

Trade, Investment and Reform: Challenges for Malaysia

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The purpose of this paper is to argue that Malaysia needs to reform some institutional aspects of the economy that impact on its trade policy. This is an important exercise because Malaysia is a very open, trade-dependent economy. The manner in which the Malaysian economy was impacted by the global financial and economic crisis of 2008 attests to the fact that Malaysia should be watchful of its trade policy to remain favourable to foreign investors. Since it depends on the developed economies for foreign direct investment there is an urgent need to introduce institutional reform. Accordingly, it is now incumbent on Malaysia to introduce competition policy; to reform and liberalise its government procurement policy; and, generally, to relax those policies that are perceived as being protectionist.

Introduction

The current global crisis prompts Malaysia to review its policy on trade, something that is of importance since it is a small open economy. There is no doubt that Malaysia's economic development in the last two decades has been driven by exports. Malaysia's growth has been highly dependent on trade and the inflow of foreign direct investment (FDI). There is some debate on whether Asian countries have decoupled from the economies of developed countries, particularly the United States, the European Union and Japan. The current crisis clearly draws attention to the fact that Malaysia depends on international trade, especially in terms of demand emanating from these countries. What is more, Malaysia's attractiveness as a location for FDI depends on the preferences of these developed economies.

The need for a reappraisal of Malaysia's trade strategy in the years to come is more pressing now than ever. While it is tempting to claim that Malaysia is unduly dependent on developed economies as destinations

for its exports and sources of FDI, it is challenging to suggest how Malaysia could adopt a different strategy to drive its economy. The reliance on external markets has to be taken into account in making policy recommendations.

Malaysia's national considerations cannot be divorced from global changes. In fact, given Malaysia's reliance on external markets and foreign investors there is a need to re-evaluate the functioning and performance of the prevailing institutions, and to assess if they are consistent with rapidly shifting global demands.

The movements in the global scenario in recent years require a more prudent and pragmatic approach to international trade and FDI. With the entry of China into the WTO and China's attractiveness as the workshop of the world, there has been an increasing flow of FDI into that country. This is coupled with the emergence of India and Vietnam's rise as an important destination for FDI in the region. Malaysia can no longer count on a cheap labour force that is reasonably educated. There are other countries that can attract FDI on the basis of a cheap and plentiful supply of labour. Offering free trade zones and accompanying fiscal incentives is no longer as straightforward as it used to be. The ground rules for being a successful export-oriented economy and recipient of FDI have changed. These are no longer features that Malaysia can depend upon for its competitiveness. In a more competitive global environment, Malaysia has to be more efficient, productive and innovative if it is to move out of its middle-income trap (Ohno, 2008). These considerations have to apply to production processes as well as to institutions.

In the light of these observations, this paper will attempt to argue that there is a need for Malaysia to re-assess its institutions in relation to trade and investment. This claim is based on the understanding that microeconomic reform is essential in order to have vibrant manufacturing and services sectors, since producers need to be assured that they can compete in a fair and free manner. Equally, microeconomic reform will mean that economic welfare as a whole will be given importance, rather than the welfare of specific sections of the economy. If the welfare of some groups is targeted, this may jeopardise the welfare of the economy, taken as a total entity.

The second section of this paper will examine the impact of the current global crisis. The purpose of this will be to demonstrate that the Malaysian economy is affected by perturbations originating from developed economies which are its dominant trading partners. This is to motivate an understanding of how dependent Malaysia is on external factors, and how it should accordingly align its economy. The next three sections consider issues that require policy consideration if Malaysia is to be a more attractive location for the inflow of foreign direct investment. Accordingly, the third section will discuss the importance of competition policy. This is followed by an examination of the issue of government procurement. The fifth section discusses protectionism as another obstacle that needs to be lifted, since it impairs the deeper development of deeper trade links with developed economies. Finally, some concluding remarks are made.

