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Abstract
This publication discusses the political and economic conditions in Malaysia, as of November 1, 2007. It is predicted that Prime Minister Abdullah Ahmad Badawi will call for an election which is scheduled in April 2009. In 2007, real gross domestic product (GDP) growth is around 6%. Growth in the country will be affected by inflation.

Malaysia

Updated as of 1-Nov-2007

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Country Report

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Malaysia
Country Update

MOST LIKELY REGIMES AND THEIR PROBABILITIES	
18-Month:	Abdullah 60%
Five-Year:	Abdullah 55%

FORECASTS OF RISK TO INTERNATIONAL BUSINESS				
	Turmoil	**Financial Transfer**	**Direct Investment**	**Export Market**
18-Month:	Low	B+	B+	A-
Five-Year:	Low	A	B+	A-

( ) Indicates change in rating. * Indicates forecast of a new regime.

KEY ECONOMIC FORECASTS			
Years	**Real GDP Growth %**	**Inflation %**	**Current Account ($bn)**
2002-2006(AVG)	5.6	2.2	16.22
2007(F)	5.8	2.0	23.80
2008-2012(F)	5.6	2.4	26.50

Abdullah Likely to Call Early Poll

A general election is not required until April 2009, but it appears increasingly likely that Prime Minister Abdullah Ahmad Badawi will opt for a return to the polls no later than the first half of 2008. Although the organizational and financial advantages of the main governing United Malays National Organization (UMNO) make it likely that the National Front (BN) coalition will win another term regardless of when the election is held, Abdullah does have some good reasons to take the plunge sooner rather than later.

At the moment, the economy is humming along quite nicely, with real GDP growth forecast to remain close to 6% again this year. Inflation remains well under control, and is forecast to ease to just 2% in 2007, after climbing to 3.6% last year. In addition, the rise in oil prices has been a boon for the treasury, which gains about $73.5 million in revenue flows from state-owned Petronas for every $1 increase in crude prices.

However, the worsening prospects for the US economy, the effect of which is already evident in the export sector, points to weaker growth in 2008. Although officials have made much of the fact that economic diversification has reduced the impact of exports on overall economic performance, the cloudy external outlook can hardly be ignored by Abdullah as he decides the timing of an election.

Moreover, while high oil prices boost government revenues, they also increase the cost of generous subsidies to retailers that have kept Malaysia's domestic fuel prices among the lowest in the region. The government last raised retail fuel prices in early 2006, and since that time the cost of crude oil has risen by 50%, hitting a record-high $96 per barrel on November 1.

Officials estimate that the bill for direct fuel subsidies and forgone taxes will amount to $4.5 billion this year and, in the absence of any further price increases, will increase to $5.2 billion in 2008. Abdullah has already indicated that another hike in prices at the pump will be unavoidable if crude prices remain near current levels.

Another consideration that will incline Abdullah toward calling an early election is the current fragmented state of the opposition. Malaysia's electoral system is structured in such a way that the opposition parties have little chance of presenting a meaningful challenge to the BN unless they forge a united front.

The People's Justice Party (Keadilan) and the Islamic Party of Malaysia (PAS) have been lobbying the ethnic-Chinese Democratic Action Party (DAP) to re-establish the Alternative Front (BA) created ahead of the 1999 elections. However, the DAP, the largest of the opposition parties in the current Parliament, has not softened its opposition to the Islamist agenda of the PAS, which was the main factor in the DAP's decision to leave the BA in 2001.

Keadilan's hopes of re-forming the BA rest on the leadership of former Deputy Prime Minister Anwar Ibrahim, who is widely viewed as the only person with sufficient stature to bridge the divisions among the opposition parties. Anwar's legal persecution following a falling out with former Prime Minister Mahathir bin Mohammed in the late 1990s transformed him into an icon of political reform movement, but his conviction on corruption charges makes him ineligible to stand for office until April 2008. That fact alone has fueled much of the speculation that Abdullah will get the election out of the way before then.

Competition for Investment

Under the five-year plan for 2006–2010, the government has launched three long-term development projects—the Iskandar Development Region (IDR), the Northern Corridor Economic Region (NCER), and the East Coast Economic Region (ECER)—that it hopes will attract more than $180 billion in investment over the next 20 years. The target for the IDR, a special economic zone next to Singapore, is $100 billion; the NCER, which focuses on infrastructure development in the island state of Penang, is aiming to draw $52.8 billion worth of investment; and the ECER, which spans the north-eastern states of Kelantan, Terengganu, and Pahang to Southern Johor, has an investment target of $33.5 billion.

However, recent data indicating that Malaysia is lagging behind several of its neighbors, notably Singapore, China, and Vietnam, in attracting foreign direct investment (FDI) suggests that the government faces obstacles to hitting its ambitious targets. Not surprisingly, then, the 2008 budget unveiled in September, the largest in the country's history, contained several measures aimed at boosting Malaysia's ability to compete. In addition to plans to cut the corporate tax rate to 25% in 2009, following a scheduled reduction to 26% in 2008, the budget also includes measures designed to reduce bureaucratic obstacles in the areas of business startups and customs, simplify the tax system, and ease restrictions on the entry of skilled foreign labor.

While the reduction of red tape will undoubtedly be welcomed by investors, it is doubtful that the proposed tax measures go far enough, particularly as Singapore recently reduced its own corporate tax rate to just 18%. The government has acknowledged that its dependence on corporate tax revenues is an impediment to competing with markets like Singapore, and officials are likely to give strong consideration to the introduction of a goods and services tax after the next election.

Higher Inflation Will Dampen Growth

The economy expanded by 5.6% in the first half of 2007, driven by robust growth of private consumption and government spending. The strong performance of the services sector, which averaged 9.5% growth over the first two quarters of the year, helped to offset the sluggishness of the manufacturing sector, which was weighed down by weak demand for electronics components. Continued strong government spending will provide a modest boost to the economy over the second half of the year, pushing annual real GDP growth to 5.8%. However, economic troubles in the US will continue to hurt the export sector in 2008, and an anticipated rise in domestic fuel prices will have a dampening effect on consumer spending, resulting in a moderate slowing of growth to 5.5%–5.6% in 2008.

The consumer price index rose 1.8 % (year-on-year) in September, with the increase mainly due to higher costs for food, liquor and tobacco. The monthly rise was slightly down from 1.9% in August, reflecting the slower growth of prices for tobacco products, which shot up by 14% following a 25% increase in the excise tax in July. The September figure brought inflation for the first three quarters of the year to just below 2%, and price increases are forecast to hold fairly close to that level over the remainder of the year. An increase in retail fuel prices will contribute to stronger inflationary pressures in 2008, when consumer prices are forecast to increase by 2.7%.

Export growth slowed to 5.9% (year-on-year) over the first two quarters of the year, from 9.6% during the same period in 2006. While imports continued to grow more quickly than exports, the rate of expansion was slower than in 2006, reflecting weaker demand for manufacturing inputs. Those trends point to a narrowing of the external surpluses in both 2007 and 2008, when the current account balance is forecast to record still sizeable surpluses of $23.8 billion and $22 billion, respectively.

Economic Forecasts for the Three Alternative Regimes

	Abdullah			Other UMNO			BA Coalition		
	Growth (%)	Inflation (%)	CACC ($bn)	Growth (%)	Inflation (%)	CACC ($bn)	Growth (%)	Inflation (%)	CACC ($bn)
2007	5.8	2.0	23.80	5.7	2.2	22.70	5.2	2.5	20.60
2008-2012	5.6	2.4	26.50	4.6	2.2	24.40	4.0	3.3	18.70

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Malaysia
Country Forecast
Highlights

MOST LIKELY REGIMES AND THEIR PROBABILITIES	
18-Month:	Abdullah 60% (55%)
Five-Year:	Abdullah 55% (50%)

FORECASTS OF RISK TO INTERNATIONAL BUSINESS				
	Turmoil	**Financial Transfer**	**Direct Investment**	**Export Market**
18-Month:	Low	B+	B+	A-
Five-Year:	Low	A (A-)	B+	A-

( ) Indicates change in rating. * Indicates forecast of a new regime.

KEY ECONOMIC FORECASTS			
Years	**Real GDP Growth %**	**Inflation %**	**Current Account ($bn)**
2002-2006(AVG)	5.6	2.2	15.85
2007(F)	5.5	2.7	22.00
2008-2012(F)	5.6	2.6	17.90

Early Election Expected

Key Points To Watch…

- ✓ Two recent state by-election victories for candidates from the ruling BN coalition suggest that Prime Minister Abdullah will be able to withstand challenges from within his own UMNO party and from the top opposition candidate for national leadership, former Deputy Prime Minister Anwar…
- ✓ In fact, there is growing speculation that Abdullah might opt for an early parliamentary election in order to take advantage of the governing coalition's momentum and avoid a head-to-head contest with Anwar, who owing to his spurious conviction on corruption and sodomy charges in the late 1990s is banned from holding elected office until April 2008…
- ✓ The opposition will not be in any position to challenge the governing BN alliance for dominance as long as unity is maintained within UMNO. The sidelining (at least temporarily) of some of Abdullah's key party rivals will allow the prime minister to pursue his strategy of positioning the party closer to the political center, with the aim of competing directly for the support of the secular opposition's natural base of support…

- ✓ However, the failure of Abdullah's political strategy to produce the promised benefits, or any developments (particularly on the economic front) that suggest Mahathir's criticisms might be more than just the cries of a bruised ego, could place Abdullah's control over the party, and the unity of UMNO, in serious jeopardy…

