



Digital and Free Trade Zones Impact on Malaysia's Economy and Its Prospects (2000–2018)

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ABSTRACT

Malaysia's continue expanding its economy successfully and make great efforts as a leader in Southeast Asia. It has pursued a comparative equitable development path toward free trade zones (FTZs) and digital FTZs which will digitally gather users with government and business services to support cross-border trade as bring reforms to attract foreign funds and foreign direct investments. This paper aims show the intensive competition between countries on creating free zones as a form of integration. The second objective is to draw the attention of Malaysian authorities to invest heavily in free zones as modern form of economic diversification.

Keywords: Export processing zones, Diversification, Economic integration, Attractiveness

JEL Classifications: F20, F21, F23

1. INTRODUCTION

In 1960, most of Malaysians lived in rural areas as fishermen or cash crop farming. By 1970, industrial and multinational firms settled in Malaysia and attracted young Malaysian workers. Later, free trade zones (FTZs) started their expansion by Americans, Europeans and Japanese corporations in Malaysia and exploited the cheaper labor in Singapore, Ong (1988). The free trade zone has played a vital role in the boosting the industrial growth. The new Malaysian policy has succeeded to earmark the industrial sector. Rasiah (1993). Actually in 2016, Malaysia population are about 30.3 million inhabitant and with its strategical location in the middle of the south east Asia is doubtfully a cost competitive area for offshore operations in the world and also has succeeded to make a great transformation step in its economy. Its government and people fought to progress from an agriculture commodity to manufacturing based on export which driven the Malaysian economy to belong a high technology which requires a great capital-intensive industry.

Free economic zones (FEZs) also called export processing zones (EPZs), free both refer to the same concept and the activities of the free zones varied according to the economic literature for

each state. However digital FTZs (DFTZs) are designed for a particular propose and represent a real electronic linkage and a sort of platform to facilitate trade between small and medium firms. They are also a gateway for a great, various numbers of investors seeking business opportunities. These zones are established around strategic and economic places as an attraction for business and international firms. They really represent areas with many geographic advantages for traders and according to the International Labor Organization's (ILOs) report, the numbers of Free zones have grown faster to more than 3500 in 116 countries in 2006 according to ILO (2007).

Generally speaking, FTZs are created with a clear government policy which aims to take advantage of a country's comparative advantage in natural resources and labor. These zones are chosen by the government Krugman (1991) and focus on concentrated commercial, trade or industrial activity.

On other hand, according to Johansson and Nilsson (1997), Free zones could be helpful while Take advantage of a country's comparative advantage in natural resources, existing infrastructure, or labor. They may also stimulate the local firms through learning and imitating the foreign firms on producing, exporting, how

applying modern strategies in distributing manufactured well in any market.

1.1. FTZs Definition

According to World Bank report (1992) “FTZs are industrial estate, usually a well-protected area of 10–300 hectares that specializes in manufacturing for export. Thus, some countries are offering foreign businesses attractive concessions and a number of investment incentives, including zero taxation and a great personage who can reach the total ownership of a subsidiary. However, the OECD defines the free zone as a government policy in selected geographically area for the propose to promote exports with a high competitive business environment and a special incentive including particular tariff exemptions” (Engman and Pinali, 2007). The ILO (2007), “defines EPZs as industrial zones with a lot of incentives set up to attract foreign investors, in which imported materials go through some various processing before being exported again. The United Nations industrial development organization “defines them as special small geographically area within a country accustomed and expected to attract export-oriented industries.”

1.2. The Historical Background of FTZs

Free zones are not a new model or a new invention but they existed in the deep past. So, while researching the history of Delos, some historians stopped thoroughly at this Greek island about 300 years BC and found out that this Island played the role of a commercial free zone which gathering Greeks, Italians, Phoenicians, Syrians, Egyptians, Palestinians, Jews and Persians who came and sail to trade in Delos without risk. The idea of the FTZs return back to the Roman era, where the first (FTZs) were in this port “Delos.”