Impact of the Crisis on the Malaysian Economy

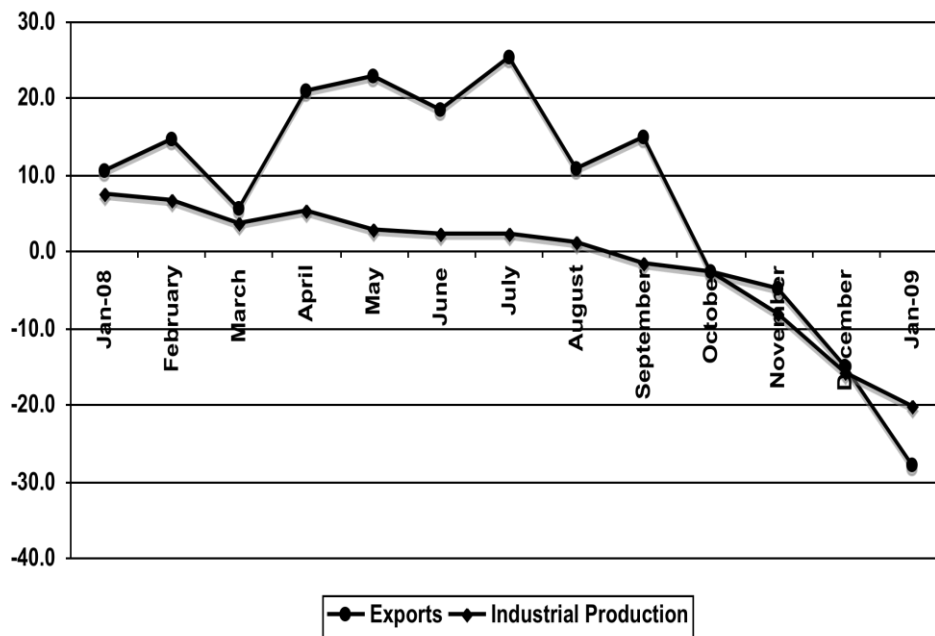
The purpose of this section is to show the extent to which Malaysia depends on external markets. The effects of the current global financial crisis have had far-reaching effects on the Malaysian economy (Goh and Lim, 2009, Nambiar, 2009a). This is because of Malaysia's reliance on exports and FDI to generate growth and employment (United Nations Development Programme, 2006). In fact, the strength of the manufacturing sector in Malaysia depends heavily on export generation. As will be pointed out shortly, it was not only the export-oriented manufacturing sector which was affected by shortfalls in demand as a consequence of the crisis (see, for instance, United Nations Development Programme, 2009). In fact, the effects were transmitted to other sectors in the economy, ultimately affecting aggregate demand and employment (Nambiar, 2009a).

Two indicators that were among the economic indicators to feel the impact of the current crisis were exports and the industrial production index. Export figures, which were doing well in first three quarters of 2008, took a downturn towards the end of that year (Fig.3). In January 2008, exports increased by 10.4 per cent (year-on-year), and more or less doubled to 20.9 per cent in April 2008. However, in October 2008 a negative figure was reported (-2.6 per cent), only to decline more deeply as the months progressed. In December 2008, a decline in exports was

registered (-14.9 per cent), and this worsened in January 2009 (-27.8 per cent).

Imports, which tend to follow export trends rather closely in Malaysia, reported a similar pattern. Imports increased by about 11 per cent (year-on-year) in February 2008 and exceeded 10 per cent in the months of June and July 2008 (12.5 per cent and 15.0 per cent, respectively). Again, the change in imports dived into negative territory from October 2008, falling from -5.3 per cent in that month to -23.1 per cent in December 2008 and dropping further to -32.0 per cent in January 2009. It is understandable that imports should fall along with decreases in exports because imports of intermediate goods are required to meet the production of exports. The strong demand for exports that emanates from Malaysia's major trading partners (US, Japan and the EU) having fallen, it was only to be expected that exports from Malaysia would also fall.

Figure 1: Exports/Industrial Production



Source: Author's calculations compiled from Department of Statistics, Malaysia (2005-2008, 2008a).

Since most of the manufacturing sector is driven by the growth of exports, it stands to follow that the industrial production index (IPI) would reflect the damp export conditions imposed by the global environment. Accordingly, the IPI sank from September 2008 (-1.7 per cent, year-on-year), deepening towards the end of 2008, particularly in December, and right into January 2009 (-15.9 per cent and -20.2 per cent, respectively) (Figure 1). These results are not surprising in view of a) Malaysia's heavy dependence on the E&E sector and b) the fact that Malaysia's major trading partners were badly affected by the global crisis. Claims that Malaysia has decoupled from the US cannot be defended against these outcomes. The argument that Malaysia has shifted its trade towards ASEAN is not convincing in the face of the foregoing evidence. While there is evidence that trade with Singapore and Thailand has been increasing, this phenomenon must be juxtaposed against the nature of production networks. Units in other parts of ASEAN are a part of the production processes where the final products are ultimately exported to countries such as the EU and the US.