Seeking Balance between Domestic and Foreign Interests

- ✓ The Ninth Five-Year Plan unveiled in late March 2006 proposes an 18% increase in public development spending to $59.4 billion over the next five years, in keeping with the goal of achieving developed country status by 2020. The new plan focuses spending on social services, agriculture, and improvements in rural areas…
- ✓ The government is also taking steps to ease restrictions on foreign investment, particularly the Iskandar Development Region, located in the southern state of Johor, which the government is hoping to transform into a leading financial and manufacturing hub capable of creating 800,000 new jobs. In addition to relaxing affirmative action requirements, the government has promised to expedite approvals of housing projects and eliminate an onerous tax on property sales. Steps have also been taken to further reduce capital controls that were tightened in response to the Asian financial crisis in the 1990s…
- ✓ In general, the government will continue to offer incentives to attract foreign investment in targeted areas, although greater emphasis will be placed on development of agriculture and small and medium-sized industrial enterprises…
- ✓ If executed according to plan, such moves should do much to help the country's overall level of competitiveness vis-à-vis its neighbors. However, stiff opposition is expected from ethnic Malays, including members of the civil service who will be responsible for ensuring smooth implementation of the revised policies…
- ✓ The more internationalist approach among the younger leaders of UMNO and the desire to expand the market for the country's exports and enhance ties with current major trading partners will encourage a general easing of barriers to trade, although some protection of favored industries will be maintained…
- ✓ The liberalization of exchange rate policy will reduce the threat of imported inflation and lower the cost of both consumer and intermediate imports, providing the central bank with greater flexibility in setting interest rates, increasing the purchasing power of consumers, and lowering the unit costs of manufacturers, all of which will benefit the economy over the medium term. More generally, a recovery in external demand and Abdullah's commitment to solidifying the country's economic fundamentals will provide a foundation for steady, healthy growth averaging 5.6% annually through 2012.

Economic Forecasts for the Three Alternative Regimes

	Abdullah			Other UMNO			BA Coalition		
	Growth (%)	Inflation (%)	CACC ($bn)	Growth (%)	Inflation (%)	CACC ($bn)	Growth (%)	Inflation (%)	CACC ($bn)
2007	5.5	2.7	22.00	4.5	3.2	18.70	4.2	4.0	17.50
2008-2012	5.6	2.6	17.90	4.6	2.2	16.20	4.0	3.3	12.00

Political Fact Sheet

CAPITAL:
Putrajaya

CONSTITUTION:
September 16, 1957

ADMINISTRATIVE SUBDIVISIONS:
13 states and the capital

POPULATION:
2006: 26.11 million

AREA:
329,758 sq. km.

OFFICIAL LANGUAGE:
Bahasa Malaysia

STATUS OF PRESS:
Mostly controlled. The government owns most of the electronic news media, as well as some of the press.

SECTORS OF GOVERNMENT PARTICIPATION:
petroleum, timber, plantation agriculture (rubber and palm oil), banking, trade

CURRENCY EXCHANGE SYSTEM:
managed float

EXCHANGE RATE:
10/26/2007 $1=3.36 ringgit

ELECTIONS:
The council of ruling sultans elects a paramount ruler every five years. Last, December 13, 2006; next, scheduled December 2011. House of Representative members are elected for a maximum five-year term; last, March 21, 2004; next, by March 2009. Senators are indirectly elected or appointed for six-year terms.

HEAD OF STATE:
Paramount Ruler Mizan Zainal Abidin (2006)

HEAD OF GOVERNMENT:
Prime Minister Abdullah bin Ahmad Badawi (2003)

OFFICIALS:
Najib Tun Razak, Deputy Prime Minister, Defense
Tan Sri Muhyiddin Yassin, Agriculture
Hishammuddin Hussein, Education
Lim Keng Yaik, Energy, Water & Communications
Abdullah bin Ahmad Badawi, Finance, Internal Security
Syed Hamid Albar, Foreign Affairs
Radzi Sheikh Ahmad, Home Affairs
Ong Kah Ting, Housing & Local Government
Fong Chan Onn, Human Resources
Zainuddin Maidin, Information
Samy Vellu, Public Works
Abdul Aziz Samsudin, Rural & Regional Development
Rafidah Abdul Aziz, Trade & Industry
Chan Kong Choy, Transport

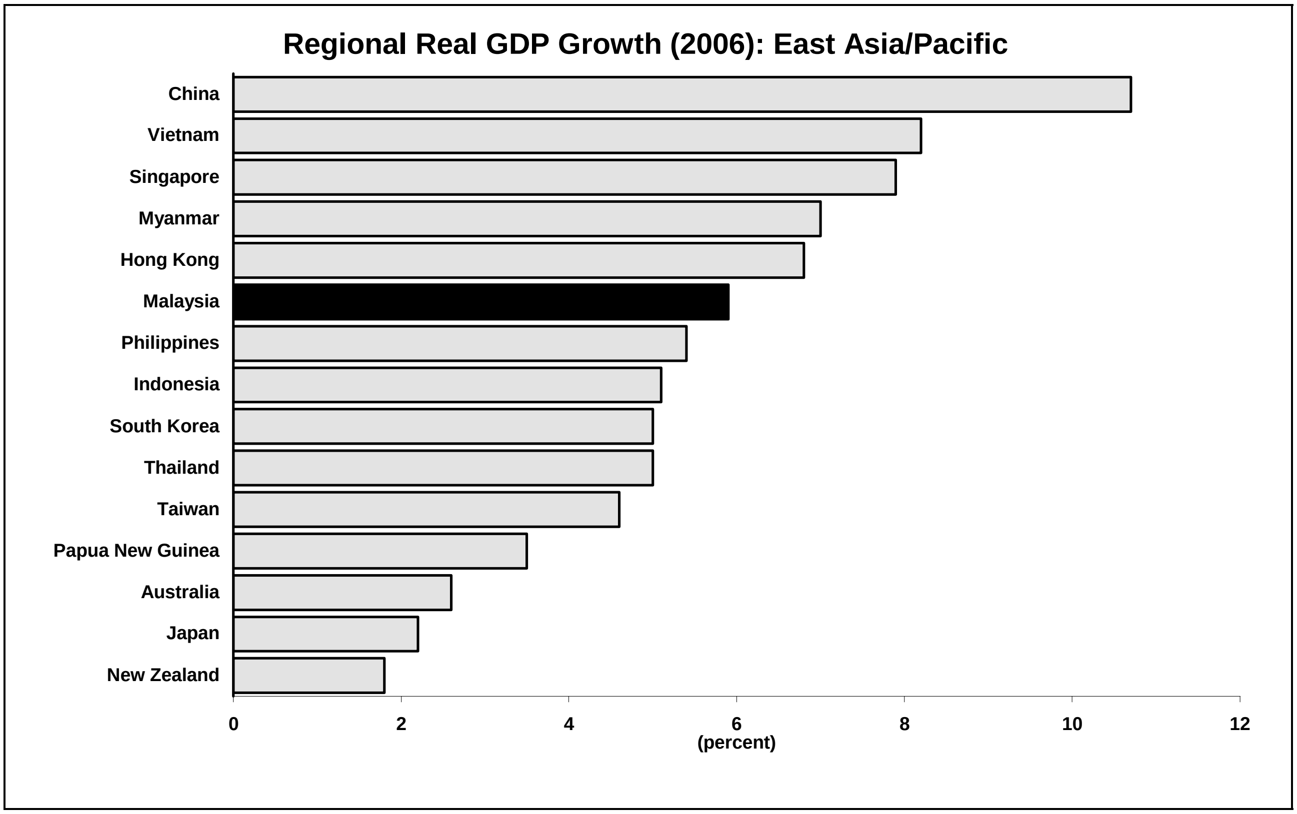
LEGISLATURE:
Bicameral Parliament: 58-member Senate and 219-member House of Representatives. Seat distribution in the House: National Front (BN), 199; Democratic Action Party (DAP), 12; Islamic Party of Malaysia (PAS), 6; People's Justice Party (Keadilan), 1; independent, 1.