Certainly, the first free zones which were known as “FTZs” without any customs tariffs or government organizing laws. They existed but just to trade goods internationally. However in 1959, the Irish government created Shannon free zone in order to attract some companies at that time with manufacturing facilities to develop the Irish trade. As a matter of fact, this zone became the first free zone and a model for other countries who established their free zones later.

2. LITERATURE REVIEW

The existing literature on free zones tends to assume that foreign direct investment has played a great role in the growth of developed and developing countries. Most studies lay out overall economic impacts of free zones in developing countries. Among these studies:

- Peng and Fei (2016) tried to analysis the legal and economic China's FTZs as legitimacy and an economic booster. He focused on how china was interested to construct FTZs such as: Shanghai, Yao D, Whalley J. (2016) Tianjin, Fujian, and Guangdong. As an efficient economic strategy.
- Alexandre and Laurent (2014) brought a new vision and looked at Free ports (FP) as international logistic interfaces that are free from border frictions besides. This study brings out a modern definition of the free port concept and provides new understanding of these infrastructures as a real bridge to the economic success and integration.
- Rondinelli (1987) took a different approach and studied the characteristics of FTZs and export free zones and talk about their advantages in attracting foreign direct investments, generating employment and providing foreign exchange earnings for the economy Warr PG (1989). In their study they focused on Chinese free zones and some Asian countries including 80 free zones which were created by 1980 and 40 (FTZs) just after this date. This study also mentioned the adverse effect of these zones on some developing countries. The output showed weak results of FTZs in these countries on labour, technology transfer and export flows.
- Hakimian (2011) focused on the rise of free zones as a global phenomenon. He tried to mention that most of these trade zones aim to attract FDI and to promote manufacturing exports, to create new opportunity jobs, to transform domestic technological skills.
- Krugman (1991) examined trade diversion and liberalization among countries effects and invites states to create free zones which are very important in increasing productivity efficiency and competitiveness. Besides, its strengthen the customs union and the integration in the global economy. He also warns countries to deal with the policy called ‘beggar my neighbor’ which is an economic policy through which one country trend to worsen the economic problems of other countries.

3. DATA RESEARCH AND METHODOLOGY

For the credibility of this article, we have focused on collecting and interpreting some useful data generated by the official department of statistics and the statistical data provided by the ministry of international trade and industry in Malaysia during the period 2015 and 2016. We also use interpretative analysis in order to disclose certain practices and economical legislative and political decisions behaviors which had a great influence on Malaysia FTZs.

3.1. Free Zones Objectives

The free zones are established to increase the exports and boost the country foreign direct investments. Moreover, these zones can provide low cost supply and diminish unemployment and gain more exchange earnings. Besides, they are developed to reach the following goals:

- Generate economic growth.
- Using digital platforms as a futurist method to help and efficiently manage cross-border trade.
- Attract foreign direct investment.
- Developing and increasing the regional economic integration of the country in the world economy.
- Promote innovations and creativity.
- Foster economic reform strategies by developing and diversifying exports.

3.2. Main Intensives for Companies in the Free Zone

The law on Free zones grants the following incentives to free zones operators and organizers:

- 100% ownership.
- No value-added tax for delivering services and supplying goods in FTZs territory.

- Tax-free profit to legal entities and no income tax for sole proprietor acting as operators or organizers of free zones.
- No property taxes on public and industrial buildings and structures owned or leased within Free zones.
- No customs charges and non-tariff regulation measures applied to the export of goods released under the customs regime “imports into FEZs.”
- Freely convertible currency is allowed as a medium of exchange while trading within FEZs.¹⁾

3.3. Types of FEZs

- DFTZ: It permits small and medium digital companies to carry out their e-commerce and benefit from globalization. It also permits small businesses to trade through using a high technology linkage in order to buy and sell goods.
- FTZs: Known as commercial free zones with a great deal on products because no one is taxing and goods are traded without any barriers.
- EPZs: Export zones focus on manufacturing of exports only and allow investors to import and export goods free of duties and exchange controls.
- Enterprise zones: A designated zones which aim to intended to revitalize distressed local areas and to promote job creation. Furthermore, they increase the capital investment in some poor, misfortunate areas of the country.
- FP: Encompass larger areas. They accommodate all types of activities, including tourism, retail sales and provide more incentives and benefits. Lavissière A, Fedi L, Cheaitou A. (2014).
- Special economic zones: According to their name, it is clear that they are special geographical areas for targeted economic activities, and have special laws often different from those that apply in the rest of the world.