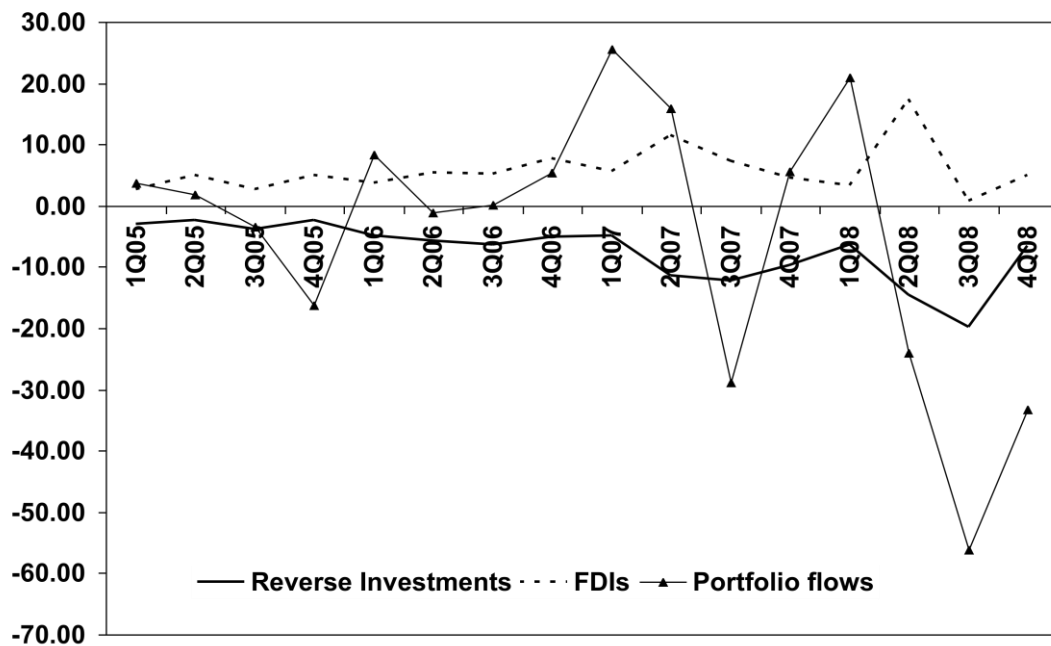
The effects of the crisis began to be expressed through the growth in GDP by the third quarter of 2008. In no sector was this clearer than the manufacturing sector (Fig.4). The manufacturing sector had a 5.6 per cent increase (year-on-year) in the second quarter of 2008. In the following quarter it was positive, but closer to two per cent (1.8 per cent, to be exact); and it was negative (-8.8 per cent) by the fourth quarter of 2008. The construction sector also showed negative growth in the fourth quarter of 2008. In fact, real GDP slid down to a 0.1 per cent growth in the last quarter of 2008.

The capital outflows from Malaysia increased with the onset of the crisis. First, reverse investments that were high in the second half of 2007 (about US\$3.1 billion), slowed down in the fourth quarter of 2008 (about US\$2.0 billion). The outflows of portfolio funds from Malaysian markets were a remarkable signpost of the reality of the global crisis. There was a surge of portfolio flows into the country in the first quarter of 2008 (US\$6.6 billion). But starting from the second quarter the outflows were massive: in the second quarter portfolio outflows amounted to US\$7.5 billion and in the third quarter they hit US\$17.5 billion, flowing out again in huge amounts in the fourth quarter of 2008 (US\$10.4 billion).

Foreign direct investments (FDI) did not in any way compensate for portfolio outflows during the same period. In fact, FDIs have been hovering at around US\$1.6 billion every quarter in recent years (2006-2008). There have been occasional spurts of FDI inflows into Malaysia. In particular there was one in the second quarter of 2007 and another one in the second quarter of 2008. The big increases in FDI that took place in 2Q 2007 amounted to US\$3.6 billion while that in 2Q 2008 touched US\$5.4 billion. The earlier was because of foreign investors (from Japan, the US, Germany and Singapore) making investments in the electrical and electronics (E&E) sector. The latter was because of a huge joint venture enterprise initiated by an Australian company relating to aluminium processing. There is no doubt that with the crisis, and with Malaysia's traditional FDI sources being hit, FDI inflows are affected. This was seen distinctly in the third quarter of 2008 when FDI worth US\$0.3 billion was all that flowed into the country, but it recovered to US\$1.6 billion the following quarter (Fig.6).

