

The Development of Free Industrial Zones—The Malaysian Experience

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The Development of Free Industrial Zones – The Malaysian experience

1. The Beginning

1.1 Malaysia which was overly dependent on its primary commodities like rubber and wood in the fifties, made a conscious effort to move into industrialization after the country gained independence in 1957. The initial focus was on encouraging import substitution industries such as consumer products and resource-based industries. However in the late 1960s, the country was faced with the mounting challenge of finding jobs for its growing population, where the unemployment rate was hovering around 7.3 % with a more critical 14.5% in Penang.

1.2 Amid such challenges coupled with the loss of Penang's free port status, the Penang State Government headed by then Chief Minister Dr Lim Chong Eu took a major step that transformed the landscape of Penang's economic development and charted the beginning of the State's journey to industrialization with the proposal to develop the free trade zones (FTZs) aimed at attracting foreign direct investments (FDIs) in export-oriented industries, which could generate jobs to absorb the high number of unemployed Malaysians. The State Government was convinced of the move, taking the cue from the successful implementation of the FIZs in Taiwan and Korea.

1.3 With the support of the Federal Government, the Free Trade Zone Act 1971 was gazetted, for the orderly development of the industrial parks for export-led industries. August 1972 saw the opening of Malaysia's first Free Trade Zone (now known as Free Industrial Zone) in Bayan Lepas, Penang.

2. The Free Industrial Zone Model

2.1 In Malaysia, land matters are under the jurisdiction of the respective State Governments while the State Development Corporations are entrusted to oversee the development of the industrial sector in their own states. In the case of the Bayan Lepas FIZ, the Penang Development Corporation (PDC) was the agency that developed the Bayan Lepas FIZ and other government initiated industrial parks in the state. As the body responsible to develop the industrial parks, PDC and other similar state corporations will need to coordinate to ensure that all the necessary infrastructure such as roads and drainage are in place and utilities including electricity, water and telecommunications are readily available when the industrial lots at the FIZ are ready to be sold or leased to potential

investors. The industrial lots are sold either as freehold land or in some states the land can be on a leasehold basis, normally either 60 years or 99 years.

2.2 Malaysia's FIZs began as FTZs with the gazette of the Free Trade Zone Act 1971. However over the years, as the country became increasingly more industrialized, there was also a corresponding development in trade and services, which require bonded areas or free zones to facilitate their businesses, such as bulk breaking grading, repacking, re-labelling and other ancillary activities geared for the export market.

2.3 Taking cognizance of this need, the Malaysian Government created two categories of free zones- the Free Industrial Zones, which replaced the original FTZs and a second category, the Free Commercial Zones to cater to the needs of the trading and services communities, in particular to promote entrepot trade.

2.4 These free zones are governed via the Free Zones Act 1990 and The Free Zones Regulations 1991, which came into force on 5 September 1991, replacing the Free Zones Act 1971. Under the Free Zones Act 1990, the Minister of Finance may declare an area to be a free zone, mainly for the manufacture of goods for export.

2.5 FIZ will have minimal customs control and deemed to be a place outside Malaysia and is not subjected to the applications of the Customs Act 1967, Excise Act 1976, Sales tax Act 1972 and Services Tax Act 1975, except with regards to the Prohibition of Imports and Exports under Section 31 of the Customs Act 1967.

2.6 To qualify for location in a FIZ, a company has to export at least 80% of its output and its raw materials/ components are mainly imported, even though the government does encourage the use of local raw materials/components. If a FIZ company has obtained an approval from the Ministry of International Trade and Industry to reduce its export condition to 60%, it can also apply to the Customs to be allowed to export 60% instead of 80%.

2.7 Companies operating in a FIZ can enjoy duty-free imports of raw materials, including packaging materials and machinery and equipment used directly in the production of approved products as in their Manufacturing Licence (ML) (unless these manufacturers are exempted from ML). The FIZ manufacturers are also exempted from the payment of sales tax, excise duty and service tax.

2.8 Machinery and equipment that are allowed to be brought in duty-free include testing equipment; tools; quality control gadgets, labeling machines, workbenches; weighing scales; spare parts for the processing equipment; replacement machinery; grinding stones and welding shields.

2.9 Raw materials or components which are not directly used in the manufacturing process will not enjoy the said duty/tax exemptions. Items under

this category includes fuel; office furniture and equipment including air conditioners; construction materials; food and drinks; vehicles and spare parts; forklifts; firefighting equipment and pollution control equipment and wearing apparel for employees.

2.10 As an FIZ is deemed to be outside the country, any goods taken out of the FIZ into the Principal Customs Area (PCA) are deemed to be imported into the country and will be subject to the payment of the prevailing customs duty and sales tax. As companies in FIZ are at least 80% export, the portion allowed for sale into the PCA will be based on the following:

- For consumer and intermediate goods, where such goods are also produced in the PCA, import duties equivalent to the Asean Free Trade Area (AFTA) Common Effective Preferential Tariff (CEPT) rates will be imposed.
- For consumer and intermediate goods, where such goods are also produced in the PCA but have local content of more than 51%, an import duty of 5% ad valorem or equivalent excise duty rate for products subject to excise duty), whichever is the higher, will be imposed.
- For consumer and intermediate goods which are not produced in the PCA, an import duty of 3% ad valorem will be imposed
- For intermediate goods such as raw materials/components, machinery and equipment for the manufacturing sector, manufacturers in the PCA can apply for full import duty exemption.

