

## MALAYSIA'S FREE TRADE ZONES AND THEIR IMPACT ON MALAYSIAN ECONOMY

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### *Introduction*

The Free Trade Zones (FTZ) are the most important and effective single physical means instituted by the Malaysian government to bring about the internationalization of the Malaysian economy. They are also the main instrument to rearticulate the economy towards international productive capital. The Free Zones Act. of 1971 was basically directed towards the attraction of foreign investment (foreign capital and technology) to assist the Malaysian economy to take off, and at the same time to help resolve the growing problem of unemployment. However, it might be doubted whether the FTZ industries are bringing in as much of the foreign exchange, transfer or technology and linkages with and within the local economy that they were envisaged to effect, and whether what they are doing is being done unproblematically.

The purpose of this article is to examine and evaluate the historical development of Malaysia's Free Trade Zones and their economic performance, to discuss the extent to which Malaysia has so far benefitted from them, and at the same time to show how they have served the internationalization of the Malaysian economy.

### *Historical Development Of Malaysia's Free Trade Zones*

Export-processing or Free Trade Zones have been designated as special areas in which foreign or domestic firms may manufacture or assemble goods for exports without being subjected to the normal custom duties on imported raw materials or exported products. As a matter of fact, the South Korean government describes its "Zone" in the following manner: (1).

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(\*) S. Ü., İ.İ.B.F. Öğretim Üyesi.

(1) "A Case Study of the Masan Free Export Zona", Industrial Administration, The Government of Korea, Seoul, 1974, p. 8.

If we examine local and export sales values and compare the values of imported raw materials, local raw materials and raw materials from other FTZs over a 9-year period, we see that the FTZs are export-oriented and internationalized in their character. For example, total sales (export and local sales) were MS4,044 million in 1982, to which exports contributed MS33,930 million and local sales only MS113,9 million. In percentage terms exports comprised 97.18 percent of total sales, and local sales made up only 2.82 percent (8). The other indicator and widely discussed feature of the FTZs is the provenance of their raw materials. We may distinguish three sources of raw materials, namely imported raw materials and raw materials from within FTZs. We used from Table 5.9 that in 1982, 86.81 percent of the total raw material used in the FTZs were imported, costing MS2,717 million, whereas only 4.8 percent of raw materials were of local origin, costing MS109,451 million. Furthermore, 8.4 percent of raw materials originated within the FTZs themselves, accounting for MS197.037 million. If we make the same calculation for local purchase of raw materials, we will find the percentages of total raw materials purchased locally were 2.3, 3.4, and 2.8, respectively. At the same time, the percentage of raw materials purchased within FTZs have risen, being 0.0 percent 4.2 and 2.7 percent respectively (9).

To place the importance of FTZs in perspective, their total exports in 1982 amounted to MS3.93 million in value. From the 1983/84 Economic Report of the Ministry of Finance, Malaysia's total merchandise export exports in that year were MS27.97 billion and total exports for manufacturing goods were MS7.72 billion. Moreover, FTZ exports comprised 14 percent of the value of manufactured goods within the electronics and electrical goods category, and exports from FTZs comprised fully 89 percent of total Malaysian exports of these commodities. From the above discussion, we can clearly draw the conclusion that production in the FTZ is more export-oriented and internationalized than in the rest of the manufacturing sector, where import-substitution predominates.

Table 3 provides the aggregate distribution of the values and percentages of exports, local sales, export/total sale ratios, imports, local purchases, purchases within FTZs and local/total raw materials, imported capital equipment, locally purchased capital, and local/total capital equipment ratio by type industry and by state.

Examination of final sales of FTZ products reveals that the electrical, electronics and garment industries are more export-oriented than the

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(8) Warr, *Ibid.*, p. 38.

(9) *Ibid.*

textile industry. Export/total sales ratios are; for the electronics industry 99 percent; for the electrical industry 100 percent; for garments 99 percent, and for textiles it is 87.3 percent. If we look at raw materials, the local/total raw material ratio for electronics is 2.2 percent, for textiles 3.5 percent, for garments 8.0 percent and for the electrical industry 37.1 percent, showing that raw materials for electronics, textiles and garments are overwhelmingly imported. Only in the electrical industry within FTZs do there seem to be strong backward linkages (i.e. benefits accruing to the local economy) with reference to raw materials.

