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COMPETITION POLICY IN MALAYSIA

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Abstract

Malaysia does not have a national competition law. Competition is regulated at the sectoral level in the country. Two economic sectors have legal provisions for competition law but these have been relatively ineffectively enforced. The benefits of Malaysia's industrial policy as well as the policy reforms in regulation and trade have been compromised by the lack of a formal institution to address competition related issues. Hence, the future priority and direction of regulatory reform is obvious – the country needs to implement a competition law and build the related institutions and capacities.

INTRODUCTION

Competition policy became important in Malaysia following the regulatory reforms that accompanied the government's ambitious privatization program. Sectoral regulation in the pre-privatization period involved mostly economic regulation and this was purely a matter "self-regulation" by the government. With privatization, new regulatory institutions and mechanisms have been established to regulate privatized entities. In the absence of a national competition policy or law, a sectoral approach to competition regulation was adopted. This approach to competition regulation has thus far been limited and ineffective.

The lack of a formal, comprehensive and coherent approach to competition regulation also resulted in the government's inability to deal with many of competition-related issues that arise from its industrial policy and policy reforms in regulation, trade as well as FDI. This paper discusses the existing state of competition regulation in Malaysia and how it relates to some of the development problems of the country. Section 2 of this paper provides the developmental and regulatory background for an evaluation of competition policy in Malaysia, This is followed by a discussion of policy reforms and competition-related problems in the country in Section 3.

We undertake a brief discussion on the impact of foreign competition on domestic development in Section 4. Section 5 concludes.

THE NATIONAL CONTEXT

This section provides a discussion of the basic characteristics of the Malaysian economy as well as the developmental and regulatory context within which competition and competition policy in Malaysia ought to be evaluated.

Basic Characteristics of the Malaysian Economy

Malaysia is a relatively small developing country with a total population of around 24.5 million. The country's GDP is around RM355 billion in 2002. The country's GDP per capita at RM13,361 puts it in the company of middle income countries. The country's economy is also very open. The country's trade intensity (ratio of total exports and imports to GDP) is around 2.3. Historically, Malaysia has relied heavily on trade as a source of economic growth and development since its independence in 1957. The nature of the country's trade pattern has, however, undergone significant changes over the years. Malaysia has managed to transform itself from a major primary commodities exporter (in tin, rubber, oil palm) to a major manufacturing exporter. Today, the country's manufacturing sector accounts for about 30 per cent of its Gross Domestic Product and 76 percent of its exports.

Development Policy in Malaysia

Growth with equity has long been the main objectives of major economic policies in Malaysia. This emphasis on economic growth and wealth redistribution was essentially a response to racial riots that occurred in the country in May 1969. Following the racial riots, the government embarked on an extensive interventionist long-term development policy called the *New Economic Policy* (NEP).¹

The NEP was implemented to eradicating poverty as well as redressing the economic imbalance between the major races in the country. In the latter case, specific targets were set for ownership in the commercial and industrial sectors. This was achieved through many means from outright purchase of equity by trustee companies (representing the *Bumiputra* (i.e. indigenous)

community's interests) to licensing, quotas and government procurements. The implementation of NEP also marked the emergence of large state owned enterprises (SOEs) such as PNB to support wealth redistribution in the country.

Another example of the implementation of NEP is the enactment of the *1975 Industrial Coordination Act* (ICA) which required manufacturing firms exceeding a given size threshold (e.g. 25 or more employees or paid-up capital exceeding RM250,000) to apply operating licenses from the government. The use of the ICA to control entry into an industry is to ensure compliance with the NEP (in terms of ownership and employment).

By the early 1980s, the government embarked on another phase of interventionist policies by promotion of heavy industry such as the national car project (*Proton*) and steel plant (*Perwaja*). The objective was economic diversification to enhance industrial linkages in the economy. Investments in these projects were accompanied by increases in import duties on both automobiles and steel. Not long after these policies were implemented, the severe recession in the mid-1980s brought about another major shift in government policy, this time in the form of privatization and economic liberalization.

The government's privatization policy, which had already begun by then, gained further momentum after the mid-1980s. The re-distributive emphasis of the NEP remained an important element in the implementation of privatization. For example, the *Privatization Guidelines* state that at least 30 per cent of equity in privatized projects should be allocated to the Bumiputra community. Since the financial crisis of 1997/98, several projects that were privatized in the 1980s (but subsequently experienced substantial losses) have been re-nationalized. These include two LRT systems in Kuala Lumpur (STAR and PUTRA), the national sewage system (IWK) and the national airline (MAS). Despite the extensive privatization that has taken place, regulatory reforms have lagged behind. Furthermore, the government continued to be a major shareholder (via vehicles such as Kazanah Nasional) of many of the privatised incumbent entities such as Telekom Malaysia Berhad and Tenaga Nasional Berhad.

Industry consolidation, involving the reduction of operators/firms via mergers etc., has also been an important feature of the economy since financial crisis of 1997/98. This has mostly taken place in the financial sector (commercial banking, finance companies, brokerage houses, insurance companies), the communications and multimedia sector and more recently the plantation sector. These mergers have been undertaken with the objective of strengthening locally-owned companies in anticipation of greater competition from foreign companies in lieu of the implementation of trade and investment liberalization measures under the country's WTO commitments.

Regulation and Competition in Malaysia

Since independence, the economic sectors in Malaysia have been regulated primarily at the sectoral level. **Table 1** summarizes the current state of sectoral regulation in Malaysia. Economic regulation in these sectors mainly took the form of government control over entry conditions (via licenses and permits) and in some sectors, prices. This sectoral approach to regulation has continued even after the implementation of a major privatization program since the mid-1980s.

