ANALYSIS OF THE REGULATION AND IMPLEMENTATION OF FOREIGN DIRECT INVESTMENT IN MALAYSIA

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Abstract

Foreign Direct Investment (FDI) is one of the ways to increase the significance of a country's economic growth. With all the easiness, facilities, strategies and maximum protection for foreign investors, Malaysia has succeeded in becoming one of the countries with high foreign investor interest. Malaysia is ranked 24th in the ease of doing business index as stated in the 2018 World Bank Doing Business Report. Until now, Malaysia has attracted more than 5,000 foreign companies from more than 40 countries to invest their capital. Therefore, this research intends to examine how the regulation and implementation of Foreign Direct Investment in Malaysia ranging from regulations, institutions, policies of the Malaysian government regarding business sectors, incentive policies and other special treatment for foreign investors. This research is also expected to be constructive information and suggestion for the development of Foreign Direct Investment in Indonesia.

Keywords: Foreign Direct Investment, Foreign Investors, Malaysia.

A. INTRODUCTION

There are so many ways for a country to acquire large funding for the national development and one of them is through Foreign Direct Investment (FDI). FDI is a foreign direct investment which is carried out according to or based on the provisions of the legislation in Indonesia or the country concerned, in the sense that the owner of the capital directly invests and bears the risk thereof. FDI can certainly provide a number of benefits to related countries such as the transfer of new technology that can increase the effectiveness of company production both locally and internationally.1

Since independence in 1957, Malaysia has fully utilized its tangible assets such as abundant natural resources, large and cheap labor, and a large domestic market. Not only that but also the intangible assets, namely the preferential trading status

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under the Generalized System of Preferences (GSP), the existence of macroeconomic stability, liberal trade regimes and efficient legal infrastructure to attract foreign investors. In general, Foreign Direct Investment (FDI) in Malaysia has been a relatively successful experiment.²

The main policy of the Malaysian Government is to utilize FDI as part of an economic development strategy to gain foreign technology, capital, and skills. For this purpose, a large part of the economic substitution took place from the import-based 1960s which became a strong and diverse export-oriented economy. This was followed by an unprecedented increase in the average Gross Domestic Product (GDP) of 8.9% per year from 1988 to 1996, mainly supported by FDI in the manufacturing sector. Since the beginning of the monetary crisis in Asia in 1997, FDI flow had been significantly declined in Malaysia. The Malaysian government has continuously increasing the investment flows after the economic situation began to stabilize.³

Malaysia is considered as one of the most attractive countries in Southeast Asia for foreign investors. Data from the Malaysian Industrial Development Authority (MIDA) states that in 2017, Foreign Direct Investment in Malaysia reached RM 54.7 billion in the manufacturing, service, agriculture, mining, plantation and commodity sectors. Malaysia's economy is relatively well-internationalized, diversification and export growth are of course Malaysia's main attractions. The country has also succeeded in creating a healthy business environment, it is ranked 24th in the ease of doing business based on the World Bank Doing Business Report 2018.⁴

Malaysia continues to make it is economically attractive to FDI by implementing a liberal and transparent investment policy. As for other advantages such as high cost-competitiveness, attractive investment incentives, infrastructure development, strategic position related to the proximity of the country to major Asian markets, important natural resources, strong service sector performance as well as higher level of domestic consumption, which driven by the highest GDP per kapita.

Malaysia also applies incentives within the framework of economic development plans to attract foreign investment in strategic sectors of activity.\(^5\) In fact, Malaysia has so far managed to attract more than 5,000 foreign companies from more than 40 countries to build their operations in the country. The foreign company also expanded and diversified its operations, reflecting their trust in Malaysia. It is undeniable, the dynamics of a good business environment, technology and infrastructure that continues to be developed, human resources are Malaysia's biggest assets, and the quality and strength of the existing economy.\(^6\)

But in recent years, foreign investment in Malaysia has decreased. Based on data from the UNCTAD World Investment Report 2019, foreign investment in Malaysia has reached between USD 9 billion and USD 12 billion since 2010, and making this country one of the highest recipients of FDI. In 2017, FDI flow fell to 9.5 billion US dollars, for the first time since 2010. But unfortunately flows to Malaysia continued to decline in 2018 with FDI flows reaching USD 8.09 billion, the lowest since 2009.\(^7\)