3.4. FTZs Impact on Malaysia's Economy

The free zones are quite efficient tools to boost the growth and integrates the different region in the country where they are settled with the global economy by creating goods for export, attracting foreign currency, and create an economic bridge which may help the local companies.

According to the data obtained from Ministry of Finance - economic report (2016 to 2017) and summarized in Table 1, we notice clearly that Malaysia DGP growth has climbed from 4.2% to 5.9% and this was due to the robust reforms and high productivity in most strategic a ns macroeconomic fields. Malaysia has succeeded to diversify its economy and has broken down its reliance on the production of raw natural resource and today, its economy has much strength as follow:

- Attractive tax incentives.
- DGP growth: 4.2% in 2016 and with \$350 billion DGP.
- \$26,211 DGP per capita, ppp.
- Inflation CPI: 2.1%.
- Unemployment rate: 3.4%.
- Engaged into modern technology.
- High developed infrastructure and high telecommunication.
- Young, educated and productive manpower.

High and developed airports and seaports.

Table 1: Some key economic indicators

Indicators	2016	2017
Population	31.7 million	32.4 million
GDP	RM1, 108.2 billion	RM1, 158.5 billion
GDP growth	4.2%	4.3–5.8%
Per capita income	RM37,758 (USD9,102)	RM39,656 (USD8,906)
Inflation rate (CPI)	2.1%	4.3%
Labour force	14.7 million persons	14.9 million persons
Unemployment	3.4%	3.5%
Total export (f.o.b)	RM785.93 billion*	RM806.53 billion
Total import (c.i.f)	RM698.66 billion*	RM718.21 billion

*A causal analysis of the data in Table 3 indicates that Malaysia is above potential and reached 5.9% instead of 4.3–4.8% in its DGP growth on 2017. According to the IMF report (2018)

The Malaysian Government has codified incentives available for investments in qualifying projects in target sectors and regions. According to the provided statistics, we can found that Malaysia's total trade for 2015 grew up to 1.2% with exports expanding 1.9%.

According to the data Chart 1, collected from the Department of Statistics (2017), we found that Malaysia, trade performance expanded from 684,729,20 RM in 2000 to 969,104,50 RM in 2005. A significant increases in trade was recorded also by 1.167 RM in 2010 compared by the 2009 were Malaysia exports with Asia and the European countries didn't reach more than 987,187,90 RM. by the year 2010, a robust export growth was realized and reached 1,271,488,30 RM in 2011 and 1,309,318,20 RM in 2012. Since 2010 the total trade in Malaysia is growing higher till it reached 1.466 RM in 2016 encouraging the increase of the living standard and a high income statue in whole Malaysia economy.

3.5. The impacts of Free Zones on Employment

Recent statistics and economic experts dealing with free zone showed that this kind of models directly stimulate growth and creates new job opportunities for local workers. For example, there were around 3500 FTZs across 116 countries in the year 2006, where nearly 66 million people were working. However, in China there were about 30 processing zones which generate about 40 million jobs. OECD (2018).