However, in the regulatory reforms that took place following privatization, new regulatory agencies were established in a few sectors such as ports, airports, energy, communications and multimedia. While economic regulation (e.g. entry, prices) continued to be the main focus of regulation in these sectors, the regulatory reforms in a few sectors have expanded the scope of economic regulation to include competition policy. These sectors include the communications and multimedia sector and the energy sector. We review economic regulation and their impact on competition in the rest of this subsection.

The Energy Sector

The statement on the competition regulation function of the Energy Commission in the Energy Commission Act 2001 is fairly general:

“to promote and safeguard competition and fair and efficient market conduct, or in the absence of a competitive market, to prevent the misuse of monopoly power or market

power in respect of the generation, production, transmission, distribution and supply of electricity and the supply of gas through pipelines.” (ECA 2001, p.14)

At present, competition regulation in the energy sector has not advanced beyond the above broad legal provision. The Energy Commission itself can be considered to be in formative stages. It has not issued any guidelines on competition regulation in the sector. There seems to be a lack of urgency to implement competition regulation in this sector. This is partly because only the power generation segment has been liberalized and this segment is primarily regulated by the ministry via contracts (between the incumbent distributor and independent power producers) and via control over tariffs.

The Communications and Multimedia Sector

The Communications and Multimedia Act 1998 identifies more specific anti-competitive conducts that it considers illegal such as collusion, rate fixing, market sharing, boycott of competitor and tying. The mechanism for competition regulation in the communications and multimedia sector is slightly more advanced than that in the energy sector. The Communications and Multimedia Commission, has published three documents that serve as guidelines on competition regulation in the sector.²

At present, the CMC is experiencing difficulties in enforcing the competition policy elements in the CMA 1998. While it may be able to assess market structure elements (e.g. dominance), detecting anti-competitive conduct and acting upon it is difficult. This partly compounded by the lack of capacity and experience on the part of CMC and the lack of any legal precedence in this area.

Transport Sector

Competition in the transport sector is affected by regulations imposed under three ministries, namely the Ministry of Transport (MOT), the Ministry of Works (MOW) and the Ministry of Entrepreneur Development (MET). Overall, MOT is the sector regulator and concentrates on transport infrastructure development (other than roads and highways) and their regulation. For example, port tariffs and airport tariffs are set by the Ministry with the advice of sectoral

regulatory commissions.³ The MOW is responsible for regulating roads and highways including privatized ones (via the Malaysian Highway Authority). Tariffs for privatized roads are set by the MOW, often after consultation and approval at the Cabinet level.

The entry conditions in private commercial vehicle markets (such as commercial taxis, buses, and trucks) are controlled by the MET via the Commercial Vehicle Licensing Board (CVLB) which is responsible for the issuance of licenses in these markets.⁴ In some cases such as commercial buses and taxis, tariffs are set by the Ministry. Most of the prominent competition-related cases in recent years have occurred in commercial vehicle markets such as commercial buses and the trucking (haulage) industry.

Distributive Trade

Distributive trade encompasses the retail and wholesale distribution sectors. The sector regulator is the Ministry of Domestic Trade and Consumers' Affairs (MDTCA). The *Price Control Act 1946* empowers the Ministry to control and stabilize the prices of selected "essential" goods (such as rice, sugar and chicken) in the country. The Ministry also control entry conditions via the issuance of licenses and permits in distributive trade markets such as petroleum retail distribution, supermarkets and hypermarkets. Recent examples of MDTCA's policy affecting competition includes restrictions on the issuance of hypermarket licenses in major cities such as (Kuala Lumpur, Johor Bahru and Penang) and in towns with less than 350,000 population.⁵ More recently, the Ministry has also considered imposing quotas on goods displayed in supermarkets to ensure local products get adequate shelf space in such establishments.⁶

Mergers and Acquisitions

The legal framework for regulation of mergers and acquisition is provided by two statutes, namely, the Securities Commission Act 1993 (Part IV Division 2) and the Malaysian Code on Take-Overs and Mergers 1998. The regulatory agency is the Securities Commission. These statutes were primarily enacted to protect investors' interest. There are no provisions in these statutes for the impact of M&As on competition. An important regulatory agency in the area of M&As is the Foreign Investment Committee (FIC) under the Economic Planning Unit in the Prime Minister's Department. Any M&A transaction involving foreign interests also needs to

get FIC approval. The FIC has guidelines limiting foreign equity participation in companies registered in Malaysia. The purpose of the FIC guidelines is to ensure that the pattern of ownership and control of private enterprises in the country is consistent with government policies such as the New Economic Policy / National Development Policy. In the past, exemptions have been allowed for foreign direct investments that are export-oriented. In the wake of the financial crisis in 1997/98, the government also relaxed limits on foreign equity participation in Malaysian private enterprises. Even though the FIC guidelines focus on distributive issues, its implementation has effects on competition. Limits on foreign equity participation constrain the amount of resources that domestic firms can enlist from foreign investors to compete in the market.

Factors Affecting Intensity of Competition

A variety of factors affect the state of competition in Malaysia. These include economic regulation as well as the various development (e.g. NEP) and industrialization policies implemented by the government and discussed earlier. We briefly discuss the possible impacts of these policies on competition.

Economic Regulation

Economic regulation is carried out extensive in all economic sectors in Malaysia. Price controls are imposed for the distribution of essential products (e.g. rice, sugar) to stabilize prices in the country. The tariffs for transport services such as taxi fares, bus fares and haulage rates are also controlled by the government. As most of the price controls are in the form of price ceilings, the impact of price controls depend on whether competition in these markets result in lower prices the official price ceilings. We discuss the haulage case in greater detail later.