**Table 1. Foreign Direct Investment Flow in Malaysia (2010-2018)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign Direct Investment (FDI) in Malaysia, 2010 - 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>RM Billion 29.2</td>
</tr>
<tr>
<td>2011</td>
<td>RM Billion 37.5</td>
</tr>
<tr>
<td>2012</td>
<td>RM Billion 28.5</td>
</tr>
<tr>
<td>2013</td>
<td>RM Billion 31.2</td>
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<tr>
<td>2014</td>
<td>RM Billion 35.5</td>
</tr>
<tr>
<td>2015</td>
<td>RM Billion 39.4</td>
</tr>
<tr>
<td>2016</td>
<td>RM Billion 47.0</td>
</tr>
<tr>
<td>2017</td>
<td>RM Billion 40.4</td>
</tr>
<tr>
<td>2018</td>
<td>RM Billion 32.6</td>
</tr>
</tbody>
</table>

**Source:** Department of Statistics Malaysia, 2018.

\(^5\) Ibid.


But in terms of investor protection, Malaysia has a higher rank than Germany, the United States, and East Asian and Pacific Countries. This is proven by a variety of bilateral investment agreements held by Malaysia included 71 (seventy-one) as well as other trade agreements to make maximum protection for investors.\(^8\)

So based on everything described above, the following will be discussed further on how to regulate and implement Foreign Direct Investment in Malaysia. Both in terms of legal structure, in the form of institutions that supervise and handle FDI in Malaysia, as well as in terms of legal substance, in the form of regulations and policies of the Malaysian government regarding business sectors, incentive policies and other special treatments for foreign investors to attract investment interest in Malaysia.

**B. RESEARCH METHOD**

The method used to examine the problems in this research is normative juridical. This research is also a literature study using secondary data.\(^9\) Based on the research method, the approach used in this research is the statute approach, which refers to the rules or regulations of the country concerned, the historical approach that refers to the historical side of a legal institution or the law itself and the comparative approach, which is by comparing the law of one country with another country.\(^10\)

**C. RESULT AND DISCUSSION**

1. **Malaysian Legislation Regarding FDI**

   In the State of Malaysia, there are not many specific regulations regarding investment, the following are the laws and regulations existed :

   a. Act 327 : Promotion of Investments Act (PIA) of 1986

   This law is the main legal-based for the investment in Malaysia, and has been revised 7 (seven) times and most recently in 2014 (Act 1468). The law also recognizes the division of companies that receive Pioneer Status (PS) and Investment Tax Allowance (ITA), tax policies (both import and export),

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incentives provided, the type of industry and infrastructure as well as various other arrangements.

b. Act 156: Industrial Coordination Act 1975
This law is more focused on regulating licensing in manufacturing. This law has also been revised twice, namely in 1977 (Act A401), and in 1979 (Act A462).

Existing business sectors must comply with this regulation which provides pollution and environmental restrictions that can be caused by related companies. Which Act has also been revised in 1985 (Act A636).


2. Main Institutions/Institutions of FDI Malaysia
There are only two main institutions that directly handle Foreign Direct Investment in Malaysia, namely the Foreign Investment Committee (FIC) and the Malaysian Industrial Development Authority (MIDA). Until 2009, all interest acquisitions, mergers or takeovers were selected by the Foreign Investment Committee (FIC), under the Prime Minister and the Economic Planning Unit.\(^{11}\)

However, there have been reforms that have eliminated the oversight function of the FIC, except for certain large property transactions, thereby removing significant barriers to foreign investment in Malaysia, especially in the service sector where market entry often involves the acquisition of local companies. The reform does not remove all obstacles to foreign investment in these sectors but allows greater flexibility. So investors don't need approval from the FIC anymore.\(^{12}\)

Whereas the establishment of MIDA in 1967 was based on the Malaysian Industrial Development Authority (MIDA) Law, which was urged by the World Bank as "a necessary encouragement for purposeful, positive and coordinated