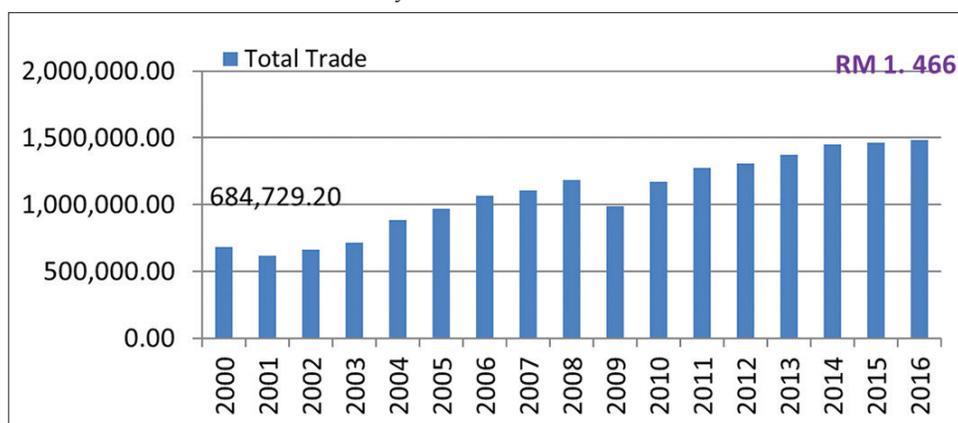
The labour force in Malaysia has raised to 14.7 million person in 2016 compared to 14.2 in 2015. However, high unemployment was registered among youth aged in 2016.

Besides, FTZs had a great impact on the inflow of FDIs and provided the balance of 28.4% 2015 which means 19.3% of total private investments.

3.6. Impacts of Free Zones on Exports

Most counties create FTZs to stimulate their economic growth and also for home consumption as well as a efficient manner of exports. From the Table 2 we can see that the total export of free zones have increased from six million dollars in 1970 to six hundred million dollars and this means a huge development in export.

From Table 2 withdraw from the ILO survey and the World Bank (2003) FTZs and Digital free zones have become widespread

Chart 1: Malaysia total trade from: 2000 to 2016

and become a form of modern trade which will involve the other sectors and other countries and will certainly encourage technology transfer and innovative industrial strategies. The contribution of (FTZs) to export seems to be great in the host country.

3.7. The impacts of Free Zones on Government Budget

The FTZ are an important tool contributing to the trade balance because if these zones are well managed they can encourage export of goods and supply the local market. On other hands, FTZ reduce the importation of a lot of manufactured productions and diminish the use of foreign currency in the home country. Thus, FTZs reduce the costs for companies by granting them the same treatment as native-producers help in boosting technological skills.

From the Table 3 taken from the Malaysia's official statistics, we can notice that the total exports expanded to RM 786.96 billion and imports grew by 1.9% to RM 698.81 billion, resulting in a trade surplus of RM 88.14 billion. We can also withdraw the Government's efforts to reduce the budget deficit from the year 2000 till nowadays. No doubt that, Malaysia is making a great step to boost domestic demand and reduce the economy's dependence on exports and from the chart below we can clearly find that the Malaysia's total trade for 2018 was about RM 156.01 or about US \$ 376 billion which represent almost 15.8% market share.

The Malaysian government tries to encourage technology transfer, and apply the protecting role for its environment and strategic sectors as well as for its cultural and religious values. Malaysia has liberalized a lot of sub-sectors and allows 100% foreign equity participations in private sectors. Most of the statistics were driven from the department of Statistics, Malaysia Official Portal.

4. EMPIRICAL RESULT AND DISCUSSION

4.1. Malaysian FTZs and Economic Strengths

The Malaysian economy is expected to keep healthy since its GDP growing reached 5.1% in 2016 compared to 2011 and 2012 Mansor and Yeoh (2016). However, the Inflation rate expected to 2.8 remained acceptable in general. Besides, the domestic demand lead to a moderate rise in the productivity and contributed as a key driver of Malaysia growth. Moreover, absolute poverty has

Table 2: The development of the total export of FTZs

1970s	Today
30 countries	More than 120 countries
80 zone projects	2000–5000 zone projects
No private zones	More than 1200 private zones
Total exports \$6 billion	Total exports exceed more than \$600 billion
Direct jobs generated=1 million	Direct jobs 50 million, of which 30 million are in China