2.11 These goods manufactured in the FIZ and brought into the PCA are deemed to be imports, hence the goods must be declared for importation on Customs Form No1. Similarly any goods from the PCA brought into the FIZ are deemed to be exports and are required to be declared on Customs Form No 2.

2.12 To ensure proper documentation of the movement of goods as below, Customs Form 8 are used for:

- Goods from a FIZ to another through PCA;
- Goods exported from FIZ through PCA
- Transfer of goods from Licensed Warehouse; Licensed Manufacturing Warehouse (LMW) to a FIZ through a PCA;
- Goods from overseas imported through PCA

2.13 There has been an increasing trend for outsourcing or subcontracting, where semi-finished goods and raw materials are sent to another factory, located in another FIZ, Licensed Manufacturing Warehouse (LMW) or in the PCA, for specific processes eg. sub assemblies and subsequently returned to the main

company in the FIZ, these are allowed provided prior approval has been obtained from the State Director of Customs.

2.14 The proper functioning of a free zone involves three parties- the Free Zone Authority, which can be a statutory body, State or Federal Department or company appointed by the Minister of Finance to administer, maintain and operate the free zone; the Customs Department and the operator or company in the zone in the case of FIZ, while in Free Commercial Zones in the vicinity of the Port, the operators are normally private entities like the port corporations.

2.15 The Free Industrial Zone Authority, which is normally under the local council/ local authority governing the area, takes charge of the entry/ departure of persons /goods from a FIZ. The scope of the Authority includes approval to operate at the FIZ, approval to construct buildings in the zone; as well as identifying areas for different activities in the zone.

2.16 The FIZ authority is also responsible to:

- build and maintain the perimeter fences surrounding the FIZ, with entry and exit points, which are to be lighted;
- provide a Customs office and examination bays,
- ensure the factories comply with the Free Zones Act 1990 and Regulations,1991
- submit annual report on all activities at the FIZ,
- control movement of people and goods into and from the FIZ,
- safeguard customs duties and dutiable goods stored in the FIZ and
- comply with directives of the Director General of Customs

2.17 The FIZ companies are responsible to maintain proper records of all activities at their premises, including goods received at the premise and taken out to the PCA, waste stock and method of disposal with the written approval of the Free Zone Authority, after consultation with the Customs Department.

2.18 The Customs Department meanwhile is entrusted to control the movement of goods at the entry/exit points and is empowered to search premises/vehicles/persons and has the power of arrest as well as seizure of goods.

3. Free Commercial Zone Model

3.1 Free Commercial Zones (FCZs) are also governed under the Free Zones Act 1990 and Free Zones Regulations 1991 as indicated earlier. The rationale for the setting up of the FCZ was the promotion of commercial and trading activities in Malaysia, including entrepot trade, in line with the promotion of the services sector.

3.2 FCZs are normally located near the country's ports due to the nature of the activities, which can include bulk breaking, repackaging of products which are either imported or sourced from companies in the FIZs or Licensed Manufacturing Warehouse (LMWs) or from the PCA. Just like in the FIZs, companies in the FCZs are exempted from payment of duties, sales tax and service tax for all imports, which will be subsequently re-exported together with other products or as components of another product being repackaged in the FCZs. To-date, the FCZs in Malaysia are as follows:

1. Mukim of Plentong , Johore Baru
2. Pengkalan Kubor, Tumpat Kelantan
3. Bukit Kayu Hitam
4. Mukim of Kapar, Klang Senagor
5. Westport Pulau Indah, Klang
6. Prai Wharf, Seberang Prai, Penang
7. Mukim 12 District of Barat Daya Penang
8. KLIA Sepang
9. Tanjung Pelepas
10. MILS Logistic Hub Mukim Klang I

4. Licensed Manufacturing Warehouse (LMW)

4.1 In efforts to encourage a more balanced dispersal of export-oriented industries in all the states in the country, the Royal Malaysian Customs has introduced the LMW facility in states where the setting up of FIZ are neither feasible nor practical. The setting up of LMWs is provided for under Section 65 and 65A of the Customs Act 1967.

4.2 A manufacturing company which exports at least 80% of its production and import the bulk of its raw materials/components qualifies to apply for the LMW facility. However a company which has obtained an approval from MITI for a lower export condition, the level of export, which is normally not less than 60% will be allowed by the Customs for the approval of LMW.

4.3 In order to expedite the evaluation of the applications, all LMW applications are evaluated at the State Customs, where the plants are to be located and approvals are given by the State Director of Customs. The LMW facility would be considered only for plants with solid buildings, which are of a permanent structure, safe and which have complied with the requirements of the Fire Department and the Local Authorities. The plants must have separate storage for raw materials, finished products and wastes/rejects. Any changes to the structure of the buildings or a change of premises require the approval of the State Director of Customs. All LMW applicants must attach a list of all their raw materials/components and machinery and equipment and their quantities

required to be used for a year. The duration of the approval or licence is one to two years, with renewal to be done at least one month prior to the expiry of the licence. An LMW licence requires an annual payment of RM1,201.