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promotional actions” for the development of Malaysian industries. To further enhance the role of MIDA in assisting investors, senior representatives from key government agencies are placed at the MIDA headquarters in Kuala Lumpur to advise investors on government policies and procedures. These representatives included officials from the Department of Labour, Immigration Department, Royal Malaysian Customs, Department of Environment, Tenaga Nasional Berhad dan Telekom Malaysia Berhad.13

The task of MIDA is to promote foreign and local investment in the manufacturing and service sectors, carry out industrial development planning in Malaysia, recommend policies and strategies for industry promotion and development to the Minister of International Trade and Industry, assist companies in the implementation and operation of their projects, and offer assistance through direct consultation and collaboration with relevant authorities at the federal and state levels and facilitating the exchange of information and coordination between agencies involved or connected with industrial development.14

3. Special Policy of the Malaysian Government Regarding FDI

The main factor that has attracted investors to Malaysia is the government's commitment to maintaining a business environment that provides opportunities for companies to grow and profit. This commitment is seen in the government's continued efforts to get feedback from the business community through consultation channels such as routine government-private sector dialogue. There are three things that become the main program of the Government of Malaysia to attract the interest of foreign investors:15 (1) Liberal Equity Policy, since June 2003, foreign investors can hold 100% of the equity in all investments in new projects, as well as investments in expansion/diversification projects by existing companies regardless of the level of exports and without excluding any products or activities; (2) Hiring Foreign Workers, foreign companies in the manufacturing sector are permitted to employ foreigners where certain skills are not available in

13 Ibid., hal. 62.
Malaysia. Companies with foreign paid-up capital of US $ 2 million and above will be allowed up to 10 expatriate posts; (3) Attractive Tax Incentives, this section will be explained in more detail in section 5 (five).

Basically the main policy that distinguishes Malaysia from other countries is the breakthrough in investment liberalization. On April 22, 2009, the Government liberalized the service sector to attract more foreign investment and bring in more professionals and technology and strengthen the sector's competitiveness. Recognizing the potential for growth in the service sector, the Government has decided to immediately liberalize 27 service sub-sectors, without equity conditions being imposed. These sub-sectors are in the areas of health and social services, tourism services, transportation services, business and computer services and related services. Even in 2018 the Government will re-open 18 other subsectors. No wonder why Malaysia is one of the countries that provides investment facilities and is targeted by investors.

4. Open and Closed Business Fields for Foreign Investment in Malaysia

Various business fields are open to foreign investors in Malaysia, since the liberalization policy in the investment sector, the Malaysian Government has not been reluctant to open dozens of sub-sectors without minimum equity requirements. This means that in the sub-sector, share ownership by foreign investors can reach 100% (one hundred percent). Even in 2003, all equity restrictions on foreign ownership in manufacturing were abolished, as was the requirement that foreign companies source half of their local credit from Malaysian banks. As a result, there are almost no restrictions remaining on foreign investment in manufacturing in Malaysia, beyond those that apply to all sectors.\(^\text{16}\)

In 2009, liberalization was carried out in several service subsectors, such as computers and related services, business services, tourist services, health and social services, transportation services and others. In 2011, the liberalization of this sub-sector was expanded, the following is: \(^\text{17}\)


Table 2. List of 18 Liberalized Sub-Sectors in 2011

<table>
<thead>
<tr>
<th>Sector</th>
<th>Liberalized Sub-Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunication</td>
<td>- Telecommunications services (network service providers and network facility provider licenses)&lt;br&gt;- Telecommunications Services (Application Service Provider license)</td>
</tr>
<tr>
<td>Health</td>
<td>- Private hospital services &lt;br&gt;- Medical specialist services &lt;br&gt;- Dental specialist services</td>
</tr>
<tr>
<td>Professional service</td>
<td>- Accounting and Taxation &lt;br&gt;- Architectural services &lt;br&gt;- Engineering services &lt;br&gt;- Legal services &lt;br&gt;- Quantity survey service</td>
</tr>
<tr>
<td>Environmental service</td>
<td>- Incineration services</td>
</tr>
<tr>
<td>Distributive trading service</td>
<td>- Department store and specialty shop</td>
</tr>
<tr>
<td>Educational service</td>
<td>- Private higher education with university status&lt;br&gt;- International school&lt;br&gt;- Technical and vocational secondary education services&lt;br&gt;- Vocational and technical secondary education services for students with special needs&lt;br&gt;- Skill training center</td>
</tr>
<tr>
<td>Courier Service</td>
<td></td>
</tr>
</tbody>
</table>