FTZs: Free trade zones

Table 3: Malaysian total trade between 2000 and 2016

Years	Imports	Exports	Total trade	Balance of trade
2000	373,270,3	311,458,9	684,729,2	61,811,4
2001	334,283,8	280,229,1	614,512,9	54,054,7
2002	357,430,0	303,090,5	660,520,5	54,339,6
2003	397,884,4	316,537,9	714,422,2	81,346,5
2004	481,253,0	399,632,2	880,885,2	81,620,8
2005	536,233,7	432,870,8	969,104,5	103,362,9
2006	589,240,3	478,147,9	1,067,388,3	111,092,4
2007	604,299,6	502,044,6	1,106,344,3	102,255,0
2008	663,013,5	519,804,3	1,182,817,8	143,209,2
2009	552,518,1	434,669,8	987,187,9	117,848,3
2010	638,822,5	528,828,2	1,167,650,7	109,994,3
2011	697,861,9	573,626,3	1,271,488,3	124,235,6
2012	702,641,2	606,676,9	1,309,318,2	95,964,3
2013	719,992,4	648,694,9	1,368,687,3	71,297,5
2014	765,416,9	682,937,1	1,448,354,0	82,479,7
2015	777,355,1	685,778,4	1,463,133,5	91,576,6
2016	786,964,2	698,818,7	1,485,782,8	88,145,5

The data in this table are taken from two different web sites: Source: Malaysia's official statistics. Available from: <https://www.dosm.gov>

been largely eliminated. On other hand, Malaysia has undertaken important reforms to enhance the entrepreneurial environment too. Monetary and trade freedom are going straight. For example Malaysia scored the 31st rank in the world according to the Economic Freedom Index in 2016 and pointed that Malaysia has made a great success in the area of open markets measured by trade freedom, investment freedom, and financial free (Soon et al., 2015) The Malaysian policy makers should strengthen the legislative sections which remain weak. As a matter of fact, the government have taken serious measures to tackle corruption more effectively.

Malaysia has really created its proper economic vision through a clear national target called the new economic model which represents a set of political and economic targets to achieve and reach the high developed countries.

No doubt, that the supportive Malaysian policies have contributed to maintain an attractive business environment with opportunities for growth especially with its liberal equity policy which was applied since 2003 and allow 100% of the equity in all investments or new project which may diversify the Malaysian economy became a strong and productive enough to overcome future difficulties and crises.

We agree that a free zone is a designated, secured area in which commercial and industrial activities are carried out and released by the Minister of Finance as stated under section 3(1) Free Zones Act 1990 (Act 438). There are almost many types of free zone in Malaysia, such as the free zone for commercial activities (FCZ) and free zone for industrial activities (FIZ) and the most recent one is the world's first DFTZ which was launched on 22 March 2017 by Dato' Sri Mohd Najib Tun Abdul Razak, the Prime Minister of Malaysia. This DFTZ was established to enhance the Malaysia's e-commerce in 2016, and to boost and double the nation's e-commerce growth through increasing the GDP contribution about US \$47.68 billion) by year 2020. The first FTZ was established in Penang in January 1972 in the Bayan. It was absolutely a real open gate towards electronics industry in Malaysia (Nesadurai, 1991).

4.2. Free Industrial and Trade Zone in Malaysia

- Bayan Lepas FTZ, Penang: Is a high-tech industrial zone on the southern part of Penang Island and The earliest phase of the industrial zone was developed in the early 1970.
- Kulim Hi-Tech Park, Kedah: It is a high technology science park in the northern of Peninsular Malaysia and only 36 km away from Penang Island. It is famous for its high quality infrastructure in term of reliable power supply, high capacity fiber optic network and abundant water supply.
- Melaka BatuBerendam FTZ (Texas instrument, Dominant semiconductor, Panasonic).
- Pasir Gudang FTZ, Johor.
- Port Klang free zone (PKFZ), Klang, Selangor: PKFZ in Port Klang, Malaysia, one of the most ideal investment for companies intending to set up or expand their business in South East Asia.
- PKFZ, an integrated 1000 acre. It represents an ideal investment for companies intending to set up or expand their business operations in South East Asia.