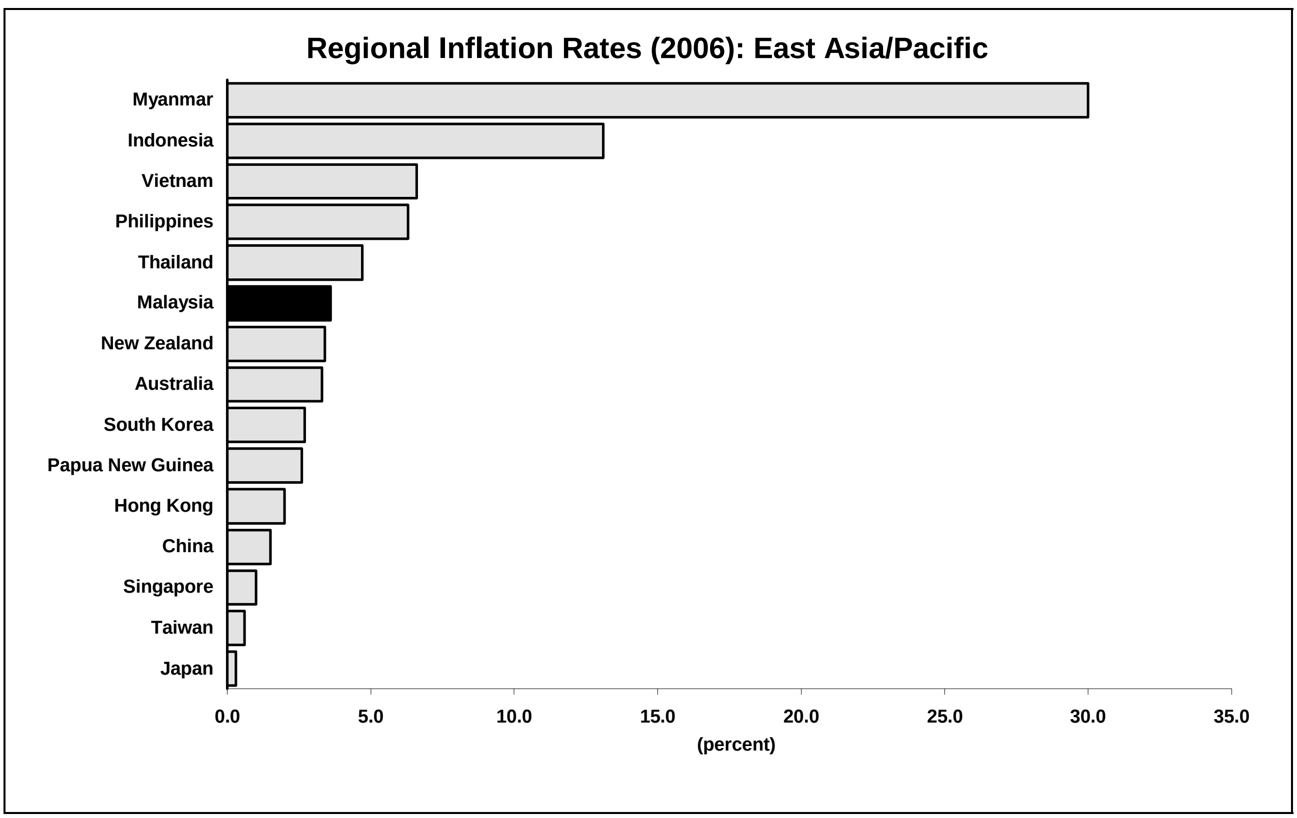
Malaysia Databank

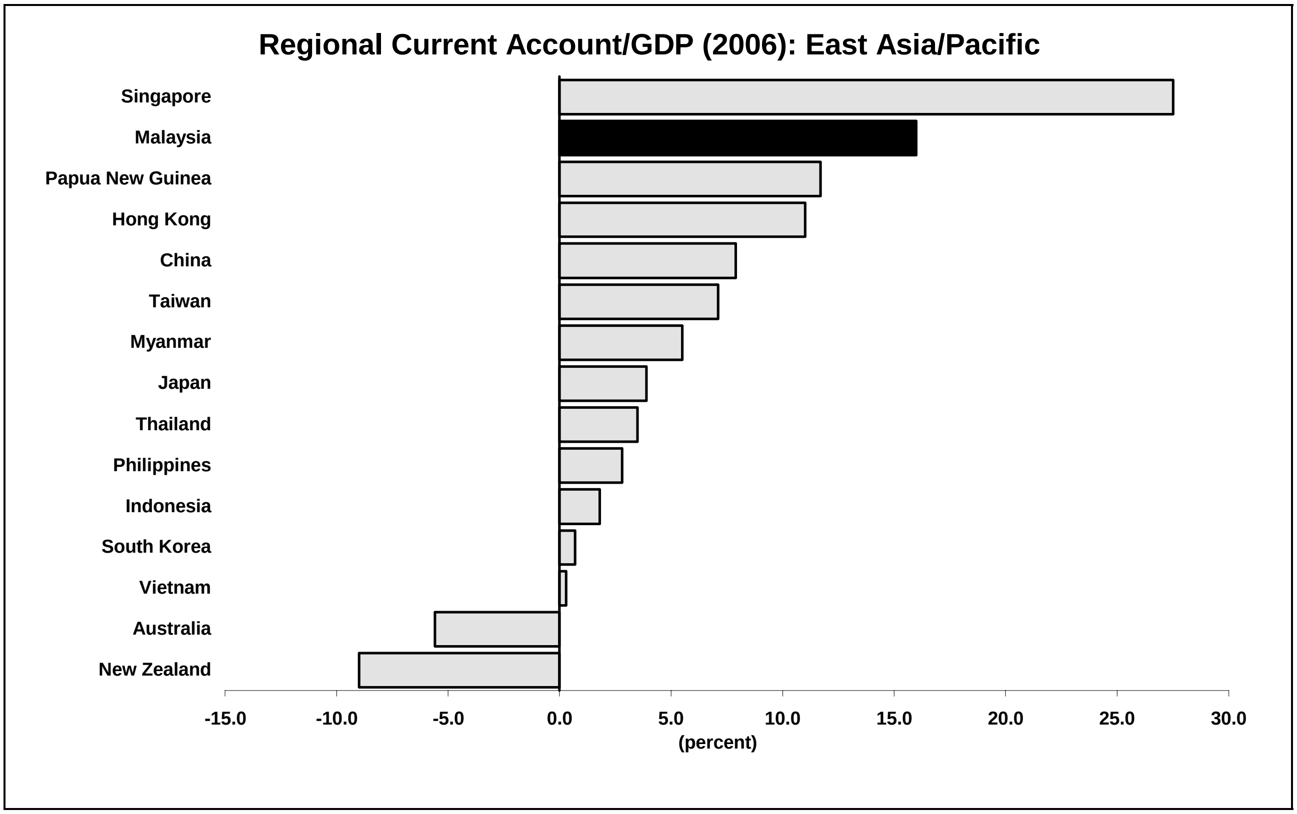
	1997-2001 Average	2002-2006 Average	1997	1998	1999	2000	2001
Domestic Economic Indicators							
GDP (Nominal, $bn)	85.97	119.48	100.18	72.18	79.15	90.32	88.00
Per Capita GDP ($)	3792	4727	4632	3257	3487	3881	3702
Real GDP Growth Rate (%)	3.0	5.6	7.3	-7.4	6.2	8.8	0.3
Inflation Rate (%)	2.7	2.2	2.7	5.3	2.7	1.5	1.4
Capital Investment ($bn)	24.98	25.07	43.19	19.36	17.33	23.09	21.93
Capital Investment/GDP (%)	28.5	21.2	43.1	26.8	21.9	25.6	24.9
Budget Revenues ($bn)	18.10	26.39	23.37	14.45	15.44	16.29	20.95
Budget Revenues/GDP (%)	20.9	22.2	23.3	20.0	19.5	18.0	23.8
Budget Expenditures ($bn)	20.31	31.58	21.01	15.38	17.95	21.45	25.76
Budget Expenditures/GDP (%)	23.6	26.7	21.0	21.3	22.7	23.7	29.3
Budget Balance ($bn)	-2.21	-5.19	2.36	-0.93	-2.51	-5.16	-4.81
Budget Balance/GDP (%)	-2.7	-4.5	2.4	-1.3	-3.2	-5.7	-5.5
Money Supply (M1, $bn)	21.01	29.91	29.45	14.68	19.40	20.89	20.62
Change in Real Wages (%)	3.3	-1.3	4.0	3.5	3.6	3.4	2.0
Unemployment Rate (%)	3.2	3.5	2.5	3.2	3.5	3.1	3.5
International Economic Indicators							
Foreign Direct Investment ($bn)	3.11	4.06	5.14	2.16	3.90	3.79	0.55
Forex Reserves ($bn)	26.09	58.24	20.01	24.73	29.67	27.43	28.63
Gross Reserves (ex gold, $bn)	26.96	59.01	20.79	25.56	30.59	28.33	29.52
Gold Reserves ($bn)	0.08	0.06	0.11	0.12	0.06	0.05	0.05
Gross reserves (inc gold, $bn)	27.04	59.07	20.90	25.68	30.65	28.38	29.57
Total Foreign Debt ($bn)	46.94	51.38	60.70	43.31	42.67	42.39	45.64
Total Foreign Debt/GDP (%)	54.7	43.9	60.6	60.0	53.9	46.9	51.9
Debt Service ($bn)	6.31	7.84	5.32	6.00	6.32	6.79	7.13
Debt Service/XGS (%)	6.3	5.4	5.5	7.0	6.4	5.9	6.8
Current Account ($bn)	6.39	16.22	-5.94	9.53	12.60	8.49	7.29
Current Account/GDP (%)	8.2	13.1	-5.9	13.2	15.9	9.4	8.3
Current Account/XGS (%)	6.4	10.6	-6.1	11.1	12.8	7.4	7.0
Exports ($bn)	83.99	125.57	77.54	71.88	84.10	98.43	87.98
Imports ($bn)	67.41	97.31	74.03	54.38	61.45	77.60	69.60
Trade Balance ($bn)	16.57	28.26	3.51	17.50	22.65	20.83	18.38
Exports of Services ($bn)	13.51	17.40	15.73	11.52	11.92	13.94	14.46
Income, credit ($bn)	1.97	4.75	2.49	1.54	2.00	1.99	1.85
Transfers, credit ($bn)	0.75	0.44	0.94	0.73	0.80	0.76	0.54
Exports G&S ($bn)	100.23	148.16	96.70	85.67	98.82	115.12	104.83
Liabilities ($bn)	0.00	2.19	0.00	0.00	0.00	0.00	0.00
Net Reserves ($bn)	27.04	56.88	20.90	25.68	30.65	28.38	29.57
Liquidity (months import cover)	4.9	6.9	3.4	5.7	6.0	4.4	5.1
Currency Exchange Rate	3.627	3.771	2.813	3.924	3.800	3.800	3.800
Currency Change (%)	-9.6	0.7	-11.8	-39.5	3.2	0.0	0.0
Social Indicators							
Population (million)	22.71	25.19	21.63	22.16	22.70	23.27	23.77
Population Growth (%)	2.4	1.9	2.5	2.5	2.4	2.5	2.1
Infant Deaths/1000	22	19	23	23	22	21	21
Persons under Age 15 (%)	35	34	36	35	34	35	35
Urban Population (%)	57	62	56	57	57	57	57
Urban Growth (%)	2.7	4.3	2.6	4.3	2.4	2.3	2.1
Literacy % pop.	84	87	85	85	85	83	83
Agricultural Work Force (%)	25	15	27	27	27	21	21
Industry-Commerce Work Force (%)	34	31	40	40	40	25	25
Services Work Force (%)	41	54	33	33	33	54	54
Unionized Work Force (%)	9	9	9	9	9	9	9
Energy - total consumption (10^{15} Btu)	1.82	2.48	1.67	1.69	1.74	1.87	2.11
Energy - consumption/head (10^{9} Btu)	0.08	0.10	0.08	0.08	0.08	0.08	0.09