4.4 An LMW Status company is deemed to be located in the PCA and is subject to the provisions of the relevant Customs laws except the Sales Tax Act 1972 and Excise Act 1976. In the initial years of implementing the LMW facility, each LMW company was required to build a fence to enclose the area, which also had the physical presence of a Customs officer to control all imports and exports from the plant or LMW. However, recognizing the need to facilitate companies doing business in Malaysia, the Customs has changed the system to a documentary control, where there was no longer a requirement to station a Customs personnel at each of the LMW, and all movement of goods ie imports, exports as well as for sub-contracting are through the proper keeping of documents by the LMW companies for submission to the State Customs on a regular basis. Customs would then undertake audits on the LMWs.

4.5 All sub-contracting or farming out work would require prior approvals of the State Director of Customs. Imported raw materials may be sent directly to the subcontractor located outside the LMW and exports undertaken on behalf of the anchor company which is the LMW company, is allowed with approval from the State Director of Customs.

4.6 LMW companies also enjoy duty-free imports of raw materials/ components and machinery and equipment, directly used in the manufacturing process with minimal Customs control. LMW companies are allowed to sell part of their output in the domestic market; however the sales will be considered as imports into the country and will be subject to the relevant import duties and sales tax, if any. However companies can apply to the Ministry of Finance for partial duty exemption on the goods to be sold in the domestic market.

5. Growth of the Bayan Lepas FIZ and Electronics and Electrical Industry Cluster

5.1 The opening of the Bayan Lepas FIZ in 1972 could be considered as the turning point for greater industrialisation in Penang and the start of the electrical and electronics industry cluster in the state.

5.2 The opening up of the FIZ with proper infrastructure which enabled duty-free import of goods into the zone for the production of finished products for export, with minimal Customs control, had attracted export-oriented manufacturers particularly from abroad, to move or expand their operations in the FIZ.

5.3 With concerted promotional efforts by both the Federal and Penang State Governments and supported by the provision of attractive incentives, eight

multinational companies- Advanced Micro Devices Export Sdn Bhd; Agilent Technologies Sdn Bhd; Clarion Sdn Bhd; Fairchild Semiconductor Sdn Bhd; Hitach Semiconductors Sdn Bhd; Intel Malaysia Sdn Bhd; Osram Opto Services and Robert services Sdn Bhd, had set up base there. The presence of these MNCs formed the nucleus of the electronics industry cluster in the country, which later also came to be known as Malaysia's Silicon Valley.

5.4 The development of FIZs in Malaysia happened at the time when the US relaxed the US Customs Regulations 806.3 and 807.0, which provided the push factor for labour-intensive US companies to relocate their production facilities overseas so as to reduce cost of production to compete with manufacturers from Japan and Europe.

5.5 The first wave of the electronics industry in Penang saw the setting up of semiconductors factories focussing on simple assembly operations, given the abundant low cost female workers. The growth of the electronics and electrical industry in Malaysia, which was given a boost with the opening of the FIZ in Bayan Lepas, has changed the landscape of Malaysia's manufacturing sector.

5.6 In 1980, Bayan Lepas FIZ (then termed as Phase 1) attracted some RM 57.4 million in foreign investments in 10 projects. From then on it was an upward trend of foreign investors bringing in new investments or expand/diversify their operations there. From 1980 until the end of the Second Industrial Master Plan (IMP2) period in 2005, the Bayan Lepas FIZ Phase 1 had recorded some RM5.3 billion in FDIs and by end-2008, the amount reached RM8.4 billion. With the success of the first phase and the still rising demand in particular by foreign investors, the Penang State added another three phases in Bayan Lepas ie Phase II, III, and IV. As at end of 2008, the four phases of the zone had attracted foreign investments of RM14.6 billion, of which over 90% (RM13.2 billion) were attributed to the E&E industry.

5.7 Total investments in the four zones amounted to RM 16.3 billion in 408 projects, generating over 89,000 potential new jobs, of which more than 80% were from E&E companies.

5.8 With the successful implementation of the FIZs in Bayan Lepas, an area in Prai on the mainland was gazetted as a FIZ. Other states in Malaysia were also drawn to Penang's early success to attract FDIs to the designated zones and had similarly set up FIZs in their respective states.

5.9 To-date there are 18 FIZs in Malaysia two in Penang - Bayan Lepas (Phase I, II, III, IV) and Prai; five in Malacca - Peringggit I,II,III, Tanjung Kling and Batu Berendam; four in Selangor -Teluk Panglima Garang, Sungai Way, Hulu Klang; Pulau Indah; two in Perak - Kinta and Jelapang II; four in Johor - Pasir Gudang, Tanjung Pelepas I,II,II and one in Sarawak - Samar Jaya. Refer to Appendix 1.

5.10 In tandem with the growth of the FIZs, the electronics industry also continued to expand. For the IMP2 period from 1996-2005, a total of 651 electronics companies with investments of RM53.2 billion, commenced operations. The total investments in the electronics industry accounted for some 92% of the total investments of RM57.4 billion by 901 companies that commenced operations in the E&E industry during the same period. These companies are mainly located in the FIZs in Penang and Selangor with a number of them expanding to the Kulim Hi-Tech Park in Kedah but operating under the LMW status.

