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Incentivizing Malaysia's shipping and port sectors

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Incentives are needed to promote the development and growth of Malaysia's shipping and port sectors until the players can be competitive on their own, argue researchers at MIMA's Center for Maritime Economics and Industries

Lending a helping hand

The maritime sector is a key sector that contributes significantly to Malaysia's economic development. Underlining this is the fact that 95% of the country's international trade is carried in whole or in part by seaborne transport. Merchant shipping plays a pivotal role in facilitating trade and in suporting Malaysia's offshore oil and gas industry, while seaports act as gateways to the nation's imports and exports.

The Malaysian Government has introduced various incentives to promote the development and growth of merchant shipping and seaports in the country. This is an acknowledgment of the crucial role they play in facilitating the nation's trade and economic growth.

Fiscal incentives, provided mainly through the tax system, favor Malaysian shipowners, ships crew and shippers using Malaysian flag vessels. By offering income tax concessions to local shipping companies, the Government underscores its acknowledgment of the importance of the sector to the nation's economic growth and underlines its commitment to promote and develop its growth. Among the incentives provided to shipowners are :

- Blanket tax exemption for revenues earned from shipping activities
- Exemption on import duty and surtax for ships
- Capital allowance on merchant ships
- Accelerated depreciation on merchant ships
- Creation of Shipping Fund to finance acquisition of ships
- Full tax exemption for seafarers' wages

In addition to the above, the Government also provided various incentives to port operators including financing for development and dredging, and subsidy on Inter-Terminal Transfer charges at Port Klang which has been discontinued.

The incentives have contributed to the development and growth of Malaysian shipping companies and ports, as measured by growing national tonnage of merchant ships. Malaysia has now emerged as the 20th in the list of nations with the largest merchant shipping capacity of over 300 GRT (gross registered tonnage), and contributing 1.08% to the world total. MISC has emerged as the world's largest owner-operator of LNG tankers, while Port Klang and Port of Tanjung Pelepas were respectively ranked 13th and 17th busiest container ports in the world in 2010 based on throughput volumes. The number of local seafarers has also grown over the years, thanks to the tax exemption given on their income.

Beside incentives specific to the shipping and port sectors, there are several other incentives introduced in the 10th Malaysia Plan (10MP) from which the maritime sector can benefit:

- The reintroduction of an RM7 billion Working Capital Guarantee Scheme,
- Small Medium Enterprise (SME) Competitive Rating for Enhancement (SCORE) system which SMEs could use to upgrade their businesses and improve their star ratings,
- An allocation of RM500 million for a Mudharabah Innovation Fund (MIF),
- The establishment of a Business Growth Fund with a RM150 million allocation to bridge the gap between invention and commercialization of high-technology products
- The setting up of a new technology investment to manage funds.

Changing operating environment

The operating environments of merchant shipping and port operations are fast changing. This demands a nimble response from the practitioners and the Government to ensure that Malaysia remains competitive as a maritime nation. In light of rapidly changing dynamics in merchant shipping and port operations, and the tough operating environment amid the global recession and financial crisis, there is a need to assess the effectiveness and adequacy of existing incentives in the two sectors. Just as important is to evaluate whether new incentives should be introduced to enable Malaysia's shipping companies and ports to remain competitive and to facilitate the nation's growing trade volumes efficiently.

The Malaysian Government has made a bold move in announcing in the 10MP a five-year plan to wean the nation off subsidies to reduce its fiscal deficit and accelerate investment. This is needed to attain the goal of 6% annual GDP growth to reach developed nation status by 2020, as envisioned by Vision 2020. In line with this, remaining subsides are not expected to continue indefinitely nor new ones introduced in line with the Government's pronouncement in the 10MP to gradually rationalize subsidies and price controls to remove market distortions.

The Government has also announced that the current subsidies to producers will be converted to productivity-based incentives. For example, incentives in the fishing industry will be provided based on volume of fish landings rather than as input subsidies. This aligns well with increasing productivity and making it a cornerstone for economic growth instead of merely depending on capital injections.

Based on these, it is expected that any incentives retained or, if at all, new ones introduced will come with an expectation of increase in productivity, efficiency, innovation and competitiveness, not merely an exercise of lending a helping hand. Shipping companies and port operators will be holding their breath in anticipation of the Budget 2012 announcement on 7 October 2011 to see if any 'goodies' will be announced to further spur the development of the two sectors.

The Government is also expected to further open up the services sector following its announcement on April 2009 to liberalize 27 service sub-sectors to attract more foreign investments and talents and to enhance the competitiveness of those sub-sectors. Two of these services are in the maritime sector, namely maritime agency services and vessel salvage and re-floating services. More maritime related services are expected to be liberalized, in line with the aspiration for Malaysia to attain global competitiveness and to become a fully developed country by 2020.

