

BTI 2008 | Malaysia Country Report

Status Index	1-10	6.36	# 42 of 125	
Democracy	1-10	5.33	# 74 of 125	➔
Market Economy	1-10	7.39	# 21 of 125	➔
Management Index	1-10	5.52	# 49 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	25.3	HDI	0.81	GDP p.c.	\$	9,681
Pop. growth ¹	% p.a.	1.8	HDI rank of 177	61	Gini Index		49.2
Life expectancy	years	74	UN Education Index	0.84	Poverty ³	%	9.3
Urban population	%	67.3	Gender equality ²	0.50	Aid per capita	\$	1.2

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Malaysia has made progress in expanding the scope of its market economy during the period under review. There is a high degree of stateness, an absence of undemocratic veto powers and institutions are stable. The institutional foundation of the market economy, such as the basic rules of organization, is firmly in place and the levels of socioeconomic development are high. Currency, prices and economic growth are stable. Economic development is based on a fairly well-developed education system, and is sustainable for some time to come. Property rights are well defined, and high growth rates have compensated for a lack of a welfare system.

However, political reforms toward liberal democracy are still insufficient, which are primarily related to problems inherent to Malaysia's political structure, as well as dynamics driven by ethno-religious tensions. Having maintained their own religions, cultures and languages, Malaysia's three major ethnic groups – Malays, Chinese and Indians – have strongly resisted any moves that might blur these boundaries. With political parties and mobilization based along ethnic and religious lines, there are increasing tensions between the Muslim majority and non-Muslim minority. These divisions also result in an absence of consensus on all key issues. In addition to ethno-religious tensions, corruption and fundamentalist Islam pose serious threats to state institutions and the secular government. Thus far, there is a low level of political violence and extremism.

Despite all these problems, there is remarkable political stability, which is in large part due to the ruling Barisan Nasional (National Front, BN) coalition, which has been in power since independence. The BN has been consistent and pragmatic in its approach to economic policies during its long tenure, giving Malaysia one of the highest growth rates in the region. Poverty rates were more than halved during the past two decades, and the biggest current problem appears to be the widening gap between the rich and

poor. Although the country was hurt by the Asian financial crisis of 1997 – 1998, it has successfully recovered. From 1970 to 2003, Malaysia has shown consistent economic growth in GDP, averaging an annual rate of about 7%. The standard of living for the majority of the population improved significantly from 1970 to 2000, with the level of GDP per capita increasing fourfold.

History and Characteristics of Transformation

The federation of Malaysia was established in 1963 with the territories of Malaya, Singapore, Sabah and Sarawak. Two years later, in 1965, Singapore was expelled from the federation. Today, Malaysia consists of 13 states and two federal territories. It is a constitutional monarchy based on the British Westminster model, a legacy of British colonialism. At the federal level, there is a bicameral legislature. The House of Representatives (lower house) is composed of members elected every five years in a first-past-the-post election from single-member constituencies. Senate (upper house) members are all appointed by the king. Executive power lies with the prime minister and the cabinet. Each of the 13 states has its own legislature.

Politically and officially, the country's population is divided into two categories: Bumiputera and non-Bumiputera. The Bumiputera group consist of Malays and other indigenous peoples, while the non-Bumiputera group consists mainly of Chinese and Indians. This divide is evident in every facet of Malaysian life, from politics to food to university admissions.

Most of the Chinese and Indians first came to Malaysia during colonial times when the British actively recruited them to open up the economy. When the country gained independence, the British left political power largely in the hands of the indigenous Malays. The Malay leaders then forged a political alliance with the major Chinese and Indian parties. This set a pattern for politics in which it became an unwritten law that the prime minister position will always be held by a Malay, specifically from the United Malays National Organisation (UMNO). The current president of UMNO, Abdullah Ahmad Badawi, is Malaysia's fifth prime minister. The alliance system collapsed in May 1969 when race riots broke out between the Malays and the Chinese after a bitterly fought election. The whole country was placed under emergency rule and the constitution suspended. When the suspension was finally lifted in 1971, new laws were passed to ensure Malay political supremacy. The UMNO became all-powerful and aggressively promoted the Malay population, who were its main supporters. A New Economic Policy (NEP) was promulgated, providing extensive benefits to the Bumiputera (i.e., Malay) community through quotas, bank loans, scholarships, special licenses, etc. The government justified the affirmative action character of the NEP on the basis that the economic gap between the Malay and the

non-Malay (i.e., Chinese) was so wide that it threatened racial harmony and had prompted the May 1969 riots. Although the NEP discriminated against the non-Bumiputera, the UMNO-led government was careful to allow a free market economy to develop. The government gave the non-Bumiputera a free hand in the economy, as long as quotas and shares were allocated for Malays. This strategy, which emphasized growth with ethnic distribution through significant foreign direct investment in the 1970s and 1980s, was so successful that Malaysia became one of the “Asian Tiger” economies.