5.11 Penang's E&E industry which has grown out of the Bayan Lepas FIZ now encompasses a wider range of products and activities including computer and peripherals; optics; telecommunications products as well as providing services such as design of integrated circuits and prototyping.

5.12 Over the years the semiconductor segment has also expanded and moved up the value chain through automation to produce advanced semiconductor packages like flip chip, organic land grid array (OLGA) packages, field-programmable gate array (FPGA) and multi-leaded chips.

5.13 The E&E industry has also evolved to a stage today, where an increasing number of MNCs in E&E have turned their Malaysian base into a centre for value added activities such as R&D, design and development, brand development, procurement, distribution and customer service while undertaking virtual manufacturing through appointed vendors. Such virtual manufacturing operations from three MNCs have benefited over 800 local sub-contractors and suppliers.

5.14 Some of these companies such as Siemens, General Electric, IBM and Sharp Electronics have set up Operational Headquarters (OHQ) while Matsushita, Sony, TDK, Hitachi, Sharp, Canon, B Braun, Dell, Acer, and Flextronics have set up International Procurement Centres (IPCs) here to serve the regional market.

5.15 With a strong presence created out of the FIZs, the E&E industry with some 1,800 companies in operation has emerged as the largest industry in Malaysia's manufacturing sector, accounting for 55.1% of the total manufactured exports in 2008. As electronics accounts for more than 90% of total E&E exports, it would be significant to observe that the electronics sector generated an output of RM167.2 billion in 2008, representing 29.3% of total manufactured output and creating employment for 296,870 people or 28.8% of total employment in the manufacturing sector.

6. Benefits of FIZs

6.1 Adoption of export-led and import substitution policies

The establishment of FIZs which are deemed to be outside Malaysia, enables the country to pursue a two-pronged strategy ie. an export-led one focusing on the FIZs and the import substitution strategy to grow local industries and reduce the dependence on imports as the implementation of import substitution industry could at times be in conflict with the promotion of export-led policies for example, to grow the local industries, the government had in the early years of industrialisation, imposed high duties to protect certain local infant industries. A high duty regime would then run contradictory to this policy.

6.2 Conducive environment for export

The development of FIZs has made available a conducive environment for export-oriented companies. The ease of importing raw materials and machinery and equipment as well as the export of goods with minimal customs control have been well-received by the MNCs. Located in an FIZ facilitates the companies' operations as they essentially need to deal with the State Customs at the entry/exit points for all their imports and exports and the disposal of waste. The companies in the FIZs have the dual benefits of enjoying the developed infrastructure at the site such as proper roads and drainage, telecommunication links and other utilities as well as third-party warehousing facilities, and yet be considered to be outside the country, thus be exempted from duties for all direct raw materials and machinery and equipment. An FIZ like Bayan Lepas also has the added benefit of a training centre- Penang Skills Development Centre (PSDC).

6.3 Development of Electronics & Electrical Industry

The most notable benefits arising from the development of FIZs in Malaysia is the emergence of the E&E industry, where companies such as Intel, Hewlett Packard, Motorola, Siemens Hitachi, Sony which set foot in Malaysia in the 70s have continued to grow their presence here. The inflow of the FDIs in E&E industry has created the multiplier effects that have a huge positive impact on the national economy, as indicated earlier. Critics may counter to say that the E&E perhaps would have developed even without the FIZs, however it cannot be denied that the availability of the FTZs then, was a definite attraction to the MNCs in the E&E, as these zones provided a conducive environment that met the needs of these export- oriented companies.

6.4 Transfer of technology

The influx of these MNCs in the E&E industry has also encouraged the transfer of technologies to their Malaysian employees, who over the years have assumed leading positions in the managerial as well as technical fields, undertaking important tasks such as production planning and coordination with other companies within the MNCs global supply chain. This is particularly evident in American companies, where the operations are headed by competent Malaysian executives. With the increasing expertise of the Malaysian technical staff, many MNCs have moved some of their research and development (R&D) facilities to Malaysia. For example, companies such as Motorola and Intel have initiated design and development works in their Malaysian operations by adopting new enabling technologies such as nanotechnology and micro-electromechanical system in manufacturing processes to bring forth miniaturised and digitalised E&E products, as well as introduced new production techniques.

6.5 Malaysia as source of technology for other offshore plants

Through the R&D activities, the MNCs' subsidiaries in Malaysia have been able to reverse the trend of being fully dependent on their HQs for the know-how to being able to export certain technologies to other offshore plants worldwide. Malaysian technical experts have also acquired the necessary expertise to be assigned to train workers in other offshore plants.

6.6 Investment in skills training

The MNCs, besides on the job training, have invested substantially in beefing up the skills and technical expertise of their staff. In this respect, it is pertinent to highlight the contributions of the MNCs, particularly those in the Bayan Lepas FIZ, on the setting up of the now highly acclaimed Penang Skills Development Centre (PSDC), the first industry-led training centre in the Bayan Lepas FIZ. Though initiated by the Penang State Government through the Penang Development Corporation (PDC) and supported by the academia, the PSDC is managed and administered by the industry, where companies in the same industry were able to pull their resources to grow the centre. The formation of the PSDC saw the joint efforts by the Chief Executive Officers of Motorola, Intel and Hewlett-Packard to form a Steering Committee to set up a skills centre. Subsequently, 24 companies, mainly from the FIZs later became the PSDC's founder members. That have helped steered the centre to its acknowledged status over the years. PSDC was also picked as one of the 10 recognised Best Workforce Development Institutions in the World by a study funded by USAid, in 1996.