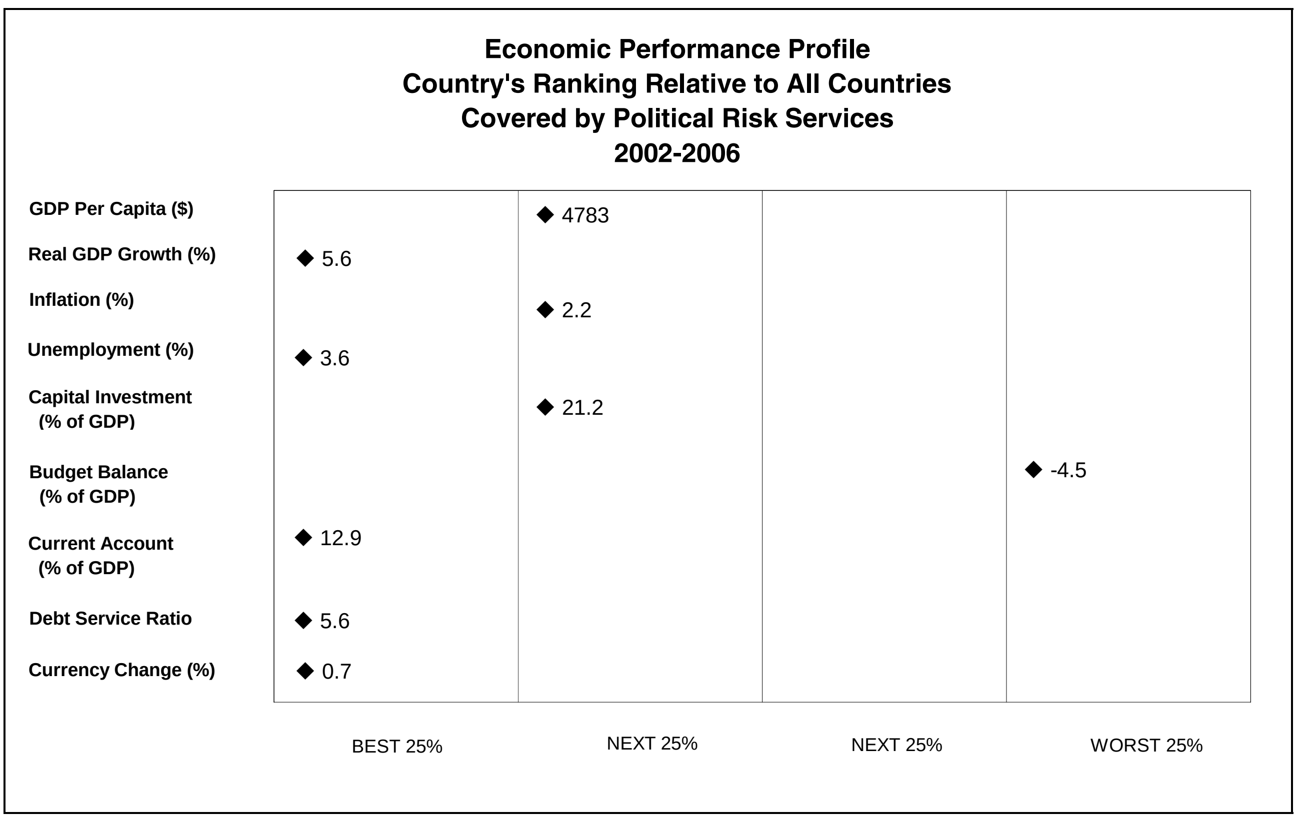
Malaysia
Databank

	1997-2001 Average	2002-2006 Average	2002	2003	2004	2005	2006
Domestic Economic Indicators							
GDP (Nominal, $bn)	85.97	119.48	95.27	103.95	118.46	130.77	148.95
Per Capita GDP ($)	3792	4727	3927	4203	4703	5098	5705
Real GDP Growth Rate (%)	3.0	5.6	4.4	5.4	7.2	5.0	6.0
Inflation Rate (%)	2.7	2.2	1.9	1.0	1.5	2.9	3.6
Capital Investment ($bn)	24.98	25.07	22.04	22.92	24.16	26.12	30.10
Capital Investment/GDP (%)	28.5	21.2	23.1	22.1	20.4	20.0	20.2
Budget Revenues ($bn)	18.10	26.39	21.97	24.37	26.16	27.95	31.51
Budget Revenues/GDP (%)	20.9	22.2	23.1	23.4	22.1	21.4	21.2
Budget Expenditures ($bn)	20.31	31.58	27.32	29.88	31.27	32.89	36.54
Budget Expenditures/GDP (%)	23.6	26.7	28.7	28.7	26.4	25.2	24.5
Budget Balance ($bn)	-2.21	-5.19	-5.35	-5.51	-5.11	-4.94	-5.03
Budget Balance/GDP (%)	-2.7	-4.5	-5.6	-5.3	-4.3	-3.8	-3.4
Money Supply (M1, $bn)	21.01	29.91	23.05	26.74	29.73	32.44	37.58
Change in Real Wages (%)	3.3	-1.3	8.2	2.7	-4.3	-10.4	-2.8
Unemployment Rate (%)	3.2	3.5	3.5	3.6	3.6	3.6	3.3
International Economic Indicators							
Foreign Direct Investment ($bn)	3.11	4.06	3.20	2.47	4.62	3.97	6.06
Forex Reserves ($bn)	26.09	58.24	32.42	42.77	64.91	69.37	81.72
Gross Reserves (ex gold, $bn)	26.96	59.01	33.36	43.82	65.88	69.85	82.13
Gold Reserves ($bn)	0.08	0.06	0.06	0.06	0.06	0.06	0.06
Gross reserves (inc gold, $bn)	27.04	59.07	33.42	43.88	65.94	69.91	82.19
Total Foreign Debt ($bn)	46.94	51.38	48.86	49.14	52.79	51.79	54.30
Total Foreign Debt/GDP (%)	54.7	43.9	51.3	47.3	44.6	39.6	36.5
Debt Service ($bn)	6.31	7.84	7.33	7.72	6.84	8.69	8.61
Debt Service/XGS (%)	6.3	5.4	6.6	6.3	4.6	5.2	4.5
Current Account ($bn)	6.39	16.22	7.19	13.38	15.08	19.98	25.49
Current Account/GDP (%)	8.2	13.1	7.6	12.9	12.7	15.3	17.1
Current Account/XGS (%)	6.4	10.6	6.5	10.9	10.1	12.0	13.3
Exports ($bn)	83.99	125.57	93.38	105.00	126.82	141.81	160.84
Imports ($bn)	67.41	97.31	75.25	79.29	99.24	108.65	124.14
Trade Balance ($bn)	16.57	28.26	18.13	25.71	27.58	33.16	36.70
Exports of Services ($bn)	13.51	17.40	14.88	13.58	17.11	19.58	21.83
Income, credit ($bn)	1.97	4.75	2.14	3.45	4.33	5.37	8.46
Transfers, credit ($bn)	0.75	0.44	0.66	0.51	0.42	0.30	0.31
Exports G&S ($bn)	100.23	148.16	111.06	122.54	148.68	167.06	191.44
Liabilities ($bn)	0.00	2.19	0.51	0.82	2.99	2.43	4.21
Net Reserves ($bn)	27.04	56.88	32.91	43.06	62.95	67.48	77.98
Liquidity (months import cover)	4.9	6.9	5.2	6.5	7.6	7.5	7.5
Currency Exchange Rate	3.627	3.771	3.800	3.800	3.800	3.787	3.668
Currency Change (%)	-9.6	0.7	0.0	0.0	0.0	0.3	3.1
Social Indicators							
Population (million)	22.71	25.19	24.26	24.73	25.19	25.65	26.11
Population Growth (%)	2.4	1.9	2.1	1.9	1.9	1.8	1.8
Infant Deaths/1000	22	19	20	20	19	18	18
Persons under Age 15 (%)	35	34	35	35	34	34	33
Urban Population (%)	57	62	58	60	62	64	64
Urban Growth (%)	2.7	4.3	3.8	5.5	5.3	5.1	1.8
Literacy % pop.	84	87	83	83	89	89	89
Agricultural Work Force (%)	25	15	16	16	16	14	14
Industry-Commerce Work Force (%)	34	31	27	27	27	36	36
Services Work Force (%)	41	54	57	57	57	50	50
Unionized Work Force (%)	9	9	9	9	9	9	9
Energy - total consumption (10^{15} Btu)	1.82	2.48	2.18	2.43	2.66	2.55	2.59
Energy - consumption/head (10^{9} Btu)	0.08	0.10	0.09	0.10	0.11	0.10	0.10


Regional Real GDP Growth (2006): East Asia/Pacific
China
Vietnam
Singapore
Myanmar
Hong Kong
Malaysia
Philippines
Indonesia
South Korea
Thailand
Taiwan
Papua New Guinea
Australia
Japan
New Zealand
0
2
4
6
8
10
12
(percent)


Regional Inflation Rates (2006): East Asia/Pacific
Myanmar
Indonesia
Vietnam
Philippines
Thailand
Malaysia
New Zealand
Australia
South Korea
Papua New Guinea
Hong Kong
China
Singapore
Taiwan
Japan
0.0
5.0
10.0
15.0
20.0
25.0
30.0
35.0
(percent)