Although the NEP officially ended in 1991, economic policies since then have retained the core character of their predecessors, including special rights for the Bumiputera and the promotion of rapid economic growth to ensure that all ethnic groups receive their share of the economic pie.

Since independence, the government has been headed up by the UMNO and the ruling coalition, Barisan Nasional (National Front, BN), has won every general election. The BN regularly gets more than two-thirds majority in parliament, allowing it to amend the constitution at will, and gave the executive the leeway to pursue policies without opposition. Having successfully managed the economy, the government has been able to proclaim that, by 2020, Malaysia will be a fully developed and industrialized country. Today, Malaysia is generally regarded as a success story among developing countries by maintaining a stable and growing economy and a relatively stable polity, despite ethno-religious conflicts.

Transformation Status

I. Democracy

Democratic transformation in Malaysia stagnated during the review process. During the past two years (2005 – 2006), key shortcomings have persisted, particularly regarding the electoral process, free media, political representation, rule of law, the effective and efficient democratic institutions, and consensus-building. Malaysia has never been a fully democratic or fully authoritarian country. Elements of both democracy and authoritarianism can be found. The country's diversity guarantees that full-fledged liberal democratic development will be difficult to achieve. Since independence, the government has sought to concentrate on economic development rather than political development, believing that once Malaysia is fully industrialized and developed, many contentious issues can more easily be resolved. One negative development during the review period is the increasing radicalism of the Islamic movement in Malaysia. Many of these groups seek the imposition of Islamic law in Malaysia and openly call for the death penalty for those who wish to convert from Islam to another religion. Many of these groups also oppose inter-faith dialogues and regard Islam as superior to all other religions. In one disturbing incident in 2006, more than ten thousand angry Muslims surrounded a Catholic church when rumors circulated that there was a baptism ceremony for Muslims planning to become Catholics. It was later revealed that one of the individuals spreading the rumor was the state mufti, the highest Islamic authority in the state. In a more positive development, NGOs have mushroomed during the period under review, many of which promote democracy, human and women's rights, the environment and inter-faith harmony. Making good use of easy Internet access, these groups have organized and publicized their actions and goals through the web, and have recruited new members. Many of these NGOs are now learning to work with political parties to create new forums for democratic debate. Arguing that almost all of these groups are critical of government policies, the government is unwilling to engage civil society groups, which slows the development of civil society. Media freedoms in Malaysia are underdeveloped. According to Reporters Without Borders, Malaysia ranks at 92nd out of 168 countries in its worldwide press freedom index.

1 | Stateness

Citizenship and the state's monopoly on the use of force are undisputed. The Malaysian state is strong and sovereign. Although there are territorial disputes with the Philippines (the state of Sabah) and Singapore, these are not deemed important by the polity and do not interfere with the workings of the state.

Monopoly on the use of force

The key political institutions of the state, such as the bureaucracy, armed forces, parliament and monarchy, are all dominated by ethnic Malays, ensuring that the state has a strong Malay contingent.

State identity

Although the country is constitutionally secular, political Islam plays an increasingly important role in public policy as the state tries to negotiate between a small but vocal band of fundamentalist Islamists and the secular majority. Parti Islam Malaysia (PAS), one of the two main opposition parties, advocates the creation of a theocratic Islamic state. In 2002, former Premier Mahathir Mohamad called Malaysia an Islamic country, but he did not alter the secular constitution. Mahathir claimed that because 60% of Malaysia's population are classified as Muslims, Malaysia is a de facto Islamic state. The current Badawi administration has also adopted a similar stand.

No interference of religious dogmas

The state's basic administration is sophisticated and sound. There are clear lines of divisions between government departments and agencies, and the administrative is, on the whole, capable, professional and well-trained. The administration follows the orders of the elected government.

Basic administration

2 | Political Participation

Malaysia has established universal suffrage and more than half of registered voters regularly take part in elections. Elections have been held on schedule (every five years) since independence. Elections in Malaysia cannot be considered free and fair. The ruling BN has never lost a general election since independence, and most analysts would attribute their excellent record of winning elections to a mixture of using repressive laws to restrict the opposition, gerrymandering, media control, and using government resources to ensure consistent victories.

Free and fair elections

Elected rulers have the power to rule, but the country's ethnicized politics allow groups promoting Malay political dominance and greater Islamization to lobby successfully against the state to change policies. For example, although there is widespread unhappiness with the NEP's racial discriminatory policies, the elected rulers refused to change this policy as it benefits the Malay population.

Effective power to govern

Although there are signs of increasing political activism among NGOs and civil society groups, there are many laws that restrict their growth and development. For example, Amnesty International has been denied permission to establish a branch in Malaysia, despite several applications. The same laws are used to restrict the growth of trade unions or other independent enclaves of political activity.