4.3. Malaysia Rankings According to the International Institutions

According to the Malaysia ranking in most known economic indexes, we can notice that Malaysia belongs a very attractive business climate supported by a favorable employment, market and income conditions. For example doing business 2016 report, Malaysia was ranked 23rd place overall among the 190 economies covered in the survey. Moreover, it came at the 19th place in world competitiveness index. However, Malaysia ranked in the 65th place

out of 167 countries. All these indexes are as a real proof that Malaysian trade policies are fruitful and the government is making progress in establishing a competitive economy (Table 4).

According to doing business index report 2017, the Malaysian economy has reached the 23rd place among the most competitive countries in the world during 2017–2018. However, it ranked 19th out of 58 countries in 2016 of the same index. The great progress towards high living conditions were measures by the government policy makers in order to lead Malaysia to become the largest economy by 2050. Despite, the efforts made to improve the business climate Malaysia came in the 23rd place in the doing business index. Evidently, Malaysia government still control the main important goods price made taxes easier to pay, too. Besides, Malaysia come at the 3rd place in the international telecommunication union: Global cybersecurity index and of course benefits from the global demand in the usage of high technology of smart phones and tablets. We can't admit that Malaysia is a democratic country since it appears at a low rank at the Democracy index released in 2016 because of corruption, criminal justice and fundamental rights.

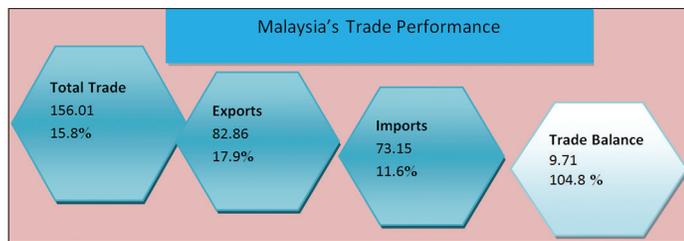
5. CONCLUSION

Certainly, The Malaysia's economy is growing faster especially with its FTZs and the new technological hub which was launched as the first DFTZ in the world and which will definitely push forwards this country to become among the high income countries during the 10 coming years at most.

Table 4: Most important Malaysia rankings in international institutions

Economic	
Baseline profitability index 2015	ranked 6 th out of 110 countries
World competitiveness year book 2016	ranked 19 th out of 58 countries
Doing business index report 2017	ranked 23 rd out of 190 countries
Global enabling trade report 2016	ranked 37 th out of 136 countries
Social Sustainable development solutions Network's World happiness report 2017	ranked 42 nd out of 155 countries
Index of ignorance 2016	ranked 36 th out of 40 countries
Technological Huawei: GCI 2017	ranked 24 th out of 50 countries
International telecommunication union: GCI 2017	ranked 3 rd out of 165 countries
Political transparency international: Corruption perceptions index 2016	ranked 55 th out of 176 countries
world justice project: Rule of law index 2016	ranked 56 th out of 113 countries
Economist intelligence unit: Democracy index 2016	ranked 65 th out of 167 countries

GCI: Global cybersecurity index

Chart 2: Malaysia's trade performance in January 2018 (in RM Bil)

FTZs are one of the basic engine that must be fostered as a main objective because these zones could help more and more the Malaysian authorities to enhance the national economy and enter in the sphere of the wealthiest countries with its economic diversification and high productivity. It became a main duty to Malaysian authorities to deal carefully with the creation of FTZs and to generalize this model in different poor region of Malaysia to get advantages the new challenge of DFTZs as hub with the most modern infrastructure and assure their success with a strong trade policy.

It is time for the Malaysian Authorities to modify its policy and create an appropriate investment climate to attract foreign capital flows as well as Attracting national immigrant capitals.

Free zones also help to exploit optimally economic resources and they are important means in reducing the deficit in the trade balance Chart 2. These trade zones require the availability of fundamental factors and clear vision to achieve the goals. However, the unavailability of geographic and non-geographic factors may cause the failure of these trade zones. "Malaysia economic performance is expected to reach the goals due to the private consumption which may give more flexibility in terms of policy for the government.

Although Malaysia belongs a lot of determinants for the success, a lot of work must be done to moderate the investment law and incentives and make them more attractive.

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