6.7 Development of local supporting industries

6.7.1 The growing presence of these MNCs in Bayan Lepas has also encouraged the development of local supporting industries to supply parts and specific services to these MNCs. As MNCs imposed exacting standards for the components and to facilitate fast delivery, the MNCs started to guide and link local SMEs to technology suppliers or through MNCs in house programmes to develop these Malaysian companies under a vendor partnership programme, to produce the products of international standards. With the assurance of a buy-back arrangement by the MNCs, local SMEs were confident to invest in new tools and equipment as well as adopting new technologies. Through such team work, the Malaysian companies are now able to supply products and offer services including precision stamping and machining; process automation; and the production of engineering plastics, electronic components such as leadframes, bonding wires, vision inspection system, in-circuit testers and packaging products; specialised services like calibration, testing, failure analysis, burn-in test, surface treatment, repairs and maintenance work, to the MNCs in the industry.

6.7.2 These local companies with the support from the MNCs by way of technology transfers have immensely assisted the growth of the local companies. Malaysian companies like Globetronics Technology Bhd, Eng Teknologi Sdn Bhd and Atlan Industries Sdn Bhd and LKT Automation Sdn Bhd have expanded from small enterprises to become international players in their respective fields, integrating into the global supply chain and in turn grow their own vendors. Other services such as transportation and logistics have also flourished with the increasing volumes of exports from the FIZs companies.

6.8 Shift from labour-intensive to capital and technology intensive industries

6.8.1 The emergence of a group of MNCs which not only invest in the physical facilities but more importantly on the technical capabilities of Malaysians, both employees and local vendors, albeit with the aim of supporting their ventures in Malaysia, has benefited the country in terms of technological investments. The end result is a structural change in Malaysia's E&E industry from a labour-intensive operations to one which is capital and technology-intensive.

6.8.2 In the early days of promoting MNCs in E&E industry to locate in the Bayan Lepas FIZ, there were concerns that these companies investing in Malaysia more to tap on the country's then cheap labour resources and would shift base when other cheaper sources surfaced. Notwithstanding the fact that all enterprises that invested in a foreign country have the prime objective of churning profit, the first batch of MNCs like Hewlett Packard (Agilent now), Motorola, Siemens and Hitachi, that started their operations in Bayan Lepas are still in operations today, which speaks volumes of their commitments to grow

their operations here. Yes, some of these companies, have relocated their labour-intensive business to countries like China, Vietnam and Cambodia, where wages are relatively lower, but these companies have brought in their R&D, design and development works as well as moving into the production of higher value products. This trend is in tandem with Malaysia's move to high-end manufacturing of value added products and capital and knowledge industries

6.9 Emergence of a larger base of female workers

6.9.1 The development of FIZs has also successfully generated thousands of jobs which help to alleviate the otherwise critical unemployment situation in the early 70s. The job offers by MNCs in the FIZs have also opened up an avenue for female employees to find employment easily as operators in the E&E factories. Even though these were relatively low-paying jobs, but the opportunity to be employed had empowered the female population and raised their standing in society.

6.9.2 Being located in an FIZ provides the companies in particular the MNCs, a sense of belonging to a closely knit community as reflected in the formation of the Free Industrial Zone Penang Companies' Association (*Freepenca*), which has built up its presence to be recognized as representing the interests of the companies in the FIZs in Penang. Freepenca has emerged as an important communication channel particularly to the State Government, on any related matters.

7. Issues on FIZs

7.1 No central coordinating body

7.1.1 Even though the FIZs facilitate import and export trade with minimal control at the state level, the decentralization means there is no Federal or main coordinating body that oversees the development of the FIZ. Hence companies that need to deal with Federal agencies or Ministries on business would have to approach many different agencies. With the management of the FIZs under the individual local councils, there is also no central compilation of national statistics on the activities in the FIZs on a regular basis.

7.1.2 In the case of Malaysia, even though there is no central or federal body to oversee all FIZs, the issues of FIZ companies having to approach many agencies for approvals, are now being facilitated through the setting up of the Industry Support Division in the Malaysian Industry Development Authority (MIDA), which has been entrusted to assist companies through each stage of implementation, should a problem arise.

7.2 Workers Representation

7.2.1 Most criticisms were hurled at the denial for workers in the E&E industry in FIZs to form trade unions to protect their rights. However the curtailment was not due to the provision in the then FTZ Act 1971, but was attributed to the grant of the Pioneer Status incentive to the MNCs, which was approved under the Pioneer Status Ordinance that prohibited the formation of trade unions. In addition, the Malaysian Government then wanted to provide an attractive location for FDIs, hence there was a need to keep the trade unions out of the electronics industry, even though there were attempts by the Electrical Industry Workers Union (EIWU) to include the electronics workers. As a substitute, in-house unions were allowed.