Association /
assembly rights

Freedoms of information, speech and assembly are all restricted by law. The only area where the law has not caught up is the Internet, where all forms of political expression are grudgingly tolerated. However, in early 2007, individuals close to the ruling BN began defamation suits against political bloggers who were critical of government policies. These legal suits are meant as a warning to others.

Freedom of
expression

3 | Rule of Law

Rule of law is generally respected in Malaysia, as long as it does not interfere with the government's political agenda. The government can change the law at will because the ruling BN has a two-thirds majority in parliament, allowing it to amend the constitution at any time. During Mahathir Mohammad's administration (1981 – 2003), the federal constitution was amended almost annually.

Separation of
powers

The judiciary came under assault from the executive, resulting in the forced removal of the chief justice and two Supreme Court justices in 1998. The Badawi administration has tried to restore confidence by adopting a more professional approach to the appointment of judges, but the consensus is that it will take years for the Malaysian judiciary to regain its reputation as an independent check on the executive. A black spot on the judiciary, the jailing of Anwar Ibrahim, was somewhat mitigated when he was released by an appeals court in September 2004. A few years earlier, a senior judge wrote a letter detailing corruption at the highest level of the judiciary. The charges were never properly investigated and the judge quietly retired, leading to speculation that a cover-up took place.

Independent
judiciary

Corruption is a key threat to the rule of law. Although there is no accurate measure of corruption in Malaysia, there is a widespread perception that corruption is common among the nation's political and business elite, whose close ties form what is often referred to as "money politics." Transparency International's 2006 Corruption Perception Index ranked Malaysia at 44th, down from 37th in 2003. Government policies that award huge infrastructure projects to selected Malay businesses without an open bidding process and grant special licenses to the same group have encouraged corruption. Although Prime Minister Badawi pledged to eliminate corruption in the 2004 general elections, little has been done since. At the lower level, corruption is dealt with effectively by the Anti-Corruption Agency (ACA). The general view is that there is a different set

Prosecution of
office abuse

of rules for the “big fish” and the “small fish” when it comes to corruption. In 2004, the government launched the National Integrity Plan with anti-corruption as one of its key platforms; however, many people are disappointed that no major political figure has been removed or arrested for corruption in the past two years. The general consensus is that there is little political will to tackle corruption at the higher levels. Tolerance of selected corruption continues primarily because the UMNO uses its power to buy its supporters. Major government contracts are almost always awarded to Malay companies and Malay individuals with close ties to UMNO; thus, any action against this group would cause a split within UMNO and may even threaten the position of Badawi, who is the president of UMNO.

There are laws restricting political participation, free expression and civil liberties. The most infamous one is the Internal Security Act (ISA), which allows for indefinite detention without judicial redress. Opponents of the government have been held under the ISA. The Official Secrets Act (OSA) automatically classifies all government documents as “secret,” thereby denying the media and the public access.

Civil rights

The police are held in low esteem by the public. A Royal Commission report in 2005 found widespread corruption in the police, routine police torture and little respect for human rights. Its key recommendation, the establishment of an independent police commission to oversee the police force, has not been adopted by the government despite widespread public support. The Human Rights Commission, established in 1999, has tried to deal with issues relating to police abuses and abuse of power by the bureaucracy. However, it has been ineffective, given that its recommendations are routinely ignored by the government.

The role of Islam in civil cases has been increasing for several years. Islam is the official religion in Malaysia and all Malays are constitutionally defined as Muslims. There is no provision for conversions from Islam. There is, however, a law stipulating mandatory conversion to Islam for the non-Muslim partner in marriage to a Muslim, which has resulted in a great number of converts in Malaysia. Others convert to Islam without telling their family members.

During the period under review, there have been four high-profile cases in which Islamic authorities have forcibly taken the bodies of recently deceased individuals from their immediate family. The authorities claimed that the deceased was a convert and that they needed to give him an Islamic burial. This is often fervently disputed by the family, who are all non-Muslims. In all these cases, the non-Muslim families are asked to appear before the Shari’ah court to determine the religion of the deceased. This is unacceptable to the family, since appearing before the Shari’ah court implies that they recognize the Islamic court’s jurisdiction. This occurs despite the fact that the law clearly states that the Shari’ah court can only deal with Muslims. Another controversial case involved

an Indian man who secretly converted his children to Islam without the knowledge of his Hindu wife. He did this to ensure that he would get custody of the children during the divorce; under Shariah law, Muslim children must live with Muslim adults. There have been many cases of estranged husbands converting to Islam to escape from alimony payments or to marry someone else without divorcing their first non-Muslim wife. The law says that once a person is Muslim, the Shari'ah court has jurisdiction, but makes no provisions for cases of Muslim conversions where one partner retains their non-Muslim faith.