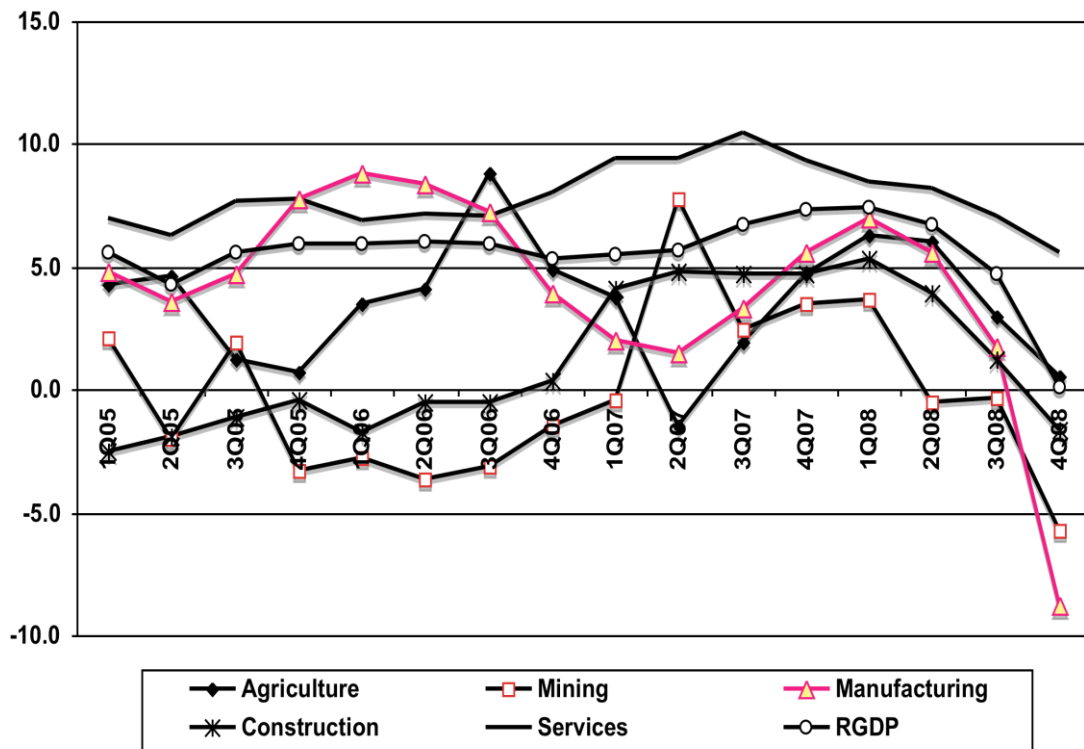
The crisis also prompted a rundown on the foreign reserves that Malaysia had been holding. The economy held foreign reserves valued at US\$314 billion in 2006. Reserves had been increasing in 2007 (US\$386.4) and a further increase was noted in 2008 (US\$447.2). Malaysia's reserves had, indeed, been high in the years subsequent to the 1997 crisis. But the present crisis had its toll on reserves. Quarterly figures depict the reality of the crisis. In the second quarter of 2008 reserves amounted to US\$125.8 billion, but they fell to a limited extent in the following quarter of the same year (US\$109.7 billion). However, in the last quarter of 2008 the fall was even sharper, reaching US\$91.5 billion, implying a dip of US\$18.2 billion of that held in the preceding quarter.

The declines in FDI, foreign reserves and portfolio funds, however, had been well-cushioned by the relatively stable current account balance. There is no doubt that in the fourth quarter of 2008, the current account balance dropped to US\$9.3 billion against the figure in the previous quarter (US\$12.1 billion). But more striking is the overall balance which had been dropping drastically since the third quarter of 2008, falling from -US\$9.8 billion (third quarter of 2008) to -US\$19.4 million in the last quarter of 2008.

Figure 2: Capital Flows (RM Billion)

Source: Author's calculations compiled from Department of Statistics, Malaysia (2005-2008).

The brunt of the crisis's impact on the Malaysian economy was felt most strongly on certain sectors of the economy. One such sector was the manufacturing sector, as we have discussed earlier. Another sector that had been affected was the construction industry. This is seen from some of the indicators on the construction industry. The number of new sales permits has been falling from July 2008. But the figures indicated the pessimism of the industry most distinctly from August 2008. The number of new sales permits, which earlier in the year reached 87, fell to 58 in August and came down to 41 in December 2008. The number of housing approvals also witnessed a downtrend. The change in the production of construction-related products reflected the bleak outlook of the industry. In September 2008 there was a 6.8 per cent increase (year-on-year) in this index; it fell in October (1.9 per cent), but was most distressing in November 2008 (-5.1 per cent).

Figure 3: GDP by Sectors (% Change)

Source: Department of Statistics, Malaysia (2008b).

Viewed, in terms of real GDP by demand expenditure, the most striking decreases in the fourth quarter of 2008 were observed in gross investment (-10.2 per cent), exports (-13.4 per cent), and imports (-10.1 per cent) (Fig.5). Private consumption also fell, but remained at a respectable rate of 5.3 per cent. By way of comparison, in the first quarter of 2008 private consumption had increased by 11.7 per cent. Similarly, in the same quarter gross investment increased by six per cent, with exports and imports showing increases, too (at 6 per cent and 3.4 per cent, respectively). The net effect of all the decreases in the various components of real GDP was a decline in real GDP growth to 0.1 per cent for the last quarter of 2008 as against about seven per cent in the first half of the same year.

As we have seen, the drop in the demand for the export-oriented manufacturing sector had far-reaching consequences. However, Malaysia's geographical area and population do not make it possible for domestic industries to depend significantly on the domestic market. Also, even if a strong services sector is developed, it would still have to be export-oriented. Under these constraints it is imperative that the economy be sensitive to the needs of the external sector. Being sensitive to the external sector would require putting in place institutions that promote trade and the intensification of trade relationships. It would also call for the dismantling of policies such as protectionism that are welfare-reducing and which jeopardise the growth of trade. It is within this context that the next section will elaborate on the institutional foundations that are necessary for a reform of trade policy.

Competition Policy and Law

To date Malaysia does not have a competition policy or law although the government does recognise the merits of a competition policy. In 1993, the Ministry of Domestic Trade and Consumer Affairs announced its intention to draft a "Fair Trade Practices Bill". This did not materialise. Indeed, in the *Eight Malaysia Plan 2001-2005* (8MP) there is an explicit statement accepting the need to encourage competition.