7.2.2 Nevertheless, it should be noted that even without the formation of a union, workers in the MNCs were known to have higher salary scales compared to other companies in the state. With that, the issue of workers forming a national electronics union was no longer crucial. Besides, Malaysia has a sound arbitration system to settle any disputes between employers and employees.

7.3 Health Hazards

7.3.1 At the early stages of the E&E industry in the FIZ, female workers were assigned to do routine manual and repetitive assembly work including manual chip mounting and microscope work, which over a number of years, had affected the sights of some of the workers. There were some who were exposed to solvents and chemicals and UV light and radiation, especially during the finishing processes and these posed a health risks to these workers.

7.3.2 However, as the industry moved up the value chain and the processes became more automated, the repetitive work had been reduced. On the use of chemicals and other pollutants arising from the production process, the companies have now provided better protective gears and use less harmful chemicals or solvents for the workers as well as isolate such processes so that workers are not unnecessarily exposed.

7.3.3 Another aspect of the health risk is the shift work. where it is a norm for female workers to work shifts, some on a three-shift rotation particularly in E&E companies in the FIZ, which need to keep up with delivery schedules during seasons of high demand. Shift work, which is known to contribute to sleep problems as it requires constant change in sleeping time and sleep cycles, affects the health of the workers.

7.3.4 One way to encourage companies to reduce shift work, yet maintain its productivity, would be to provide incentives to automate, conditional upon the companies' commitment to reduce shift work.

7.4 E&E industry boom and bust cycles

7.4.1 As is generally acknowledged the E&E industry goes through periods of boom where companies rush workers to ensure on time delivery or shipments. However during downturns such as the current times, workers were again at the receiving end when major companies downsize operations and retrench workers. During such times, not only were the workers without jobs, but the whole network of suppliers as well as service providers would be similarly affected, impacting the national economy.

7.4.2 As such Malaysia, though welcoming FDIs in the E&E industry has also put in place strategies to diversify the economy, without being too dependent on E&E. In this context, Malaysia has focused on the development of the biotechnology sector, given Malaysia rich biodiversity and the resource-based industries, given the country's ample supply of palm oil and rubber as well as leveraging on Malaysia's halal certification advantage to promote the production and export of halal food, among others.

8. Government Policies and Incentives

By and large the presence of FIZs in Malaysia has in no small measure contributed to quicken the pace of industrialization in Malaysia. The availability of FIZs has aided Malaysia to attract significant FDIs and the subsequent emergence of the E&E industry, which has become the leading industry in the country's manufacturing sector. Notwithstanding the importance of FIZs to spearhead the development of export-oriented industries, it is equally important to acknowledge the role of the Malaysian Government policy and incentives that played complementary roles to attract FDIs to the FIZs and put Malaysia on the road to industrialisation.

8.1 Policy on equity

8.1.1 Malaysia's equity in the 70s was tied up with the quantum of exports ie foreign investors which proposed to export at least 80% of their output were permitted to hold 100% equity. In efforts to attract FDIs, Malaysia was aware of the needs of foreign investors to hold equity in their own offshore plants, thus the Malaysian Government has over the years liberalised the equity in the manufacturing sector, taking into consideration the stage of development in the country.

8.1.2 From October 1 1986, Malaysia relaxed its equity policy where foreign investors were permitted to hold 100% equity on conditions that the companies export at least 50% of its output or that the company employ 350 fulltime Malaysian workers, which should reflect the racial composition in the country. A

second condition was that the companies' products do not compete with products that were then manufactured for the domestic market

8.1.3 There was also a matrix of combinations of allowable equity holdings vis-a-vis the level of exports as well as other considerations such as the level of technology, spin-off, size of investments, value addition and the utilization of local resources.

8.1.4 The relaxation of the above equity guidelines were for applications from October 1, 1986 till December 31 1990.

8.1.5 However, in its continuing efforts to attract investments, amidst the Asian financial crisis (1997/98) and the growing global competition for FDIs, Malaysia did away with linking the level of allowable foreign equity holdings with the level of exports. From July 31 1998, foreign investors were permitted to hold 100% equity in their new or expansion/diversification projects in Malaysia, irrespective of the levels of exports. These companies were also assured that the approved equity participation would not be required to be restructured at any time, provided the companies continued to comply with the original conditions of the approvals and retained the original structure of the projects.

8.2 Incentives

8.2.1 Realising that the provision of infrastructure such as the FIZs would not be adequate to attract FDI especially with the keen competition even back then, the Malaysian Government had introduced the Investment Incentives Act 1968, which expanded the scope of the incentives to include Pioneer Status, Investment Tax Allowance, Export Allowance and Double Deduction of Expenses to Promote Exports.

8.2.2 In 1971, to reduce the unemployment in the country, incentive in the form of Labour Utilisation Relief, (where the level of corporate tax exemption was linked to the number of employees) was introduced to attract labour-intensive industries.

8.2.3 Over time, the fiscal incentives have been reviewed and revised to target the type of industries that Malaysia aims to attract. In recent times, these translated to attracting companies to undertake R&D, bring in capital-intensive and knowledge-intensive industries, with the provisions of R&D incentives and incentive for high technology industries.