In early 2005, the Bar Council, working with several secular NGOs, tried to establish an Inter-Faith Commission to deal with issues arising out religious conflict. Several fundamentalist Islamic groups threatened violence, and several Muslims who supported the commission received death threats. Several Islamic NGOs have called on the government to impose the death penalty on apostasy. In 2006, the government said it will not support the commission and called on the public not to discuss Islamic issues.

4 | Stability of Democratic Institutions

Subject to the aforementioned reservations about the problems of a working system of checks and balances, key institutions are stable. The government is strong and in control. As long as there is the political will, things happen and work gets done. The only concern here is the omnipresence of the political executive. The prime minister and the cabinet make all key decisions with little regard for the wishes of parliament or the public. For the most part, parliament acts like a rubber stamp in the approval of executive decisions.

Performance of democratic institutions

Despite the dominance of the UMNO in government and the marginalization of non-Malays, the system is remarkably stable, as the smooth transfer of power from Mahathir to Badawi in 2003 shows. Key institutions, such as the armed forces, police, bureaucracy and the judiciary, are largely accepted by the polity as legitimate, although non-Malays view them as attentive only to the interests of the Malay community.

Commitment to democratic institutions

5 | Political and Social Integration

Taken as a whole, the Malaysian party system is remarkably stable in view of ethno-religious tensions. This stability comes from two sources. It comes first from the ruling coalition BN, which is comprised of 14 parties, each representing an ethnic group or a region. Although the UMNO dominates the BN, other coalition parties are allowed to champion their ethnic agendas, and concessions are made to preserve the working of the coalition. Thus, while the UMNO has

Party system

more power proportionately, others do get a minor share, thus ensuring that political stability is preserved. Second, opposition parties are also similarly divided along racial lines, ensuring that all mainstream political parties mobilize along ethnic lines. This indirectly forces the leaders of these ethnically based parties to seek compromises among themselves in order to ensure social stability. This elite bargaining allows most sensitive issues to be resolved. The only area of concern is the strong push by the opposition Parti Islam Malaysia (PAS) to establish a theocratic Islamic state. If this happens, some 40% of the population who are non-Muslim would immediately be disenfranchised from the political system. Thus far, the votes have shown a clear preference for secular parties. The state-defined and state-enforced social divide between the Bumiputera (Malay) and the non-Bumiputera remains the cornerstone of ethnic relations in Malaysia. As long as the state discriminates in favor of the Bumiputera, there will be strong resentment among the non-Bumiputera. The level of resentment will depend heavily on economic performance; ethnic tensions tend to be lowest during periods of high growth, given that all have a share in the expanding economic pie. In the medium to long term, however, the country will be divided not into Bumiputera or non-Bumiputera, but rather between Muslim and non-Muslim. Combined with the ethnic divide, this may lead to political instability.

Largely because political parties mobilize along lines of race and religion, the majority of interest groups in Malaysia are focused on both. Political conflicts, even over neutral issues such as education standards, are also seen as ethnic issues. Opposition parties are systematically disadvantaged, and civic groups can act only within the narrow limits set by the authorities and as long as they don't touch on "racial" issues or become outspokenly critical of the government.

Interest groups

There is no reliable survey data available on democratic political attitudes among the citizens of Malaysia. Anecdotal evidence, voter support for reform-oriented pro-democratic political parties, as well as occasional political protests, indicate that there is a pro-democratic sentiment among some segments of the populace. Most observers contend that most citizens and voters, as well as the majority of the political elite, support Malaysia's "semi-democratic" political status.

Consent to democratic norms

Self-organization in civil society and nonpolitical associations encounter political and cultural obstacles. Malaysia's semi-democratic political order limits associational life, the stock of social capital is weak, and the country lacks traditions of civic sociability. There are cultural barriers between the major ethnic and religious groups and social and cultural life among Muslim-Malays, Chinese, and Indians reflects a segmented autonomy. While there is, of course, some self-organization, it is very unevenly distributed among the population, and inter-communal relations are characterized by relatively low levels of inter-ethnic trust.

Associational activities

II. Market Economy

In stark contrast to his predecessor Mahthir, who pushed for mega projects such as the world's tallest building, a new capital city and a national car project, when Abdullah Badawi took over as prime minister on 31 October 2003, he announced a return to basics concerning the economy. Badawi revamped government-linked companies (GLCs) such as Telekom, Tenaga Nasional (national power corporation) and Malaysian Airlines, and new executives were appointed to these GLCs, including a new chief executive for Khazanah Nasional, the government's investment holding company. Temasek Holdings, the investment arm of the Singapore government, was allowed to buy significant stakes in GLCs and a bank. Badawi also broke with tradition by appointing a professional to be finance minister. Badawi's "Ninth Malaysia Plan" (five-year economic plan) places major emphasis on agriculture and human resources development. The markets generally approved these economic reforms.