These data are particularly interesting in the case of the electronics industry which accounted for about 85 percent of total FTZ exports in 1982 and 72 percent for the total FTZ employment. It can be seen (Table 3 and 4) that virtually all of the production of the electronics industry was exported and almost all of its raw materials and capital goods imported. Value added in this industry was 22 percent of the total sales; wages accounted for only 38 percent of total value added while total taxes constituted only 0.7 percent. This means that there was minimal direct benefit from this particular industry to the local economy except wages (10).

Moreover, the advent of rapid technological changes in the electronic industry and promotion of labour-saving production processes reflected themselves in declining ratios of wage payments to total sales through the 1970s. In 1973, this ratio was 9.1 percent and it fell to 5.2 percent in 1979 through it rose again 8.2 percent in 1982 because of rising real wages in the electronics industry (Table 5.8.). In contrast, the ratio within the electrical industry remained relatively constant, at about 8-9 percent in the same period (11).

Table 5.10 also provides some insights into the backward linkages for electricity used, total taxes paid and payments in wages. Low levels of backward linkages are evident throughout. Even the total taxes paid by FTZ firms in 1982 was as low as MS5.3 million. This may be attributed to the incentives which these companies are entitled to, particularly during their early years of operation.

Conclusion all of these suggest that the degree of linkage between FTZ firms and the domestic economy, particularly via the purchase of domestically produced raw materials and capital equipment has been less anticipated by the Malaysian government. It seems appropriate to consider linking future, tax incentives to this feature of the FTZ performance,

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(10) Warr, *Ibid.*, p. 42.

(11) *Ibid.*

perhaps by making tax exemption conditional upon such form of linkage. The primary obstacle to greater basic and raw materials domestically (especially in the case of the semi-conductor industry) at the required standards of quality, availability and this concurs with the conclusion of Peter War and M. Datta Chaudhuri (12). Clearly, then policies directed at potential supplier of raw materials and capital equipment have a crucial role to play if greater linkage between FTZs and the domestic economy is to be achieved. In short, local supplies and their operations and products since the existence of FTZ per se (?) appears to be an inadequate stimulus in that direction.

TABLE - 1  
FREE TRADE ZONES IN MALAYSIA

Free Trade Zones	State	Firms (No.)	Paid-up Capital (MS '000)	Workers (No.)
Bayan Lepas	Penang	16		34.087
Prai		10	330.400	5.287
Prai Wharf		1		2.554
Sungai Way	Belangor	16		12.471
Ampang/Ulu Klang		6	115.616	10.465
Teluk Panglima Garang		3		2.579
Banu Berendam	Malacca	8		4.904
Tanjong Kling		3	21.608	1.415
<b>TOTAL</b>		<b>83</b>	<b>467.624</b>	<b>74.875</b>

Source : M. Anazawa, "Free Trade Zones in Malaysia."

Hokudai Economic Papers, Vol. VI. 1985-86, pp. 91 - 147,

Tables 3-3, 3-4 (p. 106).

Note : Five firms are not included for numbers of firms and workers for Bayan Lepaz FTZ.

(12) M. Datta Chaudhuri, "Role of Free Trade Zones in Employment Creation and Industrial Growth in Malaya", in Export Processing Zones and Industrial Employment in Asia, Eddy Lee (ed.), International Labour Organization, Asian Employment and Programme (ARJEB), Bangkok, 1984.