Regional Current Account/GDP (2006): East Asia/Pacific
Singapore
Malaysia
Papua New Guinea
Hong Kong
China
Taiwan
Myanmar
Japan
Thailand
Philippines
Indonesia
South Korea
Vietnam
Australia
New Zealand
-15.0
-10.0
-5.0
0.0
5.0
10.0
15.0
20.0
25.0
30.0
(percent)


Economic Performance Profile
Country's Ranking Relative to All Countries
Covered by Political Risk Services
2002-2006
GDP Per Capita ($)
4783
Real GDP Growth (%)
5.6
Inflation (%)
2.2
Unemployment (%)
3.6
Capital Investment (% of GDP)
21.2
Budget Balance (% of GDP)
-4.5
Current Account (% of GDP)
12.9
Debt Service Ratio
5.6
Currency Change (%)
0.7
BEST 25%
NEXT 25%
NEXT 25%
WORST 25%

Social Indicators as of 2006

Primary Energy

Energy Consumption (10^{15} Btu):	2.59
Per Capita Consumption (10^{9} Btu):	0.10

Population

Annual Growth	1.8%
Infant Deaths per 1,000	18
Persons Under Age 15	33%
Urban Population	64%
Urban Growth	1.8%
Literacy	89%

Work Force Distribution

Agriculture	14%
Industry-Commerce	36%
Services	50%
Unions	9%

Ethnic Groups

Malay and indigenous people (58%), Chinese (24%), Indian (8%), other (10%)

Languages

Malay, English, Chinese dialects, Tamil

Religions

Muslim (60%), Buddhist (19%), Christian (9%), Hindu (6%), Confucianist and Taoist (3%), other (3%)

Malaysia
Country Forecast
Comment & Analysis

Early Election Likely

Two recent state by-election victories for candidates from the ruling National Front (BN) coalition suggest that Prime Minister Abdullah bin Ahmad Badawi will be able to withstand challenges from within his own United Malays National Organization (UMNO) and from the top opposition candidate for national leadership, former Deputy Prime Minister Anwar Ibrahim. In fact, there is growing speculation that Abdullah might opt for an early parliamentary election in order to take advantage of the governing coalition's momentum and avoid a head-to-head contest with Anwar, who owing to his spurious conviction on corruption and sodomy charges in the late 1990s is banned from holding elected office until April 2008.

The contest for the Machap seat in western Melaka, a community with a large ethnic Chinese population, was closely watched as an indicator of the BN's ability to woo Chinese voters. Owing to a long history of tensions between the country's ethnic Malay (bumiputra) majority and the Chinese minority, as well as UMNO's sponsorship of an affirmative action program that benefits the bumiputra, Chinese voters have tended to support ethnic Chinese organizations, such as the Democratic Action Party (DAP).

In the end, the governing alliance's candidate easily prevailed, winning 5,533 votes to just 1,452 for the DAP challenger. The BN also scored a convincing victory in a subsequent election held in Ijok, in central Selangor, garnering 5,884 votes, compared to 4,034 votes for the candidate of the main opposition People's Justice Party (Keadilan).

The results point to the diminished influence of Abdullah's predecessor, Mahathir bin Mohamed, who has conducted a relentless campaign of criticism against his former protégé from within UMNO, and openly encouraged voters to cast their ballots for the opposition candidates in both by-elections. At the same time, Keadilan's defeat in the Ijok contest, despite the prominent presence of Anwar in the campaign, suggests that the party at present does not pose a significant threat to UMNO's dominance.

Both victories were tainted by charges of fraud, vote-buying, and intimidation of opposition supporters that raise questions about the actual levels of support for the BN and Abdullah. But the general view is that the Ijok result can be taken as an accurate gauge of Anwar's potential for furthering his political ambitions as a member of the opposition.

Anwar still enjoys support within UMNO, and rumors continue to circulate of his possible return to the party. Both Abdullah and his deputy prime minister, Najib Razak, oppose such a move, but with Mahathir giving no indication that he plans to end his attacks on Abdullah, which have echoed Anwar's claims of widespread corruption within the government, the possibility that the former allies-turned-enemies might team up to topple Abdullah, while unlikely, cannot be dismissed out of hand.

Given the obvious disadvantages of postponing the parliamentary election until after April 2008, it would appear that Abdullah's political interests will be best served by calling an early election that the BN would almost certainly win. Armed with a fresh mandate to govern, Abdullah would then be in a much better position to undertake the task of silencing Mahathir and marginalizing Anwar.

Moves to Ease Investment Restrictions

Beyond its political implications, the government's affirmative action policy—particularly a requirement that foreign investors reserve a 30% equity stake for bumiputra—has been criticized as a significant impediment to boosting levels of foreign direct investment (FDI), which fell to $3.98 billion in 2006, a decline of 14% from the previous year. The government responded in March by announcing plans to lift the equity requirements for investments in the Iskandar Development Region (IDR), located in the southern state of Johor, which the government is hoping to transform into a leading financial and manufacturing hub capable of creating 800,000 new jobs.

Other changes are aimed at reducing red tape for property investors, including a pledge to reduce the time for approval of "high-profile" housing projects, which currently can take up to five years, to no more than four months. Regular housing projects and foreign-invested construction plans will be approved within six months. In addition, the 35-year-old tax on profits from property sales has been scrapped.

If the proposals are executed according to plan, they should do much to help the country's overall level of competitiveness vis-à-vis its neighbors. However, stiff opposition is expected from ethnic Malays, including members of the civil service who will be responsible for ensuring smooth implementation of the revised policies. In that regard, it is worth recalling the reports of police harassment of Indian workers employed in the Multimedia Super-Corridor (MSC), an ambitious business development project launched under Mahathir.

At the end of March, the central bank announced a series of changes to Malaysia's foreign exchange policies that is also intended to encourage investment and increase the country's competitiveness. As of April 1, Malaysian banks are no longer required to limit their net open foreign exchange positions to 20% of capital, and the limit for mutual funds and insurance companies has been raised from 30% to 50%. Most notable was the lifting of restrictions that prevented domestic companies from borrowing in foreign currency. The restriction was one of the key capital controls imposed after the Asian financial crisis erupted in 1997.

Increased Investment Will Fuel Expansion

Real GDP growth is expected to slow only moderately to 5.5% in 2007, as private investment and government spending help to offset the negative impact of weaker demand for electronics components on the export sector. The relaxation of investment restrictions and exchange controls will likely produce a near-term bounce in FDI levels that will provide a buffer against a larger-than-expected drop off in US export demand.

Lower oil prices and the appreciation of the ringgit have helped to contain inflation, which came in at 1.5% (year-over-year) in March, and is forecast to average 2.7% this year, after rising to 3.6% in 2007. With inflation easing, the central bank maintained its overnight lending rate at 3.5% at its policy meeting on April 28. The bank's decision was in line with market expectations, and there is growing speculation that monetary authorities will announce a cut in the overnight rate at their May meeting.

The current account surplus will narrow in 2007, reflecting weaker demand for electronics components, and increased imports of intermediate and capital goods related to upstream activity in the oil and gas sector. Growth of commodity-based exports will help to sustain a large surplus in the trade balance and increased tourism receipts in conjunction with the "Visit Malaysia Year 2007" campaign will bolster the services account, resulting in a still substantial current account surplus of $22 billion, equivalent to more than 15% of GDP. Foreign exchange reserves totaling some $86 billion are sufficient to finance about eight months of imports, and represent roughly nine times the country's short-term external liabilities.

Malaysia
Country Forecast
Forecast Scenarios

SUMMARY OF 18-MONTH FORECAST

REGIMES & PROBABILITIES	Abdullah 60%	Other UMNO 30%	BA Coalition 10%

SUMMARY OF FIVE-YEAR FORECAST

REGIMES & PROBABILITIES	Abdullah 55%	Other UMNO 35%	BA Coalition 10%

Most Likely Regime Scenario

18-Month Forecast Period:
Abdullah (60% Probability)
Five-Year Forecast Period:
Abdullah (55% Probability)

Abdullah	Growth (%)	Inflation (%)	CACC ($bn)
2007	5.5	2.7	22.00
2008-2012	5.6	2.6	17.90

Abdullah bin Ahmad Badawi took over the reins of government in October 2003, and he is likely to remain in office throughout the forecast period. The governing National Front (BN) alliance, led by Abdullah's United Malays National Organization (UMNO), solidified its already strong grip on power at a general election held in March 2004, winning fully 198 of the 219 seats (90%) in an expanded House of Representatives.

The current leader of the opposition is the ethnic-Chinese Democratic Action Party (DAP), which controls a mere 12 seats in the lower house. At one time a partner with the Islamic Party of Malaysia (PAS) and the People's Justice Party (Keadilan) in the Alternative Front (BA), the DAP withdrew from the BA in early 2002 over differences with PAS on the issue of Islamic law. PAS lost 20 of its 27 seats at the 2004 elections, in large part owing to the perception, which the government did its best to encourage, that the party seeks to establish a fundamentalist Islamic state.

Although recent statements from senior members of PAS suggest that the party realizes it must moderate its tone if it is to challenge the pre-eminence of UMNO and the BN, the retention of its hard-line leader, Abdul Hadi Awang, and the conservative views of much of the party's rank and file raise doubts as to whether any shift toward the center will be substantial enough to ease the concerns of the DAP. Consequently, divisions among the opposition parties are expected to persist, with the result that UMNO and the BN will continue to dominate the political scene throughout the five-year forecast period.