6 | Level of Socioeconomic Development

Key indicators show a medium level of development. Among the group of transformation countries in Asia and Oceania, Malaysia ranks at 61st in the 2006 UNDP's HDI. The country's level of socioeconomic development permits adequate freedom of choice for all citizens, subject to affirmative actions by the state in favor of the Bumiputera. Muslims cannot legally leave the religion. There is no fundamental social exclusion because of poverty, unequal access to education or deep gender discrimination, although the state actively maintains a quota for the Bumiputera in professional occupations, education and business. This has led to the exclusion of the non-Bumiputera at the lower level of society, although high growth in the past decade has ensured that even the most marginalized groups have benefited somewhat. Poverty rates have come down across the board, and it is generally acknowledged that poverty reduction programs in Malaysia are one of the most successful in the Asia-Pacific region. Nevertheless, problems remain. Throughout the review period, the single biggest problem has been the growing inequality between the rich and poor. According to the UNDP, in 1990, households in the lowest 40% of income earners only received around 14% of total income.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	95,164	103,992	118,461	130,326
Growth of GDP	%	4.1	5.7	7.2	5.2
Inflation (CPI)	%	1.8	1.1	1.5	3
Unemployment	%	3.5	3.6	3.5	-
Foreign direct investment	% of GDP	3.4	2.4	3.9	3.0
Export growth	%	4.5	5.7	16.3	8.6
Import growth	%	6.3	4.2	20.7	8
Current account balance	\$ mn.	7189.7	13,381.2	14871.5	19,979.9
Public debt	\$ mn.	26,414.7	25,399.6	25,570.3	22,449.3
External debt	\$ mn.	48,272.1	48,557.0	52,155.6	50,980.7
External debt service	% of GNI	9	9.8	8.2	7.6
Cash surplus or deficit	% of GDP	-6.3	-4.3	-	-
Tax Revenue	% of GDP	18.8	17.6	-	-
Government consumption	% of GDP	13.8	13.9	13.2	12.9
Public expnd. on edu.	% of GDP	8.1	8.0	-	-
Public expnd. on health	% of GDP	2.1	2.6	2.2	-
R&D expenditure	% of GDP	0.7	-	-	-
Military expenditure	% of GDP	2.4	2.8	2.3	2.4

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Malaysia has an institutional foundation for a competitive market-based economy firmly in place. However, in practice, this is not applied in cases involving individuals with high-level political access. The open bidding system is not used for key government contracts, since the government pursues a policy of ensuring Bumiputera equity, while all smaller government contracts are only open to Bumiputera companies. National interest ensures that state-owned enterprises such as Proton, the national auto manufacturer, are heavily protected by tax

Market-based
competition

rebates and excise duties. Most public utilities cannot raise prices without government permission. One area of concern is red tape. The World Bank, in its 2006 annual business report, saw Malaysia's standings drop in several areas compared to 2005, namely in dealing with licenses, employing workers, trading across borders, enforcing contracts and closing businesses. To start a business in Malaysia, entrepreneurs may have to go through nine steps – compared to the 8.2 steps taken on the average in the region – and 30 days of paperwork on average. The steps, time and cost of complying with licensing and permit requirements for ongoing operations is a staggering 281 steps at a cost of 78.19% of income per capita, compared to the region's average of only 17.6 steps. As for property, it takes about 144 days to register a property in Malaysia, compared to only 85.8 days on average in the region. It takes about 31 steps and 450 days to enforce commercial contracts in Malaysia. The time and cost required to resolve bankruptcies in Malaysia takes 2.25 years and costs about 14.50% of the estate value. The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is 38.69. Malaysia scored higher against the region in terms of investor protection, which includes transparency of transactions, liability for inside trading, shareholders' ability to sue officers and directors for misconduct, and the Strength of Investor Protection Index.

At present, there is no law against monopolies, although there are no monopolies like South Korea's chaebols. However, there are several oligopolies built by Chinese companies or public-private (Malay) enterprises.

Anti-monopoly
policy

In 2005, the government made a significant move to liberalize the capital markets when it issued full licenses to selected foreign brokerage firms. In 2006, the government relaxed regulations relating to property investments by foreign interests. Foreigners do not need permission anymore for properties priced above MYR 250,000 (\$70,000). In early 2007, the Kuala Lumpur Stock Exchange reintroduced "short selling" on the floor and removed all restrictions on money moving in and out of Malaysia. Competition will intensify in the coming years as Malaysia implements free trade agreements with countries such as the United States, Singapore and Australia. The ASEAN Free Trade Area (AFTA) will also go into effect in 2008, leading to even fiercer competition.

Liberalization of
foreign trade

The banking system was consolidated during the review period. This process has been driven by the central bank as it prepares the local banking industry for competition; Malaysia has to open up its financial markets in line with WTO requirements. The government's plan is to consolidate the 36 financial institutions into six "anchor" banks, all supposedly with adequate capital to compete, at least in the region. There is agreement, however, that Malaysian financial institutions cannot hope to compete globally, and that further rationalization may be needed.