Entry regulation via issuance of licenses continues to be an important instrument of economic regulation at the sectoral level in Malaysia. It has been an important instrument for undertaking wealth redistribution in the country. Entry regulation in Malaysia affects market structure directly. The effects of entry regulation on competition in the various sectors have been mixed. In some sectors, liberal licensing approaches have resulted in highly competitive markets such as the domestic airline industry. In some instances, price wars have occurred e.g. in the haulage

sector. In others, the government have reduced the number of players e.g. in the mobile telephony market from five firms to three firms through 3G licenses.

Industrial Policy

The Malaysian Government employs a number of instruments to further develop its economic sectors. Export-oriented industrial policies appear not to have raised competition-related issues probably because the goods produced are primarily exported. In contrast, import-substitution strategies have raised issues related to market access e.g. the automotive sector industry in Malaysia. In anticipation of greater competition from foreign companies, the government has also taken pro-active measures to consolidate various industries via mergers e.g. in the financial sector.

Privatization and Liberalization

The impact of privatization on competition has been a mixed one. In some sectors such as communications and multimedia, privatization was swiftly followed by liberalization which increased the level of competition in the industry. In the power sector, competition did not increase as only electricity generation was liberalized after the incumbent operator was privatized. In the sewerage sector, the incumbent continued to operate as a monopoly. In the airlines industry, the privatized incumbent operated as a monopoly in the domestic services sector until recently when competition intensified with the entry of a low-budget carrier. Despite widespread privatization across many sectors, the government continued to hold a significant level of shares in many of the major privatized entities such as Tenaga Nasional Berhad (power) and Telekom Malaysia Berhad (telecommunications). **Table 2** summarizes some of the government's existing shareholdings in privatized entities via Kazanah Nasional Berhad, the investment arm of the government.

Supporting Evidence on Competition in Malaysia

The existing evidence on the state of competition in Malaysia has mostly been in the form of market concentration studies in the manufacturing sector. Studies on competition in the services sector have been neglected but there is some anecdotal evidence of competition-related cases in the sector. These are typically highly visible cases that have received attention from the media.

Quantitative Evidence in the Manufacturing Sector

There has been a fair amount of empirical studies on market concentration in the manufacturing sector in Malaysia. **Table 3** summarizes the existing empirical findings on market concentration in the manufacturing sector in Malaysia. Generally, the existing evidence indicates that many of the industries in Malaysia's manufacturing sector are relatively highly concentrated.

In terms of trends in market concentration, the available evidence is inconclusive. While Zainal Aznam and Phang (1993) reported an increase in the overall concentration levels between 1979-2000, Nor Ghani et al (2000) finds an overall decrease during the 1985-1994 period. MDTCA (2003), on the other hand, finds a slight increase in market concentration over the 1996-2000 period.

Most of the studies on market concentration in the manufacturing sector in Malaysia have focussed on testing the Structure-Conduct-Performance (SCP) Hypothesis. The evidence on the importance of entry barriers appear to be fairly conclusive even though the type of entry barriers that matter may be subject to debate. The candidates for entry barriers include:

Scale economies

[Gan and Tham (1977), Lal (1979), Zainal Aznam and Phang (1993)];

Capital intensity / requirement,

[Lal (1979), Rugayah (1992), Zainal Azman and Phang (1993), Bhattacharya (2002), and MDTCA (2003)]

Advertising /Product Differentiation

[Gan and Tham (1977), Lal (1979), Zainal Aznam and Phang (1993), Bhattacharya (2002)];

A few of these studies have also attempted to ascertain the influence of imports, exports and FDI on competition. Generally the evidence here has also been very inconclusive (see **Table 3**). Rugayah (1992) found some evidence that exports and imports are related to market concentration but this has been refuted by Zainal Aznam and Phang (1993) and MDTCA (2003). Lall (1979) found FDI to be an important determinant of market concentration but Rugayah (1992) found contrary evidence. There has also been an attempt to link innovation to market

structure in the manufacturing industry. Lee (2004) found innovation to be positively correlated with the level of market concentration.

Some Anecdotal Evidence in the Services Sector

There has been a dearth of studies on market concentration in the services sector. However, the government's intervention in consolidating the financial sector has clearly increased market concentration in this sector. Other non-tradable sectors such as telecommunications have also witnessed M&As that have increased market concentration. While alternative modes of transport (such as LRT) were introduced in Kuala Lumpur, extensive consolidation (the phasing out of mini buses) has resulted in monopoly or duopoly markets in some urban bus routes. These have had impact on competition but are not well documented. We examine a few case studies of competition in the services sector that highlight some of competition-related issues in the sector.

(a) Market Entry and Competition: The MAS vs. AirAsia Case

One of the more interesting cases of competition in the services sector has been the competition between Malaysian Airlines (MAS) and AirAsia. Prior to 2002, MAS was virtually a monopoly operator in the domestic airline market. With the entry of AirAsia the domestic airline market became more competitive. AirAsia offers no-frills domestic flights at low fares. MAS responded by introducing a new pricing scheme ('Super Saver Scheme') which offers 50 percent discounts for ten seats in every flight in response to competition from AirAsia. This is surprising since, Only a year earlier, in July 2001, the government had granted a request by MAS for an increase in the fares for domestic services within Peninsular Malaysia by about 52 percent. AirAsia also responded to MAS's pricing strategy by offering lower fares in September 2002. Despite MAS's plea for government (Ministry of Transport) intervention to resolve the perceived 'price war', the government has maintained that the competition between the two firms as healthy competition. The MAS vs. AirAsia case clearly highlights the impact of market entry on competition in the services sector.