That said, both the BN coalition and UMNO are faction-ridden, and a brewing power struggle between Abdullah and former Prime Minister Mahathir bin Mohammed points to an increased potential for a divisive leadership battle. An expected showdown at an UMNO conference in November 2006 was postponed when health issues forced Mahathir to skip the meeting. Divisions may also be exacerbated by Abdullah's campaign to root out official corruption, which, if actually pursued (the record so far is inconclusive), will of necessity target members of the governing coalition.

The forced resignation of UMNO First Vice President Isa Abdul Samad in mid-2005 over charges of organizing a vote-buying scheme during UMNO leadership elections held in Fall 2004 provided Abdullah with an opportunity to reshuffle his Cabinet, which remained little changed from the one he inherited from Mahathir in 2003. However, he passed up the chance, a decision that raises questions about just how solid his control really is. Until Abdullah establishes a Cabinet dominated by close allies who share his reformist inclinations, his hold on power will remain a subject of some doubt, and the possibility of a damaging split in UMNO, or even Abdullah's removal, cannot be ruled out. An announced delay in party leadership elections that were scheduled for 2007 may portend an attempt by Abdullah to bolster his position by winning a fresh mandate in an early national election.

Seeking Balance between Domestic and Foreign Interests

A five-year plan for 2006–2010 was unveiled in late March 2006, and in keeping with the goal of achieving developed country status by 2020, the plan proposes an 18% increase in public development spending to $59.4 billion through 2010. In place of the mega-projects that were the hallmark of the development program undertaken by Mahathir, Abdullah's plan focuses spending on social services (especially education), agriculture, and infrastructure improvements in rural areas. The planned spending increases stand in sharp contrast to the generally tight-fisted policies pursued by Abdullah early in his tenure, but the budget deficit was narrowed to 3.5% of GDP in 2006.

Abdullah's administration will offer incentives to attract foreign investment, particularly in the agriculture sector and small and medium-sized enterprises. The 2006 budget extended incentives for investment in the Eastern Corridor by five years to 2010. Numerous steps have already been taken in the area of taxes to create incentives for smaller businesses, including the raising of the upper threshold for income subject to the lower 20% corporate tax rate. The 2007 budget includes a reduction in the corporate tax rate to 27% (from 28%) this year and to 26% in 2008. Existing incentives designed to attract venture capital, as well as investment in manufacturing, agriculture, and tourism enterprises in under-developed areas, will be maintained, and possibly enhanced, during the forecast period.

Excessive red tape will continue to be an obstacle for foreign investors, although recent moves have been undertaken to address the problem. In March 2007, the government pledged to reduce the time for approval of "high-profile" housing projects, which currently can take up to five years, to no more than four months. Regular housing projects and foreign-invested construction plans will be approved within six months. In a further move designed to bring vigor to the property market, the tax on profits from property sales has been scrapped.

Abdullah has pledged to bolster the affirmative action policy initiated under the New Economic Program (NEP), which set a target of increasing the corporate assets of the majority Malay population to 30% by 2020. Key elements of the program include a requirement that publicly listed companies reserve 30% of their shares for purchase by Malays, quotas for the hiring of Malay workers, restrictions on the participation of non-Malays in certain business activities (such as importing foreign-made automobiles), and preferential treatment for Malay-owned or managed companies in bidding for lucrative government contracts. The government has indicated that it will broaden the focus of the program beyond equity holdings to include ethnic Malay ownership of residential and commercial urban property, intellectual property rights, and commercial enterprises. Toward that end, the government will provide training and education aimed at nurturing a new class of entrepreneurs who will operate state subsidized small and medium-sized enterprises. The five-year plan also calls for the establishment of a state agency with an initial capital of some $500 million to purchase commercial land in urban centers on behalf of Malay business owners.

Critics of affirmative action contend that the program thwarts competition, deters foreign investment, and has only benefited a small number of Malays, whose privileged status is perpetuated by their close relationship with the main governing United Malays National Organization (UMNO), which funnels contracts in their direction in exchange for generous contributions to the party's coffers. The government announced a partial concession in March 2007, announcing plans to lift the equity requirements for investments in the Iskandar Development Region (IDR), located in the southern state of Johor, which the government is hoping to transform into a leading financial and manufacturing hub capable of creating 800,000 new jobs. But officials have made clear that the relaxation of affirmative action rules will apply only to specific targeted sectors. The fact remains that the affirmative action program is popular among the broader Malay population, which forms the core of UMNO's support, and even the limited easing of requirements could face stiff opposition from members of the civil service who will be responsible for ensuring smooth implementation of the revised policies.

In general, foreign operations will continue to face restrictions in areas such as hiring and local procurement, although the government will show greater flexibility in cases where shortages of trained executive and technical personnel would make enforcement of the rules unfairly onerous. In early 2005, the government launched a crackdown on illegal immigrants, who are believed to account for as much as one-half of a total foreign work force totaling two million people. The move raised the threat of serious labor shortages in key sectors of the economy, such as plantations producing rubber and palm oil, and the government responded by significantly relaxing the rules on the employment of legal foreign workers. However, officials made clear that the revision of employment rules was temporary, and would be applied only as long as the need persists. In any case, the government's efforts to bring foreign workers inside the tax net will put upward pressure on wages in low-skilled sectors of the economy.

The failure of the easing of capital restrictions imposed in 1998 to produce a significant rebound in levels of foreign direct investment (FDI) indicated that investors were seeking further assurances that reforms of the financial and corporate sectors undertaken by the government were sufficient to protect against the type of instability that might prompt the reimposition of controls. A positive step in that direction came in late July 2005, when the central bank announced that the Malaysian currency, the ringgit, would no longer be pegged to the US dollar. Pressure for the move had grown as a result of the loosening of capital controls, and the decision to de-peg the ringgit suggested that officials were confident that sufficient financial stability had been achieved as to limit the danger of speculative attacks. Under new rules that took effect on April 1, 2007, Malaysian banks are no longer required to limit their net open foreign exchange positions to 20% of capital, and the limit for mutual funds and insurance companies was raised from 30% to 50%. Most notable was the lifting of restrictions that prevented domestic companies from borrowing in foreign currency.

The dollar peg has been replaced by a managed float system under which the value of the ringgit is determined according to a basket of foreign currencies, including the dollar and the euro. The central bank has adopted a cautious approach to permitting the currency to appreciate, but officials have expressed confidence that the strengthening of the ringgit will not have an adverse impact on exports, as other regional currencies are also expected to make gains on the weak US currency. Healthy foreign exchange reserves (currently sufficient for about eight months of import coverage), combined with steady—if not stunning—inflows of FDI, will diminish the danger that new exchange controls might be imposed.

Modest Trade Liberalization

While Mahathir promoted the ASEAN Free Trade Area (AFTA), he stood alone in opposing the process of uniformly lowering trade barriers within the group, largely for nationalist reasons. Even so, only a tiny percentage of Malaysia's manufactured and processed agricultural products are not yet covered under AFTA's common external tariff, and all import tariffs are to be reduced to 0%–5% by 2008 under the bloc's guidelines.

Healthy trade surpluses will undermine the political rationale for high tariffs, encouraging a shift in trade policy emphasis toward incentives for the export sector. Abdullah, like Mahathir, will maintain protection for such favored industries as automobile manufacturing. Restrictions will primarily take the form of licensing requirements that allow the maintenance of unofficial quotas on selected goods.

The more internationalist approach among the younger leaders of UMNO and the desire to expand the market for the country's exports and enhance ties with current major trading partners will encourage a broader easing of barriers to trade. In May 2004, Malaysia signed a trade and investment framework agreement (TIFA) with the US, the country's top export market and chief source of foreign investment. Negotiations for a bilateral free trade agreement (FTA) began in mid-2006, with the sixth round of talks taking place in April 2007. Malaysia officials have indicated that some US demands are incompatible with AFTA rules. Malaysian officials have made a point of stating that it was the US that has pushed for the FTA, and that Malaysia will not be pressured into approving a pact that is not in the country's interest, a signal that liberalization of the financial sector may become a stumbling block. The government initiated FTA talks with Australia in 2005, and there have been two inter-session meetings since the last round of talks in July 2006. Australia has expressed concerns about Malaysia's import licensing system, while Malaysia has balked at opening up the services sector, sticking points that suggest a final agreement is still some way off. Discussions are currently under way to lay the basis for FTA negotiations between ASEAN and the EU, with formal talks expected to begin sometime in 2007.

Limited Risk from Turmoil, but Religious Tensions a Concern

Malaysia's cooperation in the US-led war on terrorism has increased the country's risk of becoming a target of attack from Islamic extremists, with likely targets being the personnel and facilities of companies from the US, the UK, and other key allies in the fight against terrorism. More recently, concerns have emerged over the possibility that terrorists might seek to disrupt traffic in the Malacca Straits, a crucial artery of international trade, possibly including attacks on the ports of littoral states, including Malaysia.

The continued liberal use of the repressive Internal Security Act (ISA), which permits long-term detention of suspects without charge, will help the government in its efforts to combat terrorism, and to prevent any significant increase in the risk of more general social upheaval. Abdullah's succession is expected to have a calming influence, as the stoking of nationalist and communalist sentiments that was Mahathir's stock in trade is replaced by the less provocative approach of Abdullah. The prime minister is promoting a program of progressive Islam (*Islam Hadhari*) that encourages Muslims to be tolerant and outward looking, while also stressing the intellectual underpinnings of Islam.

More fundamentally, three main political and social fault lines create the danger of greater turmoil: ethnic rivalries (primarily between Malays and Chinese), political divisions among the Malays, particularly along religious lines; and demands for social reform from younger Malaysians within all ethnic groups, many of whom were educated abroad.