Banking system

8 | Currency and Price Stability

For the period under review, the Malaysian government has successfully pursued a sound macroeconomic policy. Inflation has been low, around 3.1% in 2005. In 2005, the government removed the ringgit peg to the U.S. dollar, which was introduced during the Asian Financial Crisis in 1998. It has opted for the “managed float” system of currency exchange, allowing the ringgit to appreciate slowly. The ringgit has risen by about 9% against the U.S. dollar since 2005 and is expected to appreciate further in 2007.

Anti-inflation /
forex policy

Generally, the Malaysian government follows a consistent policy for stability, notwithstanding inconsistencies of institutional safeguards and a remaining risk of populist policies. Federal government revenue registered at 11.4% from 2000 to 2005. The increase was attributed to higher revenue collected from petroleum taxes and export duties, as well as returns on investments. The federal government’s operating expenditure expanded at an average annual rate of 11.6% from 2000 to 2005. Taking into account development expenditures, the overall federal government fiscal deficit declined from 5.7% of GDP in 2000 to 3.8% of GDP in 2005. Outstanding debt increased to 46.2% to GDP in 2005 (86.9% of the total being domestic debt). Macroeconomic management for the Ninth Economic Development Plan (2006 – 2010) focuses on maintaining the macroeconomic stability to consolidate the economy on a sustainable growth path for the achievement of distributional goals as well as improvement in the population’s quality of life.

Macrostability

9 | Private Property

There are no problems with property ownership rights and the regulation of property acquisition. The economy is overwhelmingly based on private ownership. Nevertheless, the government is a key player in the economy by virtue of being the major shareholder of major utilities companies, such as those dealing with construction, power, telecommunications and transport.

Property rights

More than 35% of the market capitalization in the Kuala Lumpur Stock Exchange is owned by government-linked companies. The government is officially committed to the privatization of as many government assets as possible. The only controversy is that these assets will only be privatized to Malay interests.

Private
enterprise

10 | Welfare Regime

There is no state-sponsored social welfare system in Malaysia. Rather, all employees and employers must contribute to a provident fund that can be withdrawn upon retirement. The current rate of contribution is 23% of annual salary. There are some government-run homes but these are mostly for the destitute. The family remains the core defense against social risk. The government has invested heavily in providing basic medical care for all at a nominal cost, while specialist care is available at public hospitals at a heavily subsidized price.

Social safety nets

There are a number of institutions to compensate for gross social differences. The government continues to follow a distinct affirmative action policy for Malay-Muslims and other “sons of the soil,” including economic redistribution through economic growth, as well as improvement in the quality of life of the population. However, women do not have equal access to education and public services. Chinese and Indians are deliberately disadvantaged in public office in the state bureaucracy, public enterprises and the armed forces.

Equal opportunity

11 | Economic Performance

GDP growth has been relatively strong in Malaysia for the period under review. GDP growth was 5.3% in 2003, 7% in 2004 and around 6% in 2005. The budget deficit has come down to less than 5% in the review period. As an export-oriented economy, Malaysia’s economic performance is tied very much to the global economy. If there is a global slowdown, it will affect Malaysia immediately. Although the official unemployment rate is about 3.6% in 2006, in reality there is full employment. There are currently close to 1.5 million foreign workers (mostly Indonesians, Filipinos and others from the Indian subcontinent) in the country.

Output strength

12 | Sustainability

Environmental concerns have grown in recent years among citizens, lawmakers and the government. However, the overriding objective of the government is economic growth; environmental lobbies have never won a major battle against a key development project. One example is the Bakun hydroelectric dam project; despite overwhelming objections from international and Malaysian environmental NGOs, the government is adamant about seeing this project through. The Bakun dam project envisages the creation of a lake about the size of Singapore.

Environmental policy

Malaysia has a comprehensive education system and a modern infrastructure, and continues to invest heavily in education, especially in science and engineering. Unfortunately, quality issues have emerged regarding public universities, as the quality of local academic staff and local graduates is deemed low by international standards. Many academic staff and students lack basic skills such as English language abilities. Despite this, in 2007, the government announced the establishment of three new public universities, bringing the total number of public universities to 19. Starting in the 1990s, the government liberalized tertiary education, encouraging foreign institutions to establish campuses in Malaysia and allowing private tertiary institutions to compete with public universities. In the past decade, four foreign universities have built branch campuses: Nottingham University (UK), Monash University (Australia), Swinburne University of Technology (Australia) and Curtin University of Technology (Australia). The government is also actively encouraging foreign students to study in Malaysia. Malaysia has also tried to establish itself as a major information and communications technologies (ICT) hub. The previous Mahathir administration established a Multi-Media Super Corridor (MSC) to attract international collaboration in investment in ICT. However, these efforts have not been successful. In 2006, the Badawi administration announced a multi-billion ringgit plan to turn the entire southern tip of the country, facing Singapore, into a massive industrial zone. The Iskandar Development Region will take ten years to complete and entails an investment of MYR 47 billion (\$13.5 billion). A further MYR 3.5 billion will be spent on the northern corridor, including a new bridge linking Penang Island to the mainland, and upgrading the existing airports. Despite all of these moves, Malaysia is still weak in research and development. From 2006 to 2007, Malaysia was ranked at 26th in the World Economic Forum's Growth Competitiveness Index. The stated aim of the government is to make Malaysia a fully industrialized country by 2020.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

Measured in terms of national poverty levels, educational levels, geographic location, degree of infrastructural development, health status of the population and geographic location, the structural constraints on governance are moderate in Malaysia.