(b) Regulation and Competition: The Pangkor-Lumut Ferry Case

Another competition-related case in the services sector that received widespread media attention is the Pangkor-Lumut ferry case. Ferry services between Lumut and the island of Pangkor are

provided by two firms, namely the *Pangkor-Lumut Express Feri Sdn Bhd* (PLEF) and *Pan Silver Ferry Sdn Bhd* (PSF).⁷ A price war erupted between the two firms in January 2003. As a result, the adult round trip ticket prices plunged from RM10 in December 2002 to as low as RM1 in July 2003. The ticket prices eventually stabilized at around RM4 until 20th October 2003 when ticket prices were increased from RM4 to RM10. There was an almost immediate public outcry following this price revision. An immediate response of the ferry operators to the public's complaint was to suspend the sale of monthly passes to frequent users of their services. The price increases were clearly an outcome of collusion between the two ferry operators to avert the adverse consequences of a protracted price war between them.⁸ Both firms had claimed that they incurred losses amounting to about RM10,000 per month during the price war.

The government's response to the problem has been fairly haphazard. Following the public's complaints in October 2003, the Perak state government attempted to negotiate with the ferry operators with the intention to persuade them to reduce their prices (RM7 was considered a reasonable price). This effort failed to resolve the problem. The State government has indicated that it may seek the relevant ministry's intervention in the form of issuing more licenses to create more competition. This case clearly highlights how the lack regulatory oversight by the government could lead to anti-competitive conducts.

The case raises interesting issues about the potential links between regulation and competition. For example, it is not clear whether the pre price war prices (e.g. RM10) were outcomes of collusion that were subsequently unravelled by price under-cutting by one of the firms. However, the price increases in October 2003 were clearly an outcome of the exercise of market power by the two colluding firms. It can be argued that a competition law that prohibits collusion (*per se*) would have been able to deal with this problem. Alternatively, in the absence of a competition law, the government could have opted to regulate the tariff. Clearly, it is not even clear whether this later alternative is available to the government.⁹

(c) Liberalization and Competition: The Haulage Industry Case

An interesting case study that highlights the effect of market liberalization is the haulage industry case. The haulage industry was liberalized in 1997 to increase the efficiency of the haulage

industry.¹⁰ With the liberalization of the sector, the number of haulage firms increased from five in 1997 to about 60 firms in 2003. The incumbent five firms are members of the Container Hauliers Association of Malaysia (CHAM) which has a total number of six firms in 2003. Most of the new entrants (about 30 firms) have formed or joined another association, namely the Association of Malaysian Hauliers (AMH).

Following the continued entry of more new firms into the industry, a price war broke out in the industry around year 2000. By 2003, container haulage rates had fallen between 20 to 40 percent. In an effort to end the price war, the two industry associations met to agree to stop giving rebates (i.e. price cuts) to their customers with effect on the 1st January 2004. Thus far, the Commercial Vehicle Licensing Board (CVLB), the industry regulator, has not made any recent comments on the industry initiatives even though it sets price ceilings for the industry.

In the above case, entry liberalization in the haulage industry clearly precipitated price war in the industry. Industry associations, particularly, the incumbent association, CHAM, have attempted to make a concerted effort to stop the price war. The total market share of both associations' members is fairly significant. The six CHAM members's market share in container haulage is about 55 percent. It is probably too early to tell whether the industry associations's effort to stop the price war will work especially given the large numbers of firms involved. Furthermore, the continued practice by some firms of renting out their haulier permits to other companies and the illegal trucking of empty containers can continue to undermine the industry resolve to coordinate prices.

Since prices are regulated and the absence of a price war merely means prices are at par with the price ceiling set by CVLB, it is not clear whether the industry association seemingly 'explicit collusion' can be construed as an anti-competitive conduct.¹¹ Furthermore, the prevalence of lower prices in the industry calls into question the rationale or usefulness of regulating prices in the industry. Clearly, competition issues need to be addressed together with issue of price regulation in industries such as the haulage industry.

REGULATORY, TRADE AND FDI POLICY REFORMS AND COMPETITION

Industrial policy plays an important role in economic planning and development competition in Malaysia. Regulation, trade and FDI policies are used to support the country's industrial policy. Competition issues often arise as an outcome of the interactions between these policies. In this section we discuss several case studies to explore these issues in greater detail.

Industrial Policy, Trade and Competition

(a) Industrial Policy, Trade Liberalization and Competition: AFTA and the National Car Industry

The national car company, Perusahaan Otomobil Nasional or Proton, was established in the early 1980s as a key component of Malaysia's heavy industrialization program. From the onset of the project's implementation, the government tilted playing field in the domestic car market in Proton's favour by exempting it from import duties on CKD kits. As a result, Proton was able to sell its cars at prices 20-30 percent cheaper than comparable cars produced by other car assemblers in the country.¹² By the 1990s, Proton had become the dominant car producer in the Malaysian Market.

Today, about 75 percent of vehicle sales are controlled by Proton (45 percent) and the second national car company Perodua (30 percent). This dominance was however threatened by Malaysia's commitment under the ASEAN Free Trade Area (AFTA) agreement to reduce import duties to 20 percent in 2005 and between zero to five percent in 2008.

