industrial sector. For non-fiscal incentives, they were intended to liberalise the industrial climate to attract more FDI. The Investment Incentive Act 1968 was replaced with the Promotion of Investments Act 1986 (PIA). Prior to the PIA, the equity requirement imposed on foreign investors was taken as restrictive. Then, the government began to liberalise the equity condition, i.e. the relaxation of the export requirements to hold 100% foreign equity and increase in the threshold for company’s to be exempted from the ICA, in order to attract more FDI.

Major changes in fiscal incentives were also conducted under the PIA. This streamlined the incentives previously offered and also introduced new incentives aiming at encouraging the development of selected priority sectors like EE industries. The major incentives offered by the PIA included Pioneer Status, Investment Tax Allowance, Abatement of adjusted income for exports of manufactured goods, Abatement of adjusted income for purchased from small scale companies, Export Allowance, Double deduction of expenses for promotion of exports, and so on. The PIA is still valid today as the main government legislation regarding incentives for promotions of investments. Though there are many incentives offered under the PIA, the Pioneer Status, Investment

Tax Allowance, and the Reinvestment Allowance are probably the most popular incentives for locally operating manufacturing companies/investors.

Malaysia's industrial policies and incentive especially in the second half of the 1980s to attract foreign direct investments were generally very successful. This helped the Malaysian economy to recovery from the economic slump. However, it is premature to conclude that this was attributed solely to the effectiveness of new incentive scheme introduced in the late 80s. The policy implementation was timely to seize suitable circumstances in the external economy. After the Plaza Accord in 1985, the Japanese Yen was steeply appreciated by 90% against the US Dollar by April 1988. This resulted in sharp increases in the prices of Japanese products worldwide, and to remain competitive, Japanese manufacturing began relocating overseas, especially into Southeast Asia including Malaysia.

The year 1990 witnessed the end of the OPP1 and the New Economic Plan (NEP). In place, the Outline Perspective Plan 2 (OPP2) was launched in the same year. The OPP2 also embodied the New Development Plan (NDP) which replaced the NEP. Both the OPP2 and NDP placed emphasis on national unity and balanced development among the different races in Malaysia.

From the early 1990s, ironically, Malaysia' s export-oriented industrialisation was so successful that the country faced new internal and global challenges as follows:

(a) Labour and skill shortages to support the further development of the industrial sector
(b) Lack of indigenous technical capabilities
(c) Overdependence on FDI
(d) Lack of supporting industries to support the industrial sector
(e) Little industrial linkages among industries already well established in Malaysia
(f) Emergence of new developing economies providing cheaper labour and more incentives to attract FDI and
(g) Emergence of new technologies and rapid changes of existing technologies

Malaysia responded to these challenges by formulating industrial policies to encourage industries to shift from labour intensive to high value-added, capital and skill intensive and high technology industries. For this to achieve, thanks to the favourable global circumstances in which Malaysia still enjoyed substantial inflow of investments, the government became more selective in the promotion of investments. The Capital Investment per Employee (CIPE) ratio was introduced, in which new industries with CIPE of less than RM 55,000 were selectively discouraged [‡]. It was obvious that high technology and high value-added industries were promoted, while labour-intensive industries were discouraged.

In the arena of FTZs, from 1993 sales to FTZs and LMWs were no longer deemed as export for the purpose of qualifying for higher foreign equity level under the ICA incentive. This change in classification meant that new manufacturing companies had to physically export 80% of their production out of the country to be eligible for 100% foreign equity. This also intended to create more opportunities for local SMEs to supply their products to FTZ firms. Also,

‡ However, this regulation was frozen in 1998 because of economic crisis.

the approval of expatriate posts in FTZs was more stringent.

Ⅳ. Government Policies for SMEs Promotion

To cope with the new global challenges (a)-(g) above, the most fundamental solution is, obviously, to nurture local firms which are technologically and managerially capable to work with global TNCs. The development of local firms is also important to pursue the NEP goal in order to participate more Bumiputera into business. For this objective to achieve, there are so many public agencies and institutions are involved in providing support programmes for SMEs. However, these policies are not so much successful as originally expected (Chee 1986, Ahmad and Majid 1998, Jomo 2007). This section examines this issue.

During the early period of independence, there was no precise government support programmes designed specifically for SMEs. The development of the traditional rubber and tin industries led to the growth of various workshops and foundries to cater for these industries. These became the forerunners of SME development in the country. The palm oil industry provided further impetus to the SMEs especially in the area of processing and machinery fabrication and repairs. The development of SMEs was, hence, regarded as incidental to this.