Structural constraints

Notwithstanding socioeconomic modernization and the slow but steady growth of civil society in Malaysia, traditions of civil society are still weak. However, since the 1990s, there has been a moderate increase in associational vitality.

Civil society traditions

Throughout the review period, there appear to have been three constraints on governance. First, the ruling coalition under BN is constrained by the ethnic equation. Although the UMNO dominates the coalition, it cannot ignore the interests of other coalition members who represent other ethnic groups, two of which (Chinese and Indian) collectively make up more than one-third of the population. Second, there is an increasing trend towards “Islamicization,” which makes it difficult for the BN to pursue more liberal policies that offend Islamic sensitivities. A simple example is that the government cannot build casinos as tourist attractions. Nonetheless, the BN has made remarkable progress and has managed to keep the country on a secular path. Third, there is pressure on the government to provide more opportunities and subsidies to the Bumiputera population, in addition to existing affirmative action programs and quotas. This has created tensions among non-Malays, who feel that they have already suffered enough discrimination. Many fear that more affirmative action policies will simply make Malaysia uncompetitive and scare away foreign investors. The World Bank’s latest Worldwide Governance Indicators 2006 report showed Malaysia fared worse than 10 years ago in five of the six good governance indicators: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption.

Conflict intensity

II. Management Performance

14 | Steering Capability

Undoubtedly, the Malaysian government is pursuing the long-term goal of economic growth and social development. It seeks to build and preserve social consensus about a specifically Malaysian form of capitalism (i.e., “ethnicized” market development). However, its strategic aims are not commensurate with the aim to strengthen liberal democracy; rather, the political leadership attempts to preserve the semi-democratic status of the political order.

Prioritization

The government’s steering capability is high. Because it has been in power since independence, it has near total control of all the state institutions. Policies, especially economic policies, are drawn up in a fairly rational manner and implemented effectively as long as they are in line with government priorities.

Implementation

Reviews and reforms of policies are done regularly, although these are often prone to political interference. The government’s aim and objectives are widely published and understood by the professional community. The only area of concern is the reluctance of the ruling elite to get rid of institutional discrimination policies against non-Malays, widen democracy, liberalize politically and commit to a secular state. There is, however, no reluctance to reform the economy or to adopt new economic policies, as long as these policies do not interfere with affirmative action policies.

Policy learning

15 | Resource Efficiency

The government makes fairly efficient use of available economic and human resources for its economic and social policies. Reforms of the financial markets, banking sector and corporate sector have largely been adequately planned and effectively implemented. The only area of inefficiency is the government affirmative action policy, which requires it to set aside a Bumiputera quota for all of its economic activities. The government bureaucracy is relatively professional, although politics have ensured that it is almost totally dominated by Malays. At the middle and lower levels of the bureaucracy, there are efficiency issues, since the government is often forced to absorb poor-quality graduates. These graduates, all Bumiputeras, were given places in universities under the quota system and political necessity requires the government and government-

Efficient use of assets

linked companies to offer them employment since they cannot get a job in the performance-driven private sector.

The government regularly consults experts and takes input from the private sector when it draws up the budget and economic policies. Major conflicts over economic or social policies are effectively dealt with at the cabinet level.

Policy coordination

Corruption in the civil service is probably the lowest in the region after Singapore, although many people believe that rent-seeking behavior is worsening among the political elite. Those awarded public infrastructure projects and privatization exercises are linked directly to the ruling BN; political connection is the most important criterion in awarding large contracts. There is also concern over the government's continued indirect subsidies for "national" projects such as the national automaker, Proton. Many of these projects were initiated under the previous Mahathir administration. The Badawi administration has set lower tariffs for imported cars, and Proton has been told that it will have its subsidies cut in the next few years.

Anti-corruption policy

16 | Consensus-Building

All major political and social actors, with the exception of the fundamentalist Islamists, agree on the goal of a market-based economy. There is no politically relevant actor who can derail either the reform process or the expansion of the market economy. On liberal democracy, however, there is no consensus. Due to ethnic, cultural and religious diversity, different groups have diverse ideas about democracy. The official government stand is that liberal democracy as practiced by the West is unsuitable for a pluralist country like Malaysia. It is of the opinion that Western-style democracy will lead to chaos, as seen in the race riots of 1969.