The implementation of these trade liberalization commitments would seriously affect Proton's (and Perodua's) competitiveness vis-à-vis their competitors. The government's response in 2004 was to raise the excise duties to neutralize the reduction in import duty. The import duty on CKD passenger cars from ASEAN countries were reduced from 42%-80% to 25% while excise duty was increased from 55% to between 60%-100%. For CBU units from ASEAN countries, the import duty was reduced from between 140%-300% to 70%-190% while excise duty was increased by between 60%-100%.

The above case illustrates how the impact of trade liberalization (e.g. via import tariff reduction) can be neutralized by the use domestic policies (such as excise tax) by the government to support its industrial policy. In Malaysia's case, this strategy is probably an interim strategy aimed at buying some time for restructuring of the national industry. The restructuring, for example, may take the form of a future joint venture with a major foreign car producer.

(b) Industrial Policy, Market Entry and Competition: The EON - Proton Edar Case

Industrial policy may also create anti-competition problems. The recent case of EON vs. Proton Edar illustrates this point. Cars produced by the national car company, Perusahaan Otomobil Nasional Berhad (Proton), have been traditionally distributed domestically by two firms, namely, Proton Edar Sdn Bhd (Proton Edar) and Edaran Otomobil Nasional Bhd (EON).¹³

EON was established in 1984 as the sole distributor of the national car (Proton Saga).¹⁴ The strategy adopted then was to separate the manufacturing activity from the distribution activity.

Proton Edar was established in 1985 and it later evolved into a joint-venture between DRB and Proton Berhad in 1993 to distribute Proton's cars (Proton Wira). Proton Edar became a wholly-owned subsidiary of Proton in 2000 and subsequently began to distribute other Proton models (Wira, Perdana and Iswara) that were previously distributed by EON. In the same year, the 10-year distribution agreement between Proton and EON ended. A new dealership agreement have since not been concluded. These changes set the stage for further intensification of the rivalry between EON and Proton Edar to distribute Proton's cars.

Problems arose with the launching of a new Proton car, namely the *Gen.2* on 8th February 2003. Not surprising, Proton chose to initially distribute Gen.2 solely through its wholly-owned subsidiary Proton Edar.¹⁵ In addition, EON will have to obtain its supply of Gen.2 from Proton Edar! Proton has also argued that EON should restrict itself to selling "a single brand in a single showroom", referring to EON's current practice of selling Proton's cars as well as that of Audi and Chevrolet.

Anti-competitive conduct is fairly obvious in the EON-Proton Edar case. There is a severe conflict of interest due to Proton's ownership of Proton Edar. It is in Proton's commercial interest to favor its own subsidiary Proton Edar against EON. This has manifested in Proton's conduct to vertically restraint EON's competitiveness by restricting its access to a new product. Worse, EON's only source of supply of the new product is now its rival Proton Edar. Furthermore, Proton's insistence on the “a single brand in a single showroom” distribution policy is akin to market foreclosure to reduce inter-brand competition in the car market.¹⁶

There was no government intervention at the initial stages of these controversies surrounding the EON-Proton Edar case. As the above debate became more public and acrimonious, the government did intervene to hasten both parties to sign a five-year dealership agreement on 2 March 2004. Part of the government ability to intervene in the above case is due to the fact that it is a major shareholder in both Proton and EON. The dealership agreement signed may contain elements that should go under competition policy scrutiny. One such clause is the requirement that EON allocates 70 percent of its servicing capacity to Proton cars. This may be construed as the use of market power by the supplier firm (Proton) to force a buyer firm (EON) to limit the latter's ancillary services to other competing suppliers. This is an important issue given the importance of the ancillary services to the actual sale of the primary product (cars).

Industrial policy can also restrict competition via the promotion of strong vertically integrated structures. In the Proton case, this took the form of car production and distribution. The absence of a competition law obviously exacerbated these vertical restraint problems. If such a law had existed and if Proton was found to be guilty of anti-competitive conduct, it could have been forced to divest its distribution subsidiary. Furthermore, the government currently ‘regulates’ these companies via its substantial shareholdings in these companies. If the government were to divest its controlling shareholding in these companies, these companies would need to be regulated by competition laws.

(c) Industrial Policy, Regulation and Competition: The Steel Industry Case

Industrial policy can also create significant problems due the linkages of the targeted industry with other sectors. The steel industry in Malaysia is one such example. Aside from the car

industry, Malaysia also focused on steel production as part of its heavy industrialization program in the early 1980s. The two largest steel projects in Malaysia are Perwaja (producing billets) and Megasteel (producing hot-rolled coils, HRCs and cold roll coils, CRCs). After investing more than RM10 billion in Perwaja, the then loss making firm was sold to a private company, Maju Group. Megasteel, in contrast, has always been a privately owned steel plant costing more than RM2.4 billion.

Both investments are protected from foreign competition via import duties and permits (administered by Ministry of International Trade and Industry, MITI) and price regulation (set by Ministry of Domestic Trade and Consumer Affairs, MDTCA). Rising demand for steel scrap (the basic raw material for making steel products) abroad since early 2003 had reduced the profit margin of local production of steel billets and bars for domestic consumption. As a result, steel supply for domestic consumption declined leading to a sharp increase in steel prices. Domestic consumers of steel products such as the construction industry were severely affected. Concomitantly, both Perwaja and Megasteel reported significant improvements in their financial performance.

The government responded to this problem by suspending for six months the import restrictions on steel billets and bars as well as exempted their raw materials from import duties. In addition, exports of steel were also restricted. The MDTCA was also directed to prepare a new pricing control scheme for domestic steel billets and bars in the form of an automatic price adjustment mechanism (APM). This new price mechanism is intended to provide incentives for steel production for domestic consumption.

