Multinational Corporations and Development in Malaysia: A Comment

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Introduction

A recent article by Lim Mah Hui argues that the effects of foreign investment on Malaysian economic development are generally unfavourable. Although Lim presents statistical data to support his arguments, the inferences he draws from these data are open to question. His conclusions about the unfavourable effects of foreign investment in Malaysia may be correct, but they do not necessarily follow from the analysis of the data he presents. The reason for this is that the available data are usually too aggregative and too imprecise to justify the inference of general statements about the effects of foreign investment on Malaysian economic development.

High Rates of Profit

Lim (page 56) states that the rate of profit multinational corporations earn in Malaysia is excessively high when compared to the rate of profit they earn in their operations in the world as a whole, or in their operations in their home countries.

The first piece of evidence Lim presents is a Table (Table 3 page 67) from the Reddaway Report which shows that the average annual rate of profit (before taxes) earned by UK foreign direct investment in Malaysia for the period 1956-64 was the third highest after West Germany and Italy in a sample of fifteen countries. This is taken as evidence of the view that, compared with other countries, Malaysia is a source of very high profitability for multinational corporations. While this may be the case, the Reddaway data should be treated with caution since there are reasons to believe that the reported rate of profit for UK foreign in Malaysia may be biased upwards.

First, the Reddaway Report itself points out that the high rate of profit before taxes may be a consequence of tax considerations. There is a positive, though weak, correlation between profit taxes and the pre-tax rate of profit. Looking at taxes as a percentage of capital employed (the factor by which the pre-tax profit rate has to be reduced in order to arrive at the post-tax profit rate), Malaysia had the fifth highest ratio of taxes to capital employed in the sample of fifteen countries. This accounts for its very high rate of profit before taxes. The post-tax rate of profit earned by UK foreign investment in Malaysia is also high, but this may be a reflection of the fact that multinational corporations raise their pre-tax profits by more than is necessary.
to allow for taxes since there are no restraints on the repatriation of profits from Malaysia.

Second, the rate of profit for Malaysia includes the mining and plantation sectors in addition to the manufacturing sector. Although the Reddaway Report\(^4\) states that the high rate of profit for Malaysia owed a good deal to the mining sector, we are not told to what extent the Malaysian rate of profit is biased upward on this account. All we are told is that the profit rate for other industrial groups was considerably above their average for the world as a whole.

Third, the rate of profit for Malaysia includes data from Singapore since the latter did not become a separate political entity until 1965. Taking "Malaysia" in the Reddaway Report to mean "Peninsular Malaysia" only (as implied in the article by Lim) assumes that the inclusion of Singapore in the data is unlikely to cause any bias in the reported rate of profit. This may not be the case.

Fourth, the computations of the rate of profit in the Reddaway Report are based on historical cost and make no allowance for stock appreciation. The Report itself points out\(^4\) that computations on a replacement cost basis alone will reduce the average rate of profit for the whole sample by about 3 percentage points. This is a reduction of about 30% in the average rate of profit. Unfortunately, no replacement cost estimates of the rate of profit are given for individual countries. All we are told is that the excess of market value over book value of UK assets in Malaysia at the end of 1964 was 131%. This figure was considerably higher than the corresponding figure for all the other countries in the sample (except Italy) and suggests that, when computed on a replacement cost basis, the rate of profit ranking of countries will be quite different from that shown in the Reddaway Report.

Fifth, no allowance is made, in the interpretation of the rate of profit, for risk. Considering that the period covered in the Reddaway Report (1956-64) contains some turbulent years of the Malaysian economy (e.g., the uncertainties surrounding the granting of independence amid terrorist insurgency in 1959; the political and racial violence during the formation of Malaysia in 1961; and the subsequent "Confrontation" offensive by Indonesia during 1961-63), it is likely that the rate of profit of foreign investment in Malaysia during this period contains a large risk premium.

Thus the high rate of profit recorded in the Reddaway Report to be earned by UK foreign investment in Malaysia is likely to be biased upward. It may be conceded, however, that foreign investment in Malaysia yields a higher rate of profit for multinational corporations compared with most other less developed countries. The reasons for this are to be found in the efficient primary product export industries established by the British during the Colonial era, the social and financial infrastructure laid down during this period, and the relatively affluent domestic market which enabled profitable manufacturing industries to be established.\(^4\) While it may be conceded that the rate of profit earned by foreign investment in Malaysia may be higher than that earned in most other less developed countries, whether this rate is excessively high cannot be decided by appealing to the data in the Reddaway Report since, for the reasons given above, the data should be treated with caution.

Lim (page 56) also quotes the Reddaway Report\(^7\) to show that during the first five years of a "green field" venture (one which has not been developed before), a project in a developed country is usually still incurring losses, whilst that in a less