TABLE - 2  
 AGGREGATE PERFORMANCE OF FREE TRADE ZONE FIRMS : TOTAL ALL FIRMS, 1972 - 1982  
 (HS 1,000)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Exports (HS 1,000)	6,929	223,742	448,809	723,282	1,157,266	1,153,462	21,179,295	3,622,531	3,872,375	3,818,887	3,930,347
Local sales (HS 1,000)	—	338	5,571	4,229	17,869	12,602	23,230	58,081	2,944	36,406	113,889
Imported raw materials	4,145	155,666	362,173	502,729	718,674	702,451	1,412,734	1,676,492	2,484,677	2,384,336	2,717,395
Local raw materials	205	3,674	12,051	20,398	26,308	37,973	47,226	51,648	61,763	72,760	109,451
Raw materials from FTZs	—	—	—	15,152	32,669	33,845	95,434	143,532	170,068	117,420	197,037
Imported capital equipment	434	47,731	157,141	93,603	50,634	64,887	67,089	186,211	165,260	178,436	184,795
Local capital equipment	1,558	19,847	66,975	74,592	8,406	12,974	16,821	53,697	14,733	19,721	16,773
Employment (number)	n.a	21,243	25,591	31,743	42,051	46879	53,309	59,529	67,053	72,509	69,757
Total wages paid	3,130	23,283	53,174	64,043	94,451	126,136	183,522	221,476	304,863	346,205	327,586
Total electricity used	31	2,149	5,130	16,360	22,360	22,116	22,763	39,394	57,157	83,372	84,329
Total taxes paid	—	—	—	1	17	94	415	390	347	2,165	5,309
Total number of firms	12	23	45	55	58	61	68	68	74	82	84

Source: P. G. Warr, "Malaysia's Industrial Enclaves: Benefits and Costs",  
 in *The Developing Economies*, Vol. XX, Tokyo, 1987.

TABLE - 3  
AGGREGATE CHARACTERISTICS OF FREE TRADE ZONE FIRHS, 1982

Industry	Exported (M\$ 1.00)	Local Sales (M\$ 1,000)	Export/ Total Sales (%)	Imported (M\$ 1,000)	Local Purchase (M\$ 1,000)	Purchase within the FTZs (M\$ 1,000)	Local/ Total Raw		Purchase Imported (M\$ 1,000)	Purchase Total (M\$ 1,000)	Local/ Total (%)
							Material	Imported			
Electronics	3,343,835	3,323	99.9	2,458,755	57,449	63,540	2.2	167,650	13,836	7.6	
Electrical	91,403	0	100.0	40,273	23,801	—	37.1	2,243	1,639	42.2	
Garments	9,996	10	99.9	8,888	772	—	8.0	317	0	0	
Textiles	343,244	49,811	87.3	164,204	10,670	133,497	3.5	4,018	566	22.3	
Others	141,870	10,725	70.0	45,275	16,759	—	27.1	10,567	732	6.5	
Selangor	1,873,780	3,110	99.8	1,313,026	40,861	—	3.0	85,528	6,360	6.9	
Melaka	387,080	671	99.8	188,474	15,371	4,735	7.4	13,682	1,219	8.2	
Pulau Pinang	1,660,587	110,088	99.8	1,215,895	53,219	192,302	3.6	85,585	9,194	9.7	
TOTAL	3,930,347	113,369	97.2	2,717,395	109,451	197,037	3.6	184,795	16,773	9.3	

Source : Ibid.

TABLE - 4  
 AGGREGATE CHARACTERISTICS OF FREE TRADE ZONE FIRHS, 1982

Industry	Total Employment	Total Wages (M\$ 1,000)	Electri. Used (M\$ 1,000)	Total Taxes		Total Value Added (M\$ 1,000)	Value/Added. Total Sales (%)
				Paid (M\$ 1,000)	Added (M\$ 1,000)		
Electronics	52,954	261,616	46,661	4,934	720,753	21.5	
Electrical	895	11,567	8	0	27,321	29.9	
Garments	1,572	4,774	178	9	2,892	28.9	
Textiles	7,451	35,104	33,058	18	51,626	13.1	
Others	6,885	14,525	4,424	348	141,412	67.2	
State							
Selangor	26,107	102,227	24,447	749	506,556	26.9	
Malaka	7,352	30,486	5,640	86	173,481	44.7	
Pulau Pinang	36,298	194,873	54,242	4,474	263,967	14.8	
<b>TOTAL ALL FIRHS</b>	<b>69,575</b>	<b>327,586</b>	<b>84,329</b>	<b>5,309</b>	<b>944,004</b>	<b>23.1</b>	

Source : Ibid.

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