Consensus on goals

Fundamentalist Islamists in Malaysia reject democracy categorically and want Malaysia to be a theocratic state. They see moves to strengthen Western-style democracy as un-Islamic. Racial and religious identification is so strong that moves to promote consensus, such as Bangsa Malaysia (Malaysian race), are met with strong resistance by various ethnic groups who see it as an attempt to "dilute" their culture, language and religion.

Anti-democratic veto actors

Given the strong degree of ethnic and religious heterogeneity, ethno-religious cleavages in addition to economic and ideological cleavages are clearly significant. While the political leadership follows a policy of national integration and reconciliation, based on the principles of affirmative action and segmented autonomy, this policy prevents cleavage-based conflicts from escalating, rather than defusing them.

Cleavage / conflict management

The political leadership only takes into account and accommodates the interests of civil society actors as long as they are not seen as interfering with the government policies. Where it feels that civil society is acting “politically” or in a way that threatens the interests of the ruling coalition or the government, civil society actors are ignored. When there is a conflict between demands by civil society organizations and government preferences, the political leadership tends to formulate its policy autonomously.

Civil society participation

There is little chance of reconciliation given that the ethnic and religious gulf between the Malay and Muslims against the non-Malays and non-Muslims is widening daily. Malay political leaders manipulate history to justify their *Kekuatan Melayu* (Malay dominance) ideology. Bringing an end to discriminatory NEP policies would be the first step toward reconciliation, but Malay leaders have stated they have no intention of doing so.

Reconciliation

17 | International Cooperation

The political leadership cooperates with bilateral and multilateral donors and international financial institutions, and tries to make use of international assistance as long as this seems to suit the government’s preferences. It does not facilitate notable policy learning, nor does it promote strengthened democracy and civil rights.

Effective use of support

Malaysia became a major player on the international scene when it simultaneously assumed the administration of both the Organization of the Islamic Conference (OIC) and the Non-Aligned Movement (NAM) in October 2003. It has taken a strong stand against terrorism, against the war in Iraq, and against the West’s failure to help developing countries. In terms of economics, it prides itself as the only nation to reject IMF advice during the Asian financial crisis. Instead, it pegged its currency, the ringgit to the U.S. dollar. Nevertheless, the government remains fully engaged with the World Bank, IMF, ADB and other international financial institutions.

Credibility

Malaysia actively promotes “South-South” (Langkawi) dialogues, which bring leaders of African countries to Malaysia to discuss economic and trade cooperation. Despite Malaysia’s strong anti-Western stand on key political issues, it has excellent international trading links. The government has skillfully separated trade from political issues. ASEAN remains the cornerstone of Malaysian foreign policy.

Regional cooperation

Strategic Outlook

Overall, economic transformation in Malaysia has progressed during the period under review. The government has consistently pursued rational and sound economic policies, and demonstrated its commitment to growth and further liberalization of the market. However, there are persistent institutional problems in democratic transformation. Ethnic and religious tensions continue, and the government has difficulty in managing them. While the majority of the Muslim population is moderate and progressive in its outlook, there is an increasingly vocal minority that advocates fundamentalist Islam, including the establishment of a theocratic state to replace the present one. Some of these radical groups advocate violence to achieve their aims. The government, backed by an efficient security apparatus, has been able to thwart various attempts at violence, and many of these groups now operate underground. These groups are not a threat to the nation-state as long as they remain outside mainstream Islam. There are encouraging signs that the main Islamic party, PAS, has rejected these fundamentalist groups and is willing to play by the rules by winning power through the ballot box. On the economic front, much remains to be done. More efficiency is needed and priorities must be set in the services sector. The financial sector, especially banking, needs to consolidate further. None of the Malaysian banks have the capital or the expertise to compete against foreign banks. The greatest challenge will be in the manufacturing sector, since the ASEAN Free Trade Agreement will become a reality by the end of the decade. The manufacturing sector cannot hope to compete with cheap labor countries such as Vietnam and Indonesia. Businesses in this sector must move up the technological ladder, attract more foreign investments and increase their competitive capacity. To advance reform and improve Malaysia's competitive capacity, the government must bring an end to its Bumiputera affirmative action policy, which encourages rent-seeking behavior and impedes competition. The policy has also prevented improved ethnic relations between the Bumiputera and non-Bumiputera, who feel discriminated against in all spheres of life. If the government annuls this policy, there is every reason to believe that the economy will be much more competitive, and more importantly, it will strengthen national cohesion while unifying the citizenry. The government must also tackle the increasing gap between the rich and poor. The country's Gini coefficient has worsened from 0.452 in 1999 to 0.462 in 2004. The income share of the bottom 40% of households decreased from 14% in 1999 to 13.5% in 2004, while the income share of the top 20% of households increased from 50.5% to 51.2%.