Recent Trends in Foreign Direct Investment in Malaysia

Introduction

Foreign investments continue to account for about one-third of total private investment in Malaysia. The trend in gross FDI has remained stable since 2000 after a moderation during the Asian financial crisis. This stability is largely due to existing multinational companies (MNCs) expanding and diversifying their operations, with funding mainly from retained earnings. The pattern of FDI flows has also changed in favour of the higher value-added services sector, as the services sector is transformed and accounts for a larger share of GDP. As the services sector tends to be less capital intensive, the scale of the gross value of new flows tends to be smaller while the value-added and contribution to growth is higher.

The Government continues to ensure that policies remain supportive of attracting new foreign investments and that Malaysia remains a place of choice for companies seeking opportunities in the Asian region. Policy initiatives include a series of Investment Guarantee Agreements (IGA), tax and non-tax incentives, sequential sector liberalization, improving administrative processes and the delivery system of the public sector and lowering the overall cost of doing business. Equally important is the commitment to sound macroeconomic policies.

Definition, Methodology and Compilation of FDI Data

In the compilation of FDI statistics in the balance of payments, Malaysia adopts international standards in terms of definition, methodology and measurement. FDI, based on the IMF's Balance of Payments Manual, Fifth Edition, is defined as "....foreign holdings of at least 10% ownership in the enterprise with a lasting interest".

Actual FDI flows are reported in the financial account of the balance of payments, released on a quarterly basis by the Department of Statistics, Malaysia (DOS). DOS data refers to actual investments that have taken place in Malaysia in all sectors. This data differs from the data on applications and approvals released on a quarterly basis by the Malaysian Industrial Development Authority (MIDA), which records mainly investments in the manufacturing sector and covers investors who have applied for the various tax incentives. MIDA's data also does not cover investments in the oil and gas sector.

Data in the financial account of the balance of payments covers all the three components of FDI, namely equity capital, reinvested earnings and other capital (mainly inter-company loans). In addition to the quarterly survey by DOS, Bank Negara Malaysia maintains the Cash Balance of Payments (CBOP) Reporting System. Under this system, Bank Negara Malaysia is able to provide data on actual FDI flows on all cross-border transactions between residents and non-residents which are effected through the banking system, inter-company accounts and overseas accounts.

While the CBOP data does not capture the retained earnings by existing foreign enterprises in Malaysia (since there are no cross-border transfers through the banking system), it provides a good indicator on the trends of new FDI flows. The CBOP data is also available on a more timely basis, with a six-week lag.

Recent FDI Trends in Malaysia

On a **gross** basis, FDI continues to be sustained at a high level of about RM18-20 billion in recent years (Graph 1). Inflows of FDI have contributed to the establishment of new industries and products, introduction of new processes and production technology, the growth of support services, research and development and access to new markets.

FDI flows during the post-crisis period remained stable as MNCs with operations in Malaysia continued to reinvest their retained earnings to expand, upgrade and diversify their production lines, in spite of the increased competition from low-wage economies in the region. Reinvested earnings accounted for nearly half of gross FDI for the period 1998 - 2002 (Graph 2).