8.2.4 Another key policy objective was to strive for a more balanced economic development across the country. In line with this, the government encouraged the dispersal of industries to the less developed areas with the provision of better fiscal incentives for projects proposed for location in the East Coast States of Kelantan, Trengganu, Pahang, Mersing in Johor, Sabah and Sarawak and

Perlis, the smallest state in the north- west part of Peninsular Malaysia, which was recently included as a promoted area.

8.2.5 In addition, to encourage the dispersal of export-oriented projects and allow companies the flexibility to locate their projects other than in FIZs, which are mainly concentrated in the developed states like Penang, Selangor and Johore, LMW facility was introduced.

8.3 Measures to reduce the Cost of Doing Business

8.3.1 Aware of the need to make Malaysia a cost competitive place to do business, amidst keen competition for FDI, the Malaysian Government has been responsive to the needs of the business community. The Government has consistently reviewed and introduced measures to expedite the public delivery system and to assist investors in all related matters pertaining to their operations in the country.

8.3.2 The Malaysian Industrial Development Authority (MIDA), the Government's principal agency for the promotion and co-ordination of the manufacturing and services sectors in Malaysia, has continued to reduce the time taken to evaluate various applications under its purview, including the approval of Manufacturing Licence, (ML), which has been reduced from two months at the start, to seven working days. A dedicated division - the Industry Support Division has been established to "hand hold" companies to ensure their projects will be implemented smoothly.

8.3.3 On a wider scale, in February 2007, the Government set up a high-level public-private sector Special Task Force (Pemudah) to facilitate business. Pemudah is entrusted to initiate improvements in the public delivery system so as to make Malaysia a more cost-competitive destination for business. The task force is co-chaired by the Chief Secretary to the Government and President of the Federation of Malaysian Manufacturers (FMM) representing the private sector. Among the initiatives introduced by Pemudah were the setting up of a one-stop centre for incorporation of companies; Government e-payment service and an on-line one-stop centre- Business Licensing Electronic Support System (BLESS) to provide information on business licensing and processing services for application of licences. Other improvements include the time taken to register a business in Malaysia, which has also been reduced from 3 days to an hour. All these measures have helped moved Malaysia four notches up to 20 th position from the 24 th placing last year, in the World Bank Doing Business Report for 2009, which surveyed 181 economies.

9. Development of the Regional Economic Corridors

Taking into consideration the level of development in the different regions in Malaysia, the Government in 2007 put in place a plan to tap the economic potential in five designated regions, leveraging on their respective comparative advantages so as to accelerate economic growth and elevate the income levels of people at the existing less developed areas. Each region has set up a coordinating agency to oversee the development in their respective corridor.

9.1 Iskandar Malaysia

9.1.1 Iskandar Malaysia in Southern Johor has been identified to be the southern region economic corridor, which aims to be developed into an efficient metropolis with seamless convergence of living, entertainment, business, academia and environmental pursuits. The Iskandar Regional Development Authority (IRDA) oversees the development in the region.

9.1.2 The 2,217 sq km corridor with the benefit of two world-class transshipment ports Pasir Gudang and Port of Tanjung Pelepas and proximity with Singapore is well-placed to focus on attracting investments. The focus is on new growth areas like biotechnology information technology, tourism, education & healthcare, Islamic finance, manufacturing including the E&E industry. To achieve a balance development, Iskandar Malaysia is further sub-divided into five zones- Johor Baru City Centre, Nusajaya; Western Gate Development; Eastern Gate Development and Senai-Skudai. The whole corridor is expected to be fully developed by 2025.

Iskandar Malaysia, being the first corridor to be launched has managed to attract investments of over RM39.93 billion (US\$11 billion), a significant amount of RM4.35 (US\$1.2 billion) came from Middle Eastern investors.

9.2 The Northern Corridor Economic Region (NCER)

9.2.1 The Northern Corridor Economic Region (NCER) covering the States of Perlis, Kedah, Penang and North Perak, targets to increase value add to existing industries and in the process transform and expand the agriculture, manufacturing, tourism and the logistics sectors in the region.

9.2.2 In agriculture, Kedah, as the rice bowl state, is expected to spearhead modern commercial farming as well as to increase the country's food self sufficiency and growing exports of fresh produce and processed food.

9.2.3 In manufacturing, NCER would leverage on Penang's established positions in E&E industry particularly in the FIZs and the industries in the Kulim Hi-Tech Park, to move the sector in the region up the value chain to R&D, D&D and high

technology industries, while at the same time encouraging the development of the logistics sector there.

9.2.4 Meanwhile, Penang and Pulau Langkawi would be the focal points to promote high-yielding tourists to the region.

9.2.5 To ensure a more balance development throughout the NCER, the Northern Corridor Implementation Authority (NCIA), has further zoned the area into seven sub-corridors, focusing on selective economic activities.

9.2.6 The NCER, strategically located within the Indonesia-Malaysia-Thailand Growth Triangle, (IMT-GT) and having well-developed infrastructure, would be well positioned to be the processing, logistics and entrepot port for the area.

9.3 East Coast Economic Corridor (ECER)

9.3.1 The East Coast Economic Corridor (ECER), covering the States of Kelantan, Trengganu, Pahang and Mersing in Johor is focusing on further developing the main economic clusters-tourism, oil & gas, manufacturing, agriculture and education. The East Coast Economic Region Development Council is the body which is overall in charge of the ECER.