The 8MP clearly enunciates the government's recognition of the usefulness of a competition law and policy and the contribution that it can make towards the economy as a whole. This is clearly expressed in the following statement:

"During the Plan period (2001-2005), efforts will be made to foster fair trade practices that will contribute towards greater efficiency and competitiveness of the economy. In this context, a fair trade policy and law will be formulated to prevent anti-competitive behaviour such as collusion, cartel price fixing, market allocation and the abuse of market power. The fair trade policy will, among others, prevent firms from protecting or expanding their market shares by means other than greater efficiency in producing what consumers want." (8MP, 2001: 467)

One could argue that competition policy, broadly speaking, has two components: 1) regulating the conduct of firms, and ensuring that they do not engage in anti-competitive acts; and 2) ensuring that consumers are able to enjoy the highest level of surplus possible (Lee, 2007). The Malaysian government has not disregarded consumer welfare. The protection of consumer interests has been embedded in the following statutes:

- Money Lenders Act 1951
- Hire-Purchase Act 1967
- Trade Descriptions Act 1972
- Weights and Measures Act 1972
- Direct Sales Act 1993
- Consumer Protection Act 1999

It must be stressed that these Acts do not cover the anti-competitive conduct of firms. These statutes are restricted in their coverage to certain sectors within the economy, viz. the distributive trade and financial sectors. However, the anti-competitive conduct of firms within these sectors is not addressed.

The communications and multimedia sector, however, has the advantage of competition regulation. The communications and multimedia sector is protected by the following statutes:

- Communications and Multimedia Act 1998 (CMA), and the
- Communications and Multimedia Commission Act 1998 (CMCA)

The CMA expressly prohibits rate fixing, market sharing, boycotting of competitors, and tying. This Act has under its ambit the Communications and Multimedia Commission (CMC). Two shortcomings are worthy of note (Lee, 2002). First, the CMA points out that anti-competitive conduct by firms can be tolerated if “national interest” demands it. Second, the CMC cannot make a judgement as to whether or not a firm’s conduct amounts to anti-competitive behaviour. This decision is solely within the mandate of the Minister concerned.

The energy sector is served by the Energy Commission, which looks into issues relating to competition. This commission is provided for by

the Energy Commission Act 2001 (ECA). The ECA points out that one of the principal duties of the commission is to promote competition. As it stands, only the communications and multimedia, and, energy sectors have regulation relating to competition. An approach to competition that is sectorally based and that too limited to two sectors is clearly not satisfactory. Further, as mentioned earlier, consumer protection under the various Acts is, again, confined to the financial and distributive trade sectors. This, too, needs review.

If the intention to have a competition policy and law is slow to see realisation it is because the government has several concerns. One of the considerations is to ensure that the distributive considerations voiced in the NEP are achieved. The government also wishes to pursue measures that will promote the growth of domestic firms. Finally, the government wants to protect domestic firms from the competition that will emanate from multinational corporations. In sum, the government hopes to achieve a development path that is in line with national aspirations rather than one that is based on the dictates of efficiency, fair trade and that can deliver the largest social welfare.

Although there is no published survey on the presence and extent of restrictive business practices (RBPs) in Malaysia, observation tends to support the presumption that there are adequate grounds for investigation and, perhaps, action (Nambiar, 2006). The following is a partial sample of such cases:

- The Federal Land Development Authority (FELDA) was established in July 1956 as a Federal Statutory Body under the Land Development Ordinance No. 20, 1956. It was originally set up to channel funds into the development of the remoter parts of the country. Since 1960 FELDA has been directly responsible for development activities that include land clearing, planting of main crops development of villages, selection and relocation of settlers, management of projects, provision of credit, processing, marketing services and facilitating social and community development. In 1980, a company called FPM was established, with Behn Meyer, a multinational corporation, having significant interests in it. However, this company has received the exclusive right of providing fertilizers to FELDA. FELDA, which used to be a government-run scheme to improve the livelihoods of farmers, is,

obviously, a lucrative market. Because of this exclusive arrangement, local manufacturers do not have access to the FELDA market.

- Megasteel and Titan Plastics are state-owned monopolies that produce steel and plastic for use by auto parts producers. Auto parts producers have the option of importing their inputs or of buying them locally. Since most auto parts producers prefer to buy their inputs from Megasteel and Titan Plastics, these companies are reputed to charge prices above world prices.
- Purchasers of cars report that they are required to buy accessories that they do not wish to possess, or are restricted to the purchase of specific brands that the suppliers have exclusive arrangements. The consumers are also 'advised' to take hire-purchase loans from certain banks and buy their car insurance from prescribed companies in order to avoid delays in the delivery of the cars. These practices constitute tied and forced selling.

Studies indicate that the prevalence of RBPs seems to bear some correlation with the level of concentration in firms. In Malaysia, the following industries in the manufacturing sector are concentrated:

- Oil and gas
- Car assembly
- Tyres and tube manufacturing
- Food and food-related products
- Plastic products
- Hydraulic cement

The oil and gas industry as well as the automotive industry are protected by the government, being national champion projects. On the other hand, the other industries mentioned are controlled by a small number of multinational corporations. Thus there are grounds to suspect and investigate the practice of RBPs, something that can be done satisfactorily if there were a competition law and authority to examine the cases brought forth.