When Malaysia embarked on an industrialisation drive in the 1960s, the government policy support programmes for SMEs were originally outlined in the First Malaysian Plan (1966–1970). The government emphasis was, however, still on bigger industries and attraction of foreign investment as, for instance, shown by the introduction of the Investment Incentives Act of 1968. Nonetheless, the significance of the development of SMEs was restated under the New Economic Policy and reaffirmed in subsequent five year National Development Plans. The mid-term review of the Fourth Malaysia Plan (1981–1985) provides the most comprehensive listing of government guidelines for SMEs' development. The most essential guideline is that the promotion of SMEs is being considered as an integral part of the overall manufacturing sector development and this is further enhanced in the Fifth Malaysia Plan (1986–1990).

Surprisingly, however, until the mid-1990s, there had been no specific policy-making by the government to support local SMEs in Malaysia. Greater emphasis on the development of SMEs appeared during the early 1970s with the introduction of the New Economic Policy (NEP); however, real effort towards encouraging and recognising the importance of SMEs in the country's economy occurred in the 1990s, when the government realised the need of establishment of an integrated public body to encourage technological upgrading and modernisation among local Malaysian SMEs. In 1996, Small and Medium Industries Development Corporation (SMIDEC) was established for this purpose (Felker and Jomo 2008). SMIDEC provides various programmes and financial assistance schemes for SMEs together with other government agencies such as Malaysian Industrial Development Finance Berhad (MIDF). The programmes include, for example, the Industrial Linkage Programme (formerly Vendor Development Scheme), Technology Development Programme, Skill Upgrading Programme.

Presently, there are as many as 13 ministries and nearly 30 government institutions/agencies, including SMIDEC, offering a wide variety of programmes with varying responsibilities to promote SMEs' development. However, based on my fieldwork which surveyed forty-five locally-owned SMEs around Penang in 2009, a substantial proportion of them do not receive assistance from the government-sponsored agencies/institutions. This implies that government policies are partly nominal and ineffective to support the development of local SMEs. The following part of this section aims to identify the problems of Malaysian SME policies.

The first reason to see the SME policies ineffective is observed in limited access to, or a sense of alienation from, the government agencies and their support. A significant proportion of local firms often claim that much of the assistance was not available due to certain requirements or criteria specified by the agencies concerned, including a good track record, a guarantor, qualifications as well as experience. Also, it is widely believed that only "Malay" entrepreneurs are eligible to apply government assistance, discouraging approaches by Chinese entrepreneurs which comprise a majority of manufacturing suppliers.

The second is that overall government supports generally favour large enterprises, rather than SMEs. In practice, preference and priority in terms of incentive and programmes is overwhelmingly given to large-scaled companies. For example, under the Investment Incentives Act of 1968 which incorporated Pioneer Status, Investment Tax Credit, Locational Incentives and Export Incentives, the criteria were mainly based upon the scale in capital investment, employment and export features on which large companies are advantageous. Export incentives are mainly captured by export-oriented TNCs, while these do not benefit local SMEs which produce mainly for the domestic market. As a result, small-medium firms were unable to benefit from those incentives.

The third reason is a seemingly biased priority of government policies. It is also imperative to point out that, in the line with the NEP objectives, the existing government supporting programmes focus predominantly on the development of new Bumiputera enterprises, most of which are domestic market-orientated business. These industries are saturated in small domestic markets such as food, furniture and handicraft industries. Since competition is strong in the domestic market, the profit margins are expectedly low and mortality rates are high. This is also a basic reason for entrepreneurs' awareness of alienation. Obviously, more policy assistance should be forwarded to the SMEs which are eager to engage in business with TNCs or oriented to the global market.

V. Conclusion and Discussion

It is plausible to conclude that the role of government and public bodies in creating linkages are rather mixed and still unclear. Undoubtedly, Malaysian government has been extraordinarily active to attract and support TNCs as well as local companies. Policies related to TNCs are highly effective and successful; on the other hand, efficacy of the government policies to support SMEs development, particularly its start-up, does not seem convincing. For further research, two points should be noted.

First, the roles of central and state governments in their contribution both to FDI promotion and local SME development should be examined separately. So far, the officers I have interviewed were under central government. The state government of Penang must also have influenced strongly on the regional industrial development. It is expected that additional interviews with Penang state officers like those in PDC will clarify the contribution of public sectors to regional development.

Second, related to this issue, I focused too much on the 'direct' government policies. This is partly due to my fieldwork methodology which has been totally depended on interview survey, asking what incentive and support schemes are provided by government. As is discussed above, some government supportive policies seem inconsistent with the actual local SME development. However, the capacity of government often appears in indirect manners, including provision of regulation, good market environment, macro-economic condition, institutional setting, and international relations such as regional trade agreement. Interview survey with local government officers may not be best suitable to detect and examine the effect of these influences. A deep investigation into government documents, reports, and statistical data is equally important to understand the overall role of government in industrial development.

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