The deep cultural divide between Malays and Chinese dates back to the colonial era, when Chinese immigrants probably outnumbered Malays, but now hostility stems from the fact that the minority ethnic Chinese control a substantial share of Malaysia's wealth. Malays themselves are divided over how to cope with the country's ethnic divisions. Keadilan, comprised of mostly social reformers, would handle the issue as essentially an economic question, while PAS includes Muslim hard-liners who view (and would treat) the Chinese as interlopers and exploiters. UMNO has historically tried to occupy the middle ground, advocating special rights for Malays while acknowledging that the Chinese role is significant, even essential, for Malaysia's progress. Abdullah's five-year plan for 2006–2010 solidifies that centrist position through the enhancement of affirmative action measures on behalf of Malays and increases spending in rural areas where non-Malay communities are dominant.

Religious divisions have become manifest in elections, particularly at the local level, where contests among Muslims have been especially bitter. Religious hostility between UMNO and PAS still divides many villages. More recently, minority groups have expressed concern about religious freedom amid a backlash against Abdullah's embrace of "progressive Islam," which religious conservatives view to be an unacceptable dilution of their faith. Abdullah's response to complaints from both sides of the religious divide amounted to a position that the problem will go away if everyone would just stop talking about it. His refusal to directly confront the issues at the heart of religious tensions increases the danger of periodic (and possibly violent) clashes going forward.

Organized crime poses another threat to order. Understaffed security services are unable to patrol the long land and sea borders, leading to widespread smuggling of many illicit goods, including narcotics. Even the threat of the death penalty for smugglers has not stopped the illegal drug trade.

Bright Outlook for Economic Stability

Malaysia's economic prospects are closely tied to the fortunes of three key markets (the US, Japan, and Singapore) that are the destination for some 50% of the country's exports.

Real GDP growth is expected to slow only moderately to 5.5% in 2007, as private investment and government spending help to offset the negative impact of weaker demand for electronics components on the export sector. The relaxation of investment restrictions and exchange controls will likely produce a near-term bounce in FDI levels that will provide a buffer against a larger-than-expected drop off in US export demand. The liberalization of exchange rate policy will reduce the threat of imported inflation and lower the cost of both consumer and intermediate imports, providing the central bank with greater flexibility in setting interest rates, increasing the purchasing power of consumers, and lowering the unit costs of manufacturers, all of which will benefit the economy over the medium term. More generally, a recovery in external demand and Abdullah's commitment to solidifying the country's economic fundamentals will provide a foundation for steady, healthy growth averaging 5.6% annually through 2012.

The ringgit appreciated only slightly after the peg to the US dollar was abandoned in mid-2005, limiting any immediate benefit with regard to inflation. Meanwhile, a sharp increase in the retail price of fuel, together with new taxes on cigarettes and alcohol, pushed inflation to 3.6% in 2006. Lower oil prices and the appreciation of the ringgit have helped to contain inflation in early 2007, which is forecast to average 2.7% this year. With inflation easing, the central bank maintained its overnight lending rate at 3.5% at its policy meeting in late April, and there is growing speculation that monetary authorities will announce a cut in the overnight rate at their May meeting. Although sustained healthy growth levels will create persistent upward pressure on prices, responsible fiscal management and the use of monetary levers will help to hold inflation to an annual average of 2.6% through 2012.

Steady moderate growth, high productivity, and selective trade liberalization will keep the current account balance in surplus throughout the forecast period. The current account surplus will narrow in the near term, reflecting weaker demand for electronics components and increased imports of intermediate and capital goods related to upstream activity in the oil and gas sector. Growth of commodity-based exports will help to sustain a large surplus in the trade balance and increased tourism receipts in conjunction with the "Visit Malaysia Year 2007" campaign will bolster the services account, resulting in a still substantial current account surplus of $22 billion, equivalent to more than 15% of GDP, in 2007. Currency appreciation will benefit exports over the medium term by lowering the cost of imported inputs, but steady economic growth and increased purchasing power will fuel consumer demand for imports, resulting in somewhat narrower trade surpluses over the forecast period. The strength of the tourism sector will protect against a significant deterioration of the current account surplus, which will average $17.9 billion annually through 2012. Foreign exchange reserves totaling some $86 billion are sufficient to finance about eight months of imports, and represent roughly nine times the country's short-term external liabilities, limiting the risk of any serious debt-related difficulties.

Second Most Likely Regime Scenario

18-Month Forecast Period:
Other UMNO (30% Probability)
Five-Year Forecast Period:
Other UMNO (35% Probability)

Other UMNO	Growth (%)	Inflation (%)	CACC ($bn)
2007	4.5	3.2	18.70
2008-2012	4.6	2.2	16.20

The transfer of power from Mahathir to Abdullah proceeded smoothly, and the government's trouncing of PAS in the March 2004 general election reduced the danger that Abdullah might have to contend with any immediate challenges to his power from rivals within UMNO. However, the prime minister has come under direct attack from Mahathir, who has not taken kindly to what he perceives to be Abdullah's efforts to undermine his legacy. Although party leaders have thus far rallied behind Abdullah, Mahathir gives no indication that he intends to retreat, and a power struggle between Abdullah and his predecessor holds the potential to inflict real damage on the unity of UMNO and, by extension, the BN.

The maintenance of policies favoring Malays in the Ninth Five-Year Plan unveiled in March 2006 will ease the concerns of nationalist elements within the BN, decreasing the risk of defections over government policy in the near term. But Abdullah is generally regarded as lacking the aggressive political instincts needed to effectively manage factional warfare, and his decision to hold the Finance portfolio himself, despite lacking any economic management experience, leaves him very vulnerable to a backlash in the event of a serious setback in the economic arena. Mahathir's criticism has focused heavily on Abdullah's alleged mismanagement of the economy, and any developments that lend credence to those charges might very likely give rise to open expressions of doubt about Abdullah's fitness to govern. Under those circumstances, he might be forced to step aside in favor of another leader within the party, most likely Defense Minister Mohamed Najib bin Abdul Razak, who was appointed as deputy prime minister in late 2003.

Some Easing of Restrictions

While efforts to attract foreign investment would emphasize the manufacturing export sector, this regime would also ease restrictions on investments in services and refrain from imposing exchange controls as long as an economic recovery continued. However, the wariness of foreign investors in a climate of political uncertainty would increase the danger of currency instability, creating some potential for moves to tighten capital and currency controls.

In general, this regime would be eager to enter into trade pacts and international economic agreements, but its efforts might be clouded by the same chauvinistic atmosphere that Mahathir chose to foster, particularly if the former leader plays a key role in forcing the change of regime. In any case, imbalances stemming from political uncertainty might prompt moves to discourage imports, while a minor tightening of capital controls could result in increased payment delays.

Limited Threat of Unrest

The risk of turmoil would not be significantly higher under this regime, as early policy initiatives would probably include corrective measures designed to quiet discontent among Malays, including stricter enforcement of hiring quotas for Bumiputra. Reform advocates might attempt to exploit the vulnerability of the new government, which would probably adopt a policy of repression rather than accommodation, and given the deep divisions among the opposition parties, such a response would most likely meet with success.

Blow to Confidence Would Weaken Economic Performance

The uncertainty and instability arising from the circumstances that prompted Abdullah's removal from power during the forecast period would undermine the confidence of foreign investors, contributing to a more troubled economic climate. The resumption of healthy growth levels would be delayed, with the result that average annual economic expansion would be held to 4.6% during the forecast period. Lower growth levels and political instability would dampen consumer confidence, leading to lower domestic consumption that would hold inflation to an annual average of 2.2% through 2012.

Export production would be harmed less than domestic demand under the conditions of this scenario, and imports related to foreign investment would slow, contributing to an expansion of the trade surplus. However, given the potential for domestic political instability to impact negatively on the tourism sector, some narrowing of the current account surplus, to an annual average of $16.2 billion annually through 2012, would be expected.

Third Most Likely Regime Scenario

18-Month Forecast Period:
BA Coalition (10% Probability)
Five-Year Forecast Period:
BA Coalition (10% Probability)

BA Coalition	Growth (%)	Inflation (%)	CACC ($bn)
2007	4.2	4.0	17.50
2008-2012	4.0	3.3	12.00

Although unlikely, leadership struggles in UMNO could create instability that necessitated an early election that brought sufficient parliamentary gains for PAS and Keadilan to forge a majority coalition, an outcome that would most probably require the support of both the DAP and defecting BN parties. However, PAS elected a hard-line leader, Abdul Hadi Awang, in July 2003, and although he and other top party officials have attempted to moderate the tone of their rhetoric, his history of extreme stances would make it difficult to coax DAP back into the BA fold. Keadilan has also displayed limited ability to forge links with other parties, although the release of Anwar Ibrahim from prison in 2004 has created new potential on that front. Anwar is barred from holding political office until 2008, but his presence on the scene could give rise to rifts within the BN while also galvanizing the opposition.

Limited Easing of Restrictions

Given the assumed influence of PAS under this scenario, a BA coalition government would pursue only limited loosening of restraints on foreign investment. Some equity restrictions might be eased, particularly for those firms that employ sophisticated technology. However, this government would face internal disputes over the maintenance of affirmative action rules favoring Bumiputra, and would move with caution in the pursuit of integration with the global economy. A BA coalition would monitor business activities closely to ensure that firms act within prescribed guidelines. Businesses would still be urged to make sophisticated technology available to local workers and firms; they would also be expected to train local workers for skilled positions. The actual level of restrictions on a given firm would depend on an assessment of that firm's contribution to exports.

More Turmoil

At least temporary disturbances would arise because of the uncertainty of the standing of a BA-led government. As long as PAS claimed membership in the government, its insistence on promoting the goals and ideals of conservative Islam would provoke protests.