There is a need for Malaysia to seriously examine the need to introduce a competition policy regime and the appropriate legal framework. While it is indeed true that the government has for some time now been entertaining the idea of introducing competition policy and law, not much has been accomplished in concrete terms.

There seems little doubt that the anti-competitive behaviour of firms needs to be arrested; but attendant issues need to be resolved. These include the following:

- ensuring that the competition authority is free from political influence and manipulation
- formulating an industrial policy that relies on the competitive strengths that the country can offer, and
- adopting a policy that does not disrupt national economic and social objectives, particularly as it affects disadvantaged communities and small scale industries.

If the government can shed more clarity on some of the above-mentioned issues, it would allay fears that competition policy and law will restrict the growth and development of the economy and act against public interest. In fact, Malaysia will be perceived as a more attractive destination for investment if it is seen to value transparency, good governance and competition.

Government Procurement

The procurement framework in Malaysia is made up of three main components: a) the agents involved, b) the legal and regulatory framework, and c) the tender process (APEC, 2003a,b). Accordingly, we begin by providing an outline of those entities that participate in the procurement process. The Federal government is the prime entity within the government administration and machinery. The government is composed of 24 ministries and 100 federal departments. This is followed by the 13 state governments, which in turn have 240 state departments. The state governments have a mandate to generate their own revenue and expenditure, but the Federal Government also undertakes projects at the state level, so long as it falls within the

margins of the Constitution. Further to the State governments are the local authorities. The local authorities are made up of the city councils, municipalities and district councils. These bodies derive their revenue through assessments and licensing, and also from financial grants made by the Federal government and the respective state governments. The local authorities are bound by the dictates of the general government procurement procedures, and their financial interests in respect of procurement are ultimately determined by the municipal council. However, they are autonomous in so far as they are free to determine their revenue and expenditure.

Particular mention must be made of statutory bodies and government companies. Both are important entities within the procurement framework. Subsequent to Malaysia's privatisation plan in the 1980s, a number of government-owned companies were privatised. These companies began operating as business ventures, but the government remained an important stakeholder. The Ministry of Finance and the Economic and Planning Unit are represented on the Board of Directors in these privatised companies. Besides, the Ministry of Finance and other government bodies own substantial shares of these companies. Aside from continuing government involvement, albeit indirectly, both as far as ownership of equity and representation in directorship are concerned, these companies are also bound by government approval in certain procurement matters. The Board of Directors do not have the ultimate authority over financial matters relating to the procurement made by their companies. In fact, Petronas, Tenaga Nasional and Telekom have to refer to the Ministry of Finance when procuring goods and services valued at or exceeding RM15 million (about US\$4.7 million). In the case of statutory bodies that are set up under the Statute Acts, their financial authority is vested in the hands of the respective Chairpersons. The procurement that is carried out by statutory bodies has to abide by government procurement procedures although these agencies are otherwise autonomous.

The second element that needs discussion is the legal and regulatory framework that determines government procurement. Government procurement is regulated by two Acts, the Financial Procedure Act 1957 and the Government Contract Act 1949. The latter legislation permits Ministers to enter into contracts with regard to government procurement. Ministers can represent their respective ministries or delegate authority

to appropriate officers within their respective ministries to enter into contract for and on behalf of the Government of Malaysia. The Financial Procedure Act outlines the mode of control and the management of public finances. It also lays out procedures for the collection and payment of public monies as well as procedures for the purchase, custody and disposal of public property.

In addition, government procurements are regulated by the following instruments:

1. Treasury instructions,
2. Treasury circular letters, and
3. Federal central contract circulars.

Treasury instructions are concerned with the financial and accounting procedures that regulate government procurement. Whenever there are amendments to policies, rules, regulations and procedures relating to government procurement they are intimated through Treasury circulars. The Central Contract Circulars contain details of items that are centrally procured. They include details of prices, suppliers and specifications. The purpose of these circulars is to provide suppliers with the necessary information so as to promote local products and local vendors.

The third component that must be addressed is the tender process. This constitutes a crucial part of the procurement policy and process. First of all, it must be noted that a tender process is called for whenever there is a purchase of goods, services or works exceeding RM50,000 (about US\$15,631) in value. Only contractors already registered with the Government may participate in the tender process. The first step in the tender process is to draw up the tender specifications. The specifications are prepared by a technical committee, which takes care to strictly avoid specifications based on specific brands or biased towards particular countries. The committee attempts to provide thorough details, and these details may be in line with international standards, if so required.

The tender specifications and other relevant details (such as price schedule, delivery period, scope of work) are published in the tender documents, and distributed at a cost. The invitation to submit a local tender is advertised in at least one local newspaper printed in Bahasa

Malaysia. When international vendors are expected to participate, the advertisement will appear in at least two local newspapers, one a Bahasa Malaysia daily and the other an English newspaper. In addition, Embassies and High Commissions are informed of opportunities for international tenders.