Weathering the rough waves

Given the tough operating environment for shipping companies and ports, there is a strong case for the Government to continue providing incentives to players in the two sectors. Owing to the criticality of merchant shipping and ports to the nation's economic well-being, certain incentives such as tax exemption on income generated by Malaysian ships and on seafarers' wages, and the provision of funding for Federal ports for dredging should be continued. Without help from the Government, it would be extremely difficult for local shipping companies and port operators to have the necessary capacity, service level and economies of scale to be competitive in these trying times. However, the provision of incentives must not be inconsistent with national policies like reducing dependence on subsidies; promoting sustainable development and creating high-income activities.

The implementation of regional initiatives such as Asian Economic Community (AEC) and Competition Act in Malaysia will reshape the business competition landscape in the country. The merchant shipping and port sectors will not be immune to this development and the changes it will bring. When AEC is fully implemented, and Malaysia fully realizes its commitment to regional initiatives such as ASEAN Single Shipping Market and ASEAN Framework Agreement on Services (AFAS) and liberalization measures in trade and transport, certain incentives provided to the shipping and ports sectors might have to be removed. Likewise, when the Competition Act is implemented in 2012, incentives leading to anti-competition practices and distortion of market forces will have to be discontinued. In addition, Malaysia must adhere to its commitment to international organizations such as World Trade Organization and obligations to international conventions. Any incentives provided to the merchant shipping and port sectors should not run foul against these commitment and obligations.

As welcome as any form of assistance is, even incentives which are well-meaning can result in complacency among the recipients if not responsibly used. This is something which players in merchant shipping and port sectors simply cannot afford. Given the keen competition in their operating environment, they must constantly hone their competitive instincts by enhancing their efficiency, productivity and overall service levels. Incentives such as the Cabotage Policy should not be taken as a blank check that can indefinitely protect local players from the realities of a competitive business environment. As competition becomes fiercer, and as the barriers to doing trade and businesses across boundaries come down via the process of liberalization and integration, players in the two sectors cannot depend on protectionist policies forever and must compete on an even playing field. Those who fail to adjust to the realities of a competitive and borderless operating environment in these two sectors will be outmaneuvered and eventually be swamped by the wave of open competition.

To this end, there is a strong case to introduce several new incentives to boost the development of the shipping sector. For a start, the tax exemption given under Section 54A of the Income Tax Act to Malaysian-flagged ships should be extended to Offshore Support Vessels (OSV). These vessels are growing in dimension and capacity, and are increasingly being deployed in far-away places, hence should qualify as sea-going vessels which enjoyed 100% tax exemption under Section 54A. Likewise, seafarers working onboard OSV should also be entitled to 100% tax exemption on income earned, just like their counterparts working onboard sea-going vessels. Investment and tax incentives should also be offered to attract foreign investment in the shipping sector and vessel ownership among locals. Other incentives that should be considered include introducing integrated tax incentive plan for shipping companies, granting free tax status on imported parts for merchant vessels, and providing incentives to encourage maritime education and training to promote seafaring among locals. Also, incentives to further promote Malaysia as a maritime arbitration center and a jurisdiction of choice to settle admiralty disputes will be welcome by industry players.

For the port sector, the Government should continue providing funding for dredging to Federal ports but with a different financing model, perhaps in a form of loan rather than outright grant.

There is merit in re-introducing feeder incentives and subsidy on Inter-Terminal Transfer at Port Klang that was abolished in 2008. Terminal operators would also find deduction on capital expenditure incurred on ICT / hi-tech equipment useful. They would also welcome funding and incentives to conduct R&D, and exemption on stamp duty for purchase of expensive equipment such as cranes and port vehicles. To prompt port operators to help attain the nation's carbon emission reduction targets, incentives should be given to them to adapt green technologies and practices.

Help wanted

It is hard to imagine players in two capital-intensive and highly competitive economic activities like merchant shipping and port operations to succeed without support from their governments or the governments of the host countries where they operate. The high entry barrier, cyclical, competitive, transboundary and highly regulated nature of these activities necessitate one form of assistance or another to be rendered to the players to enable them to get started, develop their business, attain economies of scale and remain competitive.

The strong support by the Government stands testimony to the crucial role that merchant shipping sector and ports play in facilitating the nation's trade. Given that Malaysia's economy depends highly on international trade, much of which is carried by ships and through ports, the importance of the two sectors to the economic wellbeing of the nation cannot be overstated.

To ensure that Malaysia remains competitive as a maritime nation, support must be given to players in the two sectors to ensure they are capable of supporting the nation's trade efficiently. Shipping companies and ports need to have adequate capacity and trained human capital, and be productive, efficient and cost competitive.

This cannot happen without help from the Government. Wherever necessary, existing incentives must be continued and new ones introduced to help local shipping companies and port operators to grow and compete. Without these incentives, it would be hard to imagine Malaysia to maintain and improve on the successes in the shipping and port sectors. However, the provision of incentives must be consistent with national policies such as creating high-income activities, cutting down on carbon emissions and fostering fair competition, and not run against Malaysia's commitment and obligations on the international stage. The incentives must lead to improvements in efficiency, productivity and performance, and must not blunt the competitive, entrepreneurial and risk-taking instincts of their recipients.