Besides liberalization, other foreign ownership is also restricted in radio/television broadcasting, water and electricity distribution, banks, health services, hydrocarbons, the car industry, the Stock Exchange and leasing companies. In the health sector, private hospital services require joint ventures and ownership in equity capital of 30%, while for investment banks, insurance companies, and takaful operators (sharia insurance) the foreign equity limit is 70%.18

Another only with the Negative Investment List (DNI) owned by Indonesia in Presidential Regulation of Indonesia Number 44 of 2016. Malaysia itself does not have specific rules regarding the list of investment sectors which are prohibited for foreign investors. In practice, the fields that are closed to foreign investors are

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18 OECD, Op.cit., hal.64.
investment are the postal service, railroad transportation, power generation (although there are already steps to privatization of the national electronic board) and other public utilities. But most business sectors in Malaysia are open (positive list) for foreign investors, both with and without conditions. As explained earlier, despite investment liberalization policies, not all business sectors in Malaysia are free from equity requirements, but most have been reduced to attract foreign investors to Malaysia.  

5. Investment incentives by the Malaysian Government

In this case, the Malaysian Government provides privileges to foreign investors who have met the qualifications in the form of incentives, namely non-tax incentives and tax incentives. We will discuss tax incentives first, there are two main tax incentives for the manufacturing and service sectors. This are the following further explanation:

a. Manufacture Sector

Eligibility for Pioneer Status (PS) and Investment Tax Allowance (ITA) are based on certain priorities, including the level of added value, the technology used, and industry relations.

1) Pioneer Status (PS)

Which provides an income tax exemption of 70% - 100% of mandatory income for 5 to 10 years. Capital allowances that are not absorbed and the accumulated losses that occur during the pioneering period can be continued and deducted from the post-pioneering status of the company. Companies that are granted Pioneer Status enjoy a five-year partial exception from income tax payments. He pays tax on 30% of compulsory income (obtained after deducting income expenditure and capital allowances from gross income), with the exemption period starting from Production Day (defined as the day the production level reaches 30% of its capacity). Capital benefits that are not absorbed and the accumulated

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19 Ana Rokhmatussa’dyah dan Suratman, 2015, Hukum Investasi & Pasar Modal, Sinar Grafika, Jakarta, hal. 151.
losses incurred during the pioneering period can be continued and deducted from the company's post-pioneer income.

2) Investment Tax Allowance (ITA)

There is 60% - 100% allowance for eligible capital expenditures (factories, factories, machinery or other equipment used for approved projects) that occur within 5 to 10 years from the date the first eligible capital expenditure is issued. As an alternative to Pioneer Status, companies can apply for Investment Tax Allowances (ITA). The company granted by ITA is entitled to a 60% allowance for capital expenditures that meet the requirements (factories, factories, machinery or other equipment used for approved projects) that occur within five years from the date the first capital expenditure that meets the requirements is issued. The company can offset this allowance for 70% of compulsory income for each valuation year. Any benefits that are not used can be continued into the following years until fully utilized. The remaining 30% of mandatory income will be taxed according to the applicable corporate tax rate. As well as applications this incentive must be submitted to MIDA.

Except the two types of tax incentives above, there are also other various incentives in the manufacturing sector, such as in the Agriculture sector, also known as incentives for food production. Special incentives are introduced to attract investment into food projects both at the agricultural level and at the production / processing level. This will increase the supply of raw materials for the food processing sector and thus reduce dependence on imported raw materials.