The chain of events observed in the steel industry illustrates the complex interactions between industrial policy, competition and trade. In the above case, the implementation industrial policy (in the steel industry) via trade policy (import permits and duties) and regulation (price controls) resulted in adverse impacts on other sectors (construction and infrastructure). The temporary solution of liberalizing imports clearly increases competition between local and foreign steel producers. However, there is no indication that the government considers restricting exports as a

temporary option, that is, until the APM is implemented. There is also no indication that industrial policy imperatives in the steel industry dominate that of other sectors in the longer run.

(d) FDI, Regulation and Competition: The Hypermarket Case

FDI have been an important source of capital in Malaysia's development. FDI continues to be regarded in a positive light in the manufacturing sector, partly because most manufacturing FDI are related to export activities. They provide capital, import technology, generate employment and earn foreign exchange. FDI in the services sector also confer such benefits. However, when FDI in services may be related with the provision of services that compete with home-grown small businesses, such investments are seen to incur some social costs in the form of replacement of these small businesses. This argument is illustrated by the hypermarket case in Malaysia.

Since the establishment of the first hypermarket (Makro) in Malaysia in 1993, the sector has grown rapidly. Today, there are some 22 hypermarkets in the urban conurbation of Klang Valley.¹⁷ Most of the well-established hypermarkets such as Carrefour (France), Tesco (UK), Giant (Hong Kong) and Makro (Netherlands) are foreign-owned. They have been significant concerns, on the part of the government, that hypermarkets compete with and can replace small neighbourhood retail (sundry) shops. The regulatory climate for FDI in the hypermarket business has changed from an accommodating one to a hostile one in past two years. More stringent guidelines have been imposed over time such as higher population density precondition (more than 350,000 persons), local product display requirement, stricter definition of hypermarket (from 8,000 sq m to 5,000 sq m), and preliminary "impact on sundry shops" surveys with 3.5km radius, limit on operating hours (no 24-hour business) and limit on place of establishment (freeze on hypermarket opening in Klang Valley, Penang and Johor Bahru). This adverse FDI environment culminated in the recent (20 April 2004) five-year freeze on the establishment of foreign-owned hypermarket in Klang Valley, Penang and Johor Bahru. Interestingly, no reasons have been given by the ministry responsible for regulating distributive trade (i.e. MDTCA).

The five-year ban on the establishment of foreign owned in Klang Valley, Penang and Johor will clearly reduce the flow of FDI into the hypermarket sector. Discouraging hypermarket

establishment may also delay restructuring of the retail trade sector that could enhance local upstream-downstream linkages as well as improve their productivity levels.¹⁸ The differential treatment of foreign-owned vs. locally-owned hypermarkets also raises market access and competition issues this sector. The consistency of such policies with the country's commitment under WTO-GATS is another issue.

(e) Industrial Policy, Mergers and Competition: The Financial Sector

Countries do respond to trade liberalization commitments (such as those committed under WTO) by undertaking industrial policy measures that are aimed at strengthening locally-owned firms. One of the perceived approaches to the problem has been industry consolidation via mergers to create large locally-owned firms that are seen to be capable of competing with foreign-owned firms. This is the approach taken in the financial sector in Malaysia.

The Bank Negara Malaysia (the Central Bank) announced in September 2000 that the financial sector would be consolidated by reducing the number of financial institutions from 56 to just ten 'anchor banks'.¹⁹ The affected financial institutions include 23 commercial banks, 16 merchant banks, and 17 finance companies. The main objective of the consolidation exercise was to enhance the competitiveness of locally-owned financial institutions in anticipation of increasing competition from foreign-owned financial institutions in the future.²⁰ To the author knowledge, the basis for the choice of anchor banks has not been publicly articulated by the central bank. However, there have been attempts to examine the possible underlying rationales. Karapayah (2002), for example, finds a bias towards using size as a criterion for choosing banks for the role of anchor bank. There are also no differences in financial performance of anchor and non-anchor banks.

The competitiveness of locally-owned financial institutions vis-à-vis foreign-owned financial institutions is one of the original motivations for the mergers. The central bank does recognize the importance of information and competition between domestic banks for the benefits of mergers to materialize. In this regard, the central bank recently introduced a new interest rate determination method that can adequately signals about their respective cost-of-fund to potential depositors or lenders to enable them to make better choices.

As we have seen above, industrial policy, trade policy and FDI policy are intertwined. The neglect of addressing competition issues can substantially reduce the benefits of trade and FDI reforms that are geared towards enhancing industrial development. Lacking a coherent competition policy, the government is, in most instances, forced to rely on heavy-handed regulation to deal with such problems in an ad-hoc manner. This approach is sometimes an outcome of the extensive shareholdings of the government in the economic sector. Clearly, the Malaysian government need to adopt a more formal and coherent approach to dealing with competition issues to reap the full benefits of any reforms in trade and FDI policies. In the next subsection we discuss some examples of what these benefits might look like.

The Effects From Maximizing the Benefits of Policy Reforms

The benefits from policy reforms, be they of regulatory, trade or FDI nature, accrue to both consumers and producers. We discuss these benefits in the context of our earlier case studies.

(a) Consumers and Users

In the context of our earlier discussion, consumers gain from lower prices, higher quality products and greater variety of products. Trade liberalization in the form tariff reductions on passenger vehicles such as those committed under AFTA would have meant Malaysian paying lower prices. Market liberalization such as those in airlines sector could prompt competition between incumbent and new firms to the benefit of consumers. The same argument can be applied to hypermarkets. However, as the Pangkor-Lumut ferry case and the haulage case illustrates, competition issues could negate this benefits as operators collude to maintain high prices. The impact of policy reforms may extend beyond the sector to affect other sectors such as the case of the steel industry.