Once the bids are received they are evaluated by the technical and financial evaluation committees. On the basis of the evaluation made by these committees, the tenders are ranked. The evaluation process takes into account the ethnic origin of the parties that submit tenders and the content of goods. Locally produced goods receive preferential treatment. There is preferential treatment for locally produced goods when they constitute up to 10 per cent of the value of contracts that are below RM10 million (about US\$3.1 million). For contracts that exceed RM100 million (about US\$31.0 million), preferential treatment will be extended if locally produced goods constitute up to three per cent of the value of contracts. There is also an ethnic bias in awarding preferential treatment to parties that tender for contracts. Bumiputera agents who make tender applications will be given preferential treatment for contracts valued between RM100,000 to RM15 million (about US\$31.0 to US\$4.7 million). They will not receive such treatment for purchases exceeding RM15 million (about US\$4.7 million).

The Government Procurement Board is responsible for the selection of successful applicants. In cases where the value of the procurement exceeds certain threshold amounts the Ministry of Finance selects the vendor who is deemed successful. The Ministry of Finance makes a decision when the threshold of the tender value is above RM15 million (about US\$4.7 million) for works and RM7 million (about US\$2.2 million) for supplies and services.

As early as in 1999, proposals were made for an Agreement on Transparency in Government Procurement. The cornerstone of the proposals was non-discrimination in transparency. This implies that each member country would accord equal status to its own suppliers and to those from other countries. In other words, all suppliers, regardless of their countries of origin will be treated equally; no supplier of any specific country will be treated more favourably, neither will domestic suppliers be accorded preferential treatment. Few exceptions, if any, were stated under these proposals and these included the freedom to take

necessary action to preserve essential security interests and the right not to disclose confidential business information or any information that would interfere with law enforcement. Further, the proposed agreement on transparency would require compliance by adopting transparency in the following areas:

1. Procurement rules and methods
2. Tendering procedures
3. Information on procurement opportunities
4. Bid periods and documentation
5. Suppliers' qualifications
6. Decisions on qualification
7. Domestic review procedures, and
8. Dispute settlement

While Malaysia has been, generally speaking, supportive of the need to secure transparency of information about national procurement practices, it has been more reserved about the kind of information that can be openly disclosed. It feels that complete information regarding national regulations and procedures would be too demand a task to accomplish (WTO, 2002:10). Malaysia considers it sufficient to highlight the most significant aspects of a particular regulation or law.

Malaysia holds a guarded position when it comes to the scope of any potential disciplines. Malaysia contends that procurement that does not entertain foreign bidders should not be included within a multilateral agreement. This proposal invites objection for two reasons. First, it ignores the principle that it is to the economic advantage of a government to accept the bid that provides the best price and non-price features (e.g., quality). Second, the proposal to exclude foreign suppliers from participating in certain tenders raises questions on the breadth of the scope and definition of government procurement. The scope and definition of government procurement would be excessively narrow if most contracts were limited, by definition, to domestic suppliers.

Malaysia frequently resorts to the argument of nation building as a rationale to defend its lack of transparency in government procurement. It is argued that government procurement is a necessary instrument to promote social and economic development in the country (WTO,1997).

This point must be accepted, and, indeed, the importance of nation building is accepted within the GPA. As mentioned earlier, the GPA offers developing countries, for example, exceptions for industries in rural and backward areas that produce for government purchase. Indeed, transparency need not be an obstacle to nation building (see for example, Srivastava, 1999). Proposed agreements on transparency are based on the understanding that a transparency agreement will not impose any obligation to change domestic laws and regulations governing government procurement. However, that does not mean that there should be no transparency on procurement rules, regulations and procedures if they concern only domestic suppliers. The concern that Malaysia exercises over the disadvantaged position of the Bumiputera does not mean that its national rules and regulations should be shrouded in secrecy (Nambiar, 2004). Transparency is more likely than not to promote competition among Bumiputera suppliers.

Foreign investors will find the practice of government procurement fairly limiting. They can be expected to find the necessity to form partnerships with Bumiputera partners restrictive and not always mutually beneficial. Another complaint that has surfaced was the lack of openness in tendering processes and the declaration of results. Further, the delivery system is faulted not only due to delays in awarding contracts but also because of the uncertainty that is attached to the processes for the approval of contracts. These are important concerns for a country that is dependent of foreign direct investment. In the 70s it was possible for Malaysia to attract FDI based on its competitiveness arising from cheap labour and tax incentives. Such advantages are no longer sufficient to attract FDI. New issues such as government procurement offer opportunities for attracting foreign investment.

There are concerns regarding the procurement policy in Malaysia on several grounds. First, the policy is weighted in favour of local suppliers and for goods and services that have local content. This restricts the participation of foreign suppliers, and denies the advantages that could otherwise be obtained from trade on the basis of comparative advantage. Second, the procurement policy has an ethnic bias. Considering the social and political reality in Malaysia, this argument has some merit. In any case, the disadvantaged position of the Bumiputera is not an adequate reason for denying transparency in procurement.