Then in the Industrial Biotechnology sector there are R&D Incentives (Research and Development Incentives). The Government realizes the importance of research and development (R&D), the Government will provide the following R&D incentives for viable projects that will be assessed by Biotech Corporation. Other incentives are also specific to various fields, such as Incentives for High Technology Companies, Incentives for Strategic Projects, Incentives for Small and Medium Enterprises, Incentives for Investment in Selected Industries
(Machinery and Equipment) and Additional Incentives for the Manufacturing Sector.\textsuperscript{21}

Then the tax incentives in the services sector are apparently no different from the manufacturing sector, the main tax incentives for companies that invest are Pioneer Status (PS) and Investment Tax Allowance (ITA). However, there are different types of incentives in accordance with existing fields, namely Incentives for the Hotels and Tourism Projects, specifically for tourism projects, including ecotourism and agro-tourism projects, entitled to tax incentives. Then there are Incentives for Mine Wellness City Developers, Managers and Operators and Incentives for Environmental Management, Incentives for Research and Development, Incentives for Research and Development, Incentives for the Promotion of Healthcare Travel and many more.\textsuperscript{22}

While the non-tax incentives provided by the Malaysian Government are as follows:\textsuperscript{23}

a. Investment Guarantee Agreement (IGA)

Malaysia has signed various IGAs with other countries reciprocally. With this agreement, the Malaysian Government provides guarantees for investors who invest, namely protection against expropriation and nationalization, guarantees to provide immediate and appropriate compensation if forced to nationalize, guarantee the freedom to transfer profits, capital or other fees, as well as guarantees for resolving legal disputes in the investment sector on the basis of the International Convention on the Settlement of Investment Disputes (ICSID). This protection guarantee is given to foreign companies in Malaysia that have obtained MITI approval.

b. The Convention on the Settlement of Investment Disputes

This agreement has been ratified as a form of fair investment dispute settlement service and in accordance with the procedures and rules of international law.

\textsuperscript{21} Ibid.
c. The existence of an industrial estate (industrial estate) along with all the supporting infrastructure.

d. There is a free trade zone facility. The industry in this facility gets several facilities, namely enjoying minimal control and formalities in the fields of customs, import of raw goods, machinery, and components which are directly for industrial processes freed and custom duty, enjoying minimal control and formalities for carrying out finished or semi-finished goods.

e. Tariff protection for industrial activities which are deemed very necessary. Requests for tariff protection can be submitted to MIDA.

f. Exemption of custom duty for export-oriented goods.

g. Exemption from drawback duties that apply to goods that are re-exported.

This investment incentive policy designed by the Malaysian Government is so specific and certainly in favor of foreign investors who want to invest their capital. This has become one of Malaysia's strengths to invite and attract foreign investors. So the higher the level of foreign investment in Malaysia, then of course it will have implications for the increasing rate of growth of the country's own income.

D. CLOSING

Malaysia is one of the countries with high foreign investor interest, and has even succeeded in creating a healthy business environment. With all facilities, maximum facilities and protection for foreign investors, Malaysia has become one of the right countries to invest. In terms of legal substance, the laws governing investment especially FDI are found in the Promotion of Investments Act (PIA) of 1986 and the Industrial Coordination Act 1975. But there are also implementing and sectoral regulations such as the 1974 Environmental Quality Act, Income Tax Act 1967, Customs Act 1967, Sales Tax Act 1972, Excise Act 1976 and Free Zones Act 1990.

Institutions that supervise and handle Foreign Direct Investment in Malaysia are the Foreign Investment Committee (FIC) and the Malaysian Industrial Development Authority (MIDA). In terms of specific FDI policies implemented in Malaysia, they are divided into three main policies, namely liberal equity policies, foreign labor policies and attractive tax incentives. Regarding liberal equity policies,
the Malaysian Government does not hesitate to open dozens of sub-sectors without minimum equity requirements. But there are also some restrictions on certain business fields such as radio/television broadcasting, water and electricity distribution, banks and several other financial fields. The fields that are closed to foreign investment are postal services, rail transport, power plants and other public utilities.

In addition, when talking about incentives provided by the Malaysian Government is very specific, both non-tax incentives and tax incentives. There are two main tax incentives for the manufacturing and service sectors, namely Pioneer Status (PS) and Investment Tax Allowance (ITA) as well as various other incentives. While non-tax incentives are also very diverse such as the existence of industrial estates along with all supporting infrastructure, the existence of free trade zone facilities, tariff protection, exemption of custom duty, excise duty and others.

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Internet