(b) Suppliers

Suppliers benefit from policy reforms in different manner depending on the type and outcome of policy reforms. Trade liberalization may improve market access for foreign firms into countries such as Malaysia provided other entry barriers such as excise taxes in the car industry are not raised to neutralize import tariff reduction. In the case of the steel industry, trade policy reforms

both increase and decrease market access – import access are improved but exports are restrained. As the hypermarket case suggests, FDI-related promises ever more substantial long-run benefits – employment generation and restructuring of industry. These are, however, only forthcoming, when competition issues such as discrimination between local and foreign hypermarkets are addressed.

IMPACT OF INTERNATIONAL COMPETITION POLICY ON DOMESTIC DEVELOPMENT

Malaysia lacks a national competition law. Without such a law, the government has not been able to establish a permanent institution that focuses solely on competition-related issues. Thus, international competition policy related issues are either not dealt with at all or they are discussed in ad-hoc committees formed to address specific issues.

Due to the lack of a competition agency in Malaysia, the government has not taken pro-active interests in cross-border mergers that has gone under the scrutiny of competition authorities in the U.S. or Europe. In the Exxon-Mobil merger, the initiative to rationalize of the gasoline distribution network has been taken by the companies concerned rather than being imposed by the government.

One of the most significant developments in international competition policy that has garnered significant interest amongst policy makers in Malaysia has been the discussions, at the international level, on multilateral competition rules at the WTO. The Malaysian government's stance has been to seek deferment of this issue. This response has been influenced by the lack of a national competition law in Malaysia.

Overall, the impact of international competition policy on Malaysia's development appears to be minimal. This is foreseen to continue until either the international community makes significant progress on the discussions on multilateral competition rules or when Malaysia enacts a competition law.

CONCLUSIONS

Malaysia does not have a national competition law. Competition is regulated at the sectoral level in the country. Two economic sectors have legal provisions for competition law but these have been relatively ineffectively enforced. The benefits of Malaysia's industrial policy as well as the policy reforms in regulation and trade have been compromised by the lack of a formal institution to address competition related issues. Hence, the future priority and direction of regulatory reform is obvious – the country needs to implement a competition law and build the related institutions and capacities.

Notes

¹ Even though the NEP (1971-1990) was succeeded by other long-term development policies (such as the National Development Policy (NDP, 1991-2000), these subsequent development policies continued to emphasize on growth with equity. For more details of the NEP see Just Faaland et al (2003).

² See Appendix 1.

³ Corporatized or privatized are regulated by their own port commission which assumes an advisory capacity in relation to the MOT on matters relating to tariffs

⁴ The licensing of commercial vehicles was originally the responsibility of the Transport Ministry. This function was transferred to the Ministry of Entrepreneur Development (then, the Ministry of Public Enterprises) in the early 1970s to support the NEP policies.

⁵ The STAR, "No hypermarkets in smaller towns", 17 February 2004.

⁶ New Straits Times, "Govt may impose quota on goods displayed in supermarkets", 17 February 2004

⁷ The information discussed in this case were compiled from: (a) STAR, "Fare war bleeds ferry operators", 25th October 2003; (b) STAR, "Ferry operator seek consensus", 3rd November 2003; and (c) New Straits Times, "Legal advice sought over fare dispute", 17th December 2003.}

⁸ In the media reports the two firms were reported to have "consolidated" their operations.

⁹ For most ports, tariffs for ferry services operated by private companies are set by the port commission and/or the Ministry of Transport.

¹⁰ The information discussed in this case were compiled from: (a) STAR, "Call to stabilise haulage rates", 22 December 2003; (b) New Straits Times, "Haulage groups agree to stop giving rebates", 19 January 2004; and New Straits Times, "Smaller Hauliers on the road to overtaking major players", 4 February 2004.}

¹¹ Another important question is whether CHAM and AMH can be considered to be cartels.

¹² Jomo (2003).

¹³ The information discussed in this case were compiled from: (a) STAR, "Officials meet Cabinet over distributorship", 12 February 2004; (b) New Straits Times, "For EON, Proton Edar, it's business amid talk of rift", 17 February 2004; (c) STAR, "Proton and EON deny report on termination of distribution deal", 17 February 2004; (d) STAR, "Mahaleel: EON will have to wait for GEN.2", 18 February 2004; (e) New Straits Times, "EON must sell Gen.2 in separate showrooms, says Proton CEO", 18 February 2004; (f) New Straits Times, "Proton, EON sign five-year super dealership agreement", 3 March 2004.

¹⁴ Significant shareholders include the DRB-HICOM Group, Employees Provident Fund Board, Khazanah Nasional Bhd and the Jardine Group.

¹⁵ Commenting on EON's order of Gen.2 from Proton, the CEO of Proton was reported to have said, "They can order. They can wait." and laughed.

¹⁶ This may deter entry into the car market.

¹⁷ Klang Valley covers the districts of Shah Alam, Klang, Petaling Jaya, Kuala Lumpur, Kajang, Kepong, Puchong.

¹⁸ See Sieh (2003).

¹⁹ In an earlier announcement in July 1999, the Central Bank proposed a list containing only six anchor banks.

²⁰ This is related to Malaysia's WTO commitments to liberalize the sector by 2003.