9.3.2 In tourism, the ECER will leverage on the regions pristine beaches and coral-lined islands as well as its culture and heritage.

9.3.3 The region has a well established oil & gas cluster centred around activities in Kerteh, Trengganu and Gebeng in Pahang. The activities include oil and gas exploration, development of oil & gas reserves, crude oil refining, petroleum and natural gas processing, and the production of petrochemical products. With ample feedstock, the region is promoting the development of downstream value added products like polymer resins and materials.

9.3.4 The existing manufacturing sector in the ECER is concentrated mainly in resource-based industries such as the petrochemicals, wood-based and food processing .Going forward, the ECER aims to boost the production of halal products including halal food, given the growing global market for these products.

9.3.5 In agriculture, the ECER will focus on modern farming of crops, rearing of livestock and fisheries, and the planting of kenaf, to be used for the production of medium density board and other value added products.

9.3.6 The region is also focused on education as an enabler for the further development of all the other sectors.

9.4 The Sabah Development Corridor (SDC)

9.4.1 The Sabah Development Corridor (SDC) aims to propel growth in the state and to turn Sabah into a regional gateway for trade, investment and tourism.

9.4.2 SDC is set to focus on the development of the services sector, including tourism activities as well as, agriculture and manufacturing to uplift the state's economy.

9.4.3 The west coast has been identified for an industrial sub-corridor and an agro-food zone for small and medium enterprises, while Central Sabah has been identified for the development of tourism particularly in Pulau Sipadan, Danum Valley and Darvel Bay, which will be developed to become world-class tourist destinations, besides the Kinabalu National Parks. Other planned developments in the Central region include the highland agriculture and agro-forestry zones. The eastern region will see the establishment of the industrial, marine tourism, integrated agro-food, agro-biotechnology and palm oil industry zones.

9.4.4 A free industrial zone is planned to be built next to the Sepanggar Bay Container Port, while Sandakan, could be positioned as a trading centre for the Borneo Island and its surrounding region.

9.5 The Sarawak Corridor of Renewable Energy (SCORE)

9.5.1 The Sarawak Corridor of Renewable Energy (SCORE) is keen to transform Sarawak into an industrialised state by 2020 and improving the socioeconomic wellbeing of the people, by tapping on its vast energy resources. A Regional Economic Development Authority (RECODA) was set up to develop, promote and manage the zone.

9.5.2 Sarawak with the benefit of 28,000 MW of hydropower; 1.46 billion tonnes of coal; and 40.9 trillion sq cu ft of natural gas; located within the central region, is well-positioned to attract energy-intensive industries, which will boost the development of other supporting and related industries.

9.5.3 Ten priority areas have been identified for promotion ie oil-based aluminium, steel, glass, tourism, palm oil, timber-based and marine engineering industries as well rearing of livestock and aquaculture.

10. Impact of Asean Free Trade Agreement/World Trade Organisation Commitments

10.1 The growing trend towards a globalised economy with the increasing free trade agreements is here to stay. Will these then have a negative impact on the attractiveness of FIZs, which in essence thrive on duty free movement of goods?

10.2 Under AFTA import duties on all products will be abolished by January 1 next year, for Brunei, Indonesia, Malaysia, the Philippines, Thailand and Singapore; and by January 1, 2015 for Cambodia, Lao People's Democratic Republic, Myanmar and Vietnam except for certain sensitive products which will be opened up in 2018. Nevertheless, since 2003, Malaysia has gradually reduced duties on products under AFTA, but did not witness a pull out of companies from the FIZs due to Malaysia's tariff reduction/elimination. In fact, the full enforcement of AFTA will benefit foreign investors who can leverage on Malaysia's well-developed infrastructure in the FIZs, to expand their outreach to the Asean market.

10.3 Similarly, Malaysia's free trade agreements with its major trading partners like Japan, China and eventually with the US, should not negatively impact the operations in the free zones, as these pacts will also offer opportunities for companies making niche products for these markets. Besides, FIZs today do not solely rely on duty free import/export, but as an area where special focus will be made to enhance the efficiency and cost-effective operations to ensure that their products can get to the global market on time and competitively.

10.4 In fact, FIZs in Malaysia, which have the advantage of proximity to supporting industries and logistics firms as well as skills training for human resource development support, have been known to be prime industrial sites for FDIs targeting to expand to the regional and even the global markets.

11. The way forward

11.1 With hindsight of Malaysia's performance in the development of the FIZs, is this the way forward for developing countries?

11.2 Based on the above observations, it can be concluded that FIZs which are still in place in Malaysia, would allow developing countries an advantage to attract export-oriented companies as well as similarly adopt import substitution policies, if the need arises.

11.3 Globalization and the increasing free trade agreements would appear to lessen the impact of having the FIZs, however it would not nullify the many benefits as outline above.

11.4 For countries without the benefit of sufficient land, LMW or a combination of both may be an option worth considering in order to encourage export-oriented companies.

11.5 Nevertheless, FIZs should only be seen as a mode to facilitate investments into a country, hence they need to be supported by business-friendly policies as well as the right fiscal and non fiscal incentives to create a cost-competitive environment for businesses to thrive.

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