Malaysia's stage of development does warrant some space to accommodate its national interests and socio-economic development. The accession to the GPA could lie further down the time horizon. While acceding to an international agreement on procurement could be a more distant matter, there is no reason why Malaysia should not set the stage for open policies on government procurement. Indeed, as a first step towards a possible GPA there is an urgent need for good institutional strategies and processes as mechanisms to facilitate the efficient functioning of the procurement process in Malaysia. Not only will this aid in ensuring that overall social welfare objectives are maximised, but it will also defeat vested corporate interests from utilising the government to achieve their own commercial interests.

There are strong arguments for transparency in institutional process. It is obvious that transparency and good institutional strategies are a good defence against rent-seeking and corruption (Dee, 2006). By implementing transparency one can hope to achieve competition and an efficient allocation of resources. This will help the government achieve value for money in its procurement contracts. Further, transparency would help improve the perception that foreign investors have of Malaysia's procurement policy, in particular, and governance, in general (Nambiar, 2009b). Further, this will encourage the flow of foreign investment, something especially important for an open economy like Malaysia's.

Protectionism as Policy Response

Globalisation brings with it increased competition and more opportunities for trade. However, the competition that comes with globalisation, more than being viewed as a challenge that provides opportunities, is often seen as a threat. This is particularly obvious in the case of Malaysia, which has resorted to protectionism in the case of its automobile industry. This section examines the case of the automobile industry to illustrate how such a policy can retard the potential of an economy such as Malaysia's which depends so heavily on FDI and international trade.

The genesis of Malaysia's protectionism policy in the automotive industry can be traced to the misguided policy of picking "winners" as part of its industrial policy. The automotive industry was seen as a

mechanism for boosting bumiputera participation in industry as well as an industry that would have export potential. However, the industry rather than being an engine for driving exports has proved to be one that has required constant support. The automotive industry would not, in all probability, have survived thus far without government support, and quite obviously does not have the capacity to compete in regional markets, let alone in the international market.

The protectionist policy that the automobile industry has enjoyed has been made possible through the National Automotive Policy, which has been in operation for more than twenty years. This policy has involved extremely high tariffs on imported vehicles and components as well as direct subsidies to Proton and Perodua. Further, the government has imposed a regime of restrictive import licensing that protects the domestic automotive sector from regional and global influences.

The Ministry of International Trade and Industry (MITI) is responsible for the system of import licensing that it manages through its approved permits (APs). APs are required for cars manufactured or assembled overseas before they can be imported, although they still would be subject to current duties. The APs are issued to bumiputera companies, which MITI endorses to be qualified importers. This licensing system has two purposes: a) to limit the number of imported cars relative to the size of the domestic market and b) to encourage the bumiputera to participate in the motor vehicle distribution business. This licensing system creates distortions in the domestic market for automobiles, decreases consumer welfare and creates a class of rent-seekers, all of which hampers achieving any progress towards the conclusion of free trade agreements (FTAs). Aside from the AP system, it has been noted that a large number of the vendors that service Proton and Perodua are bumiputera companies. While encouraging bumiputera participation in business is arguably a necessary part of the national agenda, subsidising a national project that is uncompetitive hardly helps the nation achieve its goals of liberalisation and integration in the process of globalisation. Thus, any argument that claims that it is necessary to support the automotive industry because it sustains the bumiputera vendors would be a flawed argument because the costs of doing so far outweigh any benefits that it could bring to the economy.

In the face of increased competition, it is necessary to liberalise and to remove bottlenecks that restrict trade or that discourage the inward flow of FDI. The automotive policy is an instance of protectionism that is not beneficial to the nation's economic development. First, the automotive industry is an industry that has not been able to survive despite government support for more than 20 years, and it involves the loss of consumer welfare. Second, a protectionist policy such as this is a hindrance to the accomplishment of FTAs with countries such as the United States and Australia. Third, protecting an industry that continually depends on government support is not an appropriate response for a country that has to squarely face the competition for FDI and export markets.

Conclusion

This paper holds the view that Malaysia being a small open economy should be sensitive to the international environment, particularly to shifts that affect Malaysia's exports and the inflow of FDI. This position stems from the fact that international trade and investments drive Malaysia's economic growth. In view of this fact, to adopt institutions or policies that affect the country's ability to attract FDI would only jeopardise our growth prospects.

Similarly, the structure of our exports clearly indicates that our manufacturing sector is largely export-oriented. Clearly, the country needs to adopt policies that will encourage the growth of our export-oriented industries. In that respect there is a need for microeconomic reform that stresses competition, efficiency and productivity. Policies that are based on sound microeconomic foundations will attract FDI and encourage the growth of manufacturing industries.

As the recent crisis has demonstrated, Malaysia is very vulnerable to external shocks. This indicates that Malaysia should be mindful of its domestic policy space. Towards this end, institutional reform has been suggested in order to promote competition, liberalisation and a transparent economy. These policies will be an important step in preparing ourselves for an increasingly competitive economic environment.

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