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Table 1: Sectoral Regulation in Malaysia

| Sector | Regulatory Agency | Legislation | Type of Regulation |
|-------------------------------|---|--|--|
| Distributive Trade | Ministry of Domestic Trade and Consumer Affairs (MDTCA) | Consumer Protection Act 1999, Price Control Act 1946 and the Supply Control Act 1961 | Prices of essential goods are regulated. No provision for competition regulation. |
| Road | Public roads are regulated by the Road Transport Department (Ministry of Transport) Privatized roads are regulated by the Malaysian Highway Authority under the Ministry of Works. | Road Transport Act, 1987 | Price regulation (toll rates) By Ministry of Works Commercial vehicle licensing (entry) by Commercial Vehicle Licensing Board, Ministry of Entrepreneurial Development |
| Railways | Railways Department (Ministry of Transport) | Railways Act 1991 and Railways (Successor Company) Act 1991 | Price regulation (fare rates) by Ministry of Transport |
| Ports | Corporatized ports are regulated by the respective Ports Commission (e.g. Johor Port Authority, Bintulu Port Authority, Klang Port Authority etc.) Federal ports are regulated by the Ministry of Transport. | Ports Authorities Act 1963, Ports Act (Privatization), 1990, and the various port commission acts for each port | Price regulation by port commission |
| Airports | Civil Aviation Department, Ministry of Transport | Civil Aviation Act, 1969; Landing, Parking and Housing, Passenger Services and Air Navigation Facility Charges (and) Regulations 1992. | Price regulation by Ministry of Transport |
| Communications and Multimedia | Communications and Multimedia Commission | Communications and Multimedia Act 1998 | Price regulation and Competition regulation – CMC advises the Ministry of Energy, Communications and Multimedia. Entry is regulated via licensing. |
| Electricity Supply | Energy Commission | Energy Commission Act 2001, Electricity Supply Act 1990, Electricity Supply (Successor Company) Act 1990 | Regulation of wholesale prices via agreements between IPPs and Tenaga Nasional (incumbent distributor company). Retail tariffs regulated by Ministry of Energy, Communications and Multimedia. |
| Water Supply | Water Supply Department, Water Board, PWD | Water Supply Act, and state legislation | For privatized supplier prices are regulated concession agreements. |

Table 2: Government's Shareholding via Kazanah Nasional Berhad in Selected Privatized Entities

| Company | Sector | % Held |
|---|-------------------------------|---------------|
| Telekom Malaysia Berhad | Communications and Multimedia | 34.0 |
| Malaysia Airports Holdings Berhad | Airports | 23.5 |
| PLUS Expressways Berhad | Road Transport - Highways | 20.9 |
| Projek Penyelenggaraan Lebuhraya Berhad | Road Transport - Highways | 30.5 |
| Tenaga Nasional Berhad | Power | 35.6 |
| | | |

Source: Malaysian Business

Table 3: Market Concentration Studies in Malaysia, 1977-2004

| Study | Sector Coverage | Period Coverage | Findings |
|-----------------------------|-----------------|------------------|--|
| Gan and Tham (1977) | Manufacturing | 1968 – 1971 | Barriers of entry (scale economies, advertising) have significant influence on price-cost margins. Concentration is positively related to profitability. |
| Gan (1978) | Manufacturing | 1971 | Concentration is related to profitability and this relationship is discontinuous. |
| Lall (1979) | Manufacturing | 1972 | Barriers of entry (scale economies, capital requirements and product differentiation) are related to profitability. FDI is positively related to concentration. This impact is greater in the non-consumer industry. |
| Rugayah (1992) | Manufacturing | 1978-86 | Price-cost margin is related to seller concentration, optimal plant size, minimal capital requirement, product differentiation competition from exports and imports and capital intensity. FDI is not related to profitability. |
| Zainal Aznam & Phang (1993) | Manufacturing | 1979, 1985, 1990 | Scale economies, capital intensity and advertising are related to concentration. Foreign presence (measured by ration of output of foreign-controlled firm to total industry output) has some impact on market concentration. Entry of foreign induced oligopolistic market structures through large firm size and product differentiation. Import competition and export opportunities are not related to market concentration. |
| Nor Ghani (2000) | Manufacturing | 1985 - 1994 | Of the 132 industries surveyed, 12 showed increase in concentration, 53 showed decrease in concentration and 59 do not show any significant trends. |
| Bhattacharya, M. (2002) | Manufacturing | 1986, 1996 | Capital intensity, advertising, and market size is related to market concentration. |
| MDTCA (2003) | Manufacturing | 1996, 1999, 2000 | Efficient scale is related to market concentration. Firm size, capital intensity and export competition are not significantly related to concentration. |
| Lee (2004) | Manufacturing | 2000-2001 | The propensity to innovate is positively correlated to market concentration. |

Appendix 1: Competition Guidelines in the Communications and Multimedia Sector

The three documents relating to competition policy that were published in the communications and multimedia sector are:

Guideline on Substantial Lessening of Competition (CMC 2000a). This document clarifies the various notions (e.g. market, potential rivalry), anti-competitive conducts (e.g. predatory pricing, foreclosure etc.) and conditions (e.g. intentionality) under which such a conduct is deemed illegal under the CMA 1998. The document also provides an analytical framework for analyzing cases where substantial reduction in competition is thought to have occurred.

Guideline on Dominant Position in a Communications Market (CMC 2000b). This document clarifies the concept of dominance and the various structural characteristics (market shares, vertical integration, barriers to entry) and anti-competitive practices (pricing and supply behavior) that might be associated with the presence of a dominant firm. The guideline also makes provision for an analytical framework for determining dominant position in a market.

Process for Assessing Allegations of Anti-Competitive Conduct: An Information Paper. (CMC 2000c). This paper set out in greater detail the sequence of actions to be taken by the CMC when it investigates incidents and firms involving the substantial reduction in competition and presence of dominant market position.