Economic Recovery, Eventually

Tensions between PAS and other members of the coalition government might contribute to uncertainty over the direction of policy that would deter investment, holding economic growth well below potential. Even though a BA regime would generally favor a more liberal business environment, political and social strains would impede the implementation of free-market reforms. Real GDP growth would average 4% annually through 2012. Inflation would rise to an annual average of 3.3% over the entire forecast period. Disruptions to production would undercut the current account surplus, which would narrow to an annual average of $12 billion through 2012.

Forecast Summary

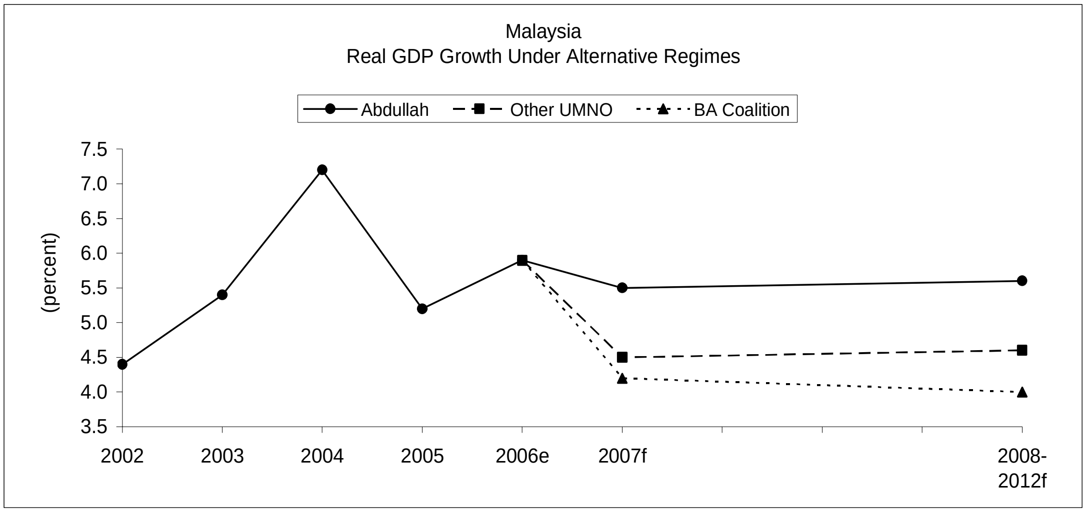
SUMMARY OF 18-MONTH FORECAST

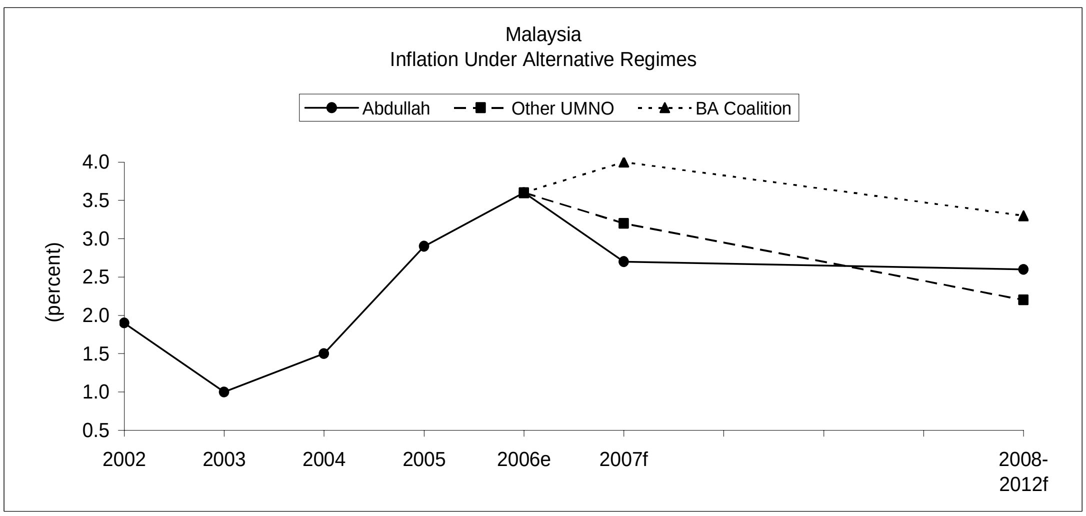
REGIMES & PROBABILITIES		Abdullah 60%	Other UMNO 30%	BA Coalition 10%
RISK FACTORS	**CURRENT**			
Turmoil	Low	Same	SLIGHTLY MORE	MORE
Investment				
Equity	Moderate	SLIGHTLY LESS	SLIGHTLY LESS	Same
Operations	High	SLIGHTLY LESS	Same	Same
Taxation	Moderate	SLIGHTLY LESS	SLIGHTLY LESS	Same
Repatriation	Low	Same	Same	SLIGHTLY MORE
Exchange	Moderate	SLIGHTLY LESS	SLIGHTLY MORE	SLIGHTLY MORE
Trade				
Tariffs	Moderate	SLIGHTLY LESS	Same	Same
Other Barriers	Moderate	Same	SLIGHTLY LESS	Same
Payment Delays	Moderate	Same	SLIGHTLY MORE	SLIGHTLY MORE
Economic Policy				
Expansion	High	SLIGHTLY LESS	Same	Same
Labor Costs	Moderate	SLIGHTLY MORE	SLIGHTLY MORE	SLIGHTLY MORE
Foreign Debt	Low	Same	Same	Same

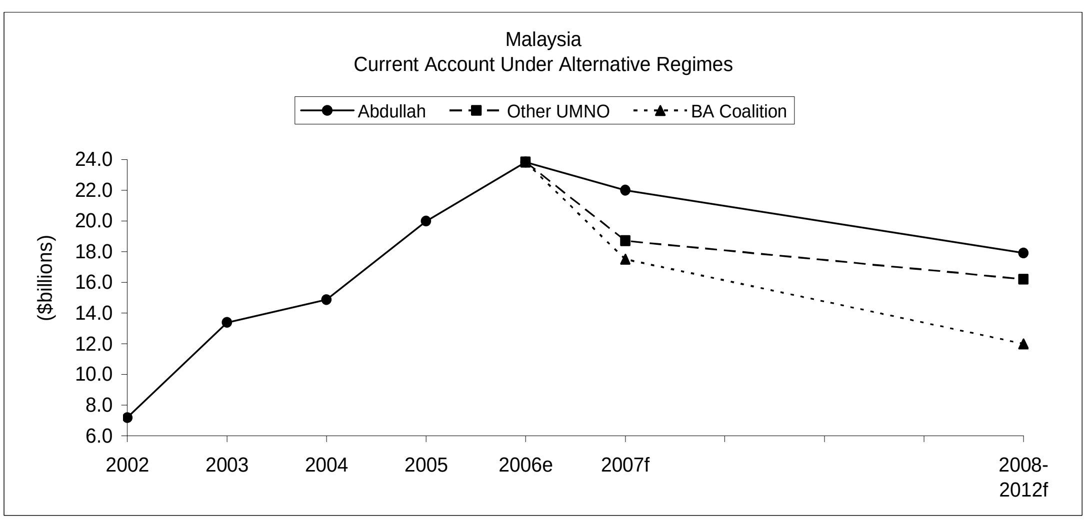
SUMMARY OF FIVE-YEAR FORECAST

REGIMES & PROBABILITIES		Abdullah 55%	Other UMNO 35%	BA Coalition 10%
RISK FACTORS	**BASE**			
Turmoil	Low	Same	SLIGHTLY MORE	SLIGHTLY MORE
Restrictions				
Investment	Moderate	Same	Same	SLIGHTLY LESS
Trade	Moderate	Same	Same	Same
Economic Problems				
Domestic	Moderate	Same	SLIGHTLY MORE	SLIGHTLY MORE
International	Low	Same	SLIGHTLY MORE	MORE

* When present, indicates forecast of a new regime


Malaysia
Real GDP Growth Under Alternative Regimes
Abdullah
Other UMNO
BA Coalition
(percent)
7.5
7.0
6.5
6.0
5.5
5.0
4.5
4.0
3.5
2002
2003
2004
2005
2006e
2007f
2008-2012f


Malaysia
Inflation Under Alternative Regimes
Abdullah
Other UMNO
BA Coalition
(percent)
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
2002
2003
2004
2005
2006e
2007f
2008-2012f


Malaysia
Current Account Under Alternative Regimes
Abdullah
Other UMNO
BA Coalition
($billions)
24.0
22.0
20.0
18.0
16.0
14.0
12.0
10.0
8.0
6.0
2002
2003
2004
2005
2006e
2007f
2008-2012f

Malaysia
Country Forecast
Political Framework
Players To Watch

Abdullah bin Ahmad Badawi: Abdullah succeeded Mahathir bin Mohammed as prime minister in October 2003, following a prolonged period of being groomed for the job, and won a clear mandate to govern at parliamentary elections held in March 2004. He has strong connections to several factions within UMNO, but he has come under heavy criticism from his predecessor for his alleged mismanagement of the economy. He is by reputation averse to confrontation, a factor that could make him vulnerable to challenges to his authority, especially if he attempts to use anti-corruption efforts to undermine his rivals…

Najib bin Abdul Razak: Najib moved from the Education Ministry to Defense in 2000; both posts are established training grounds for future prime ministers. He is also a vice president of UMNO and was named deputy prime minister following Abdullah's promotion to the premiership. All of these factors place Najib first in line to succeed Abdullah, and he could become a dangerous rival to the prime minister in the event of political difficulties…

United Malays National Organization: UMNO is the most powerful political party in the country, but its internal dynamics require constant attention, as the party is highly prone to factionalism. Abdullah's anti-corruption campaign, which has targeted top members of the party, has heightened factional infighting that, in combination with a brewing power struggle between Abdullah and Mahathir, raises some doubts about UMNO's long-term unity…

Islamic Party of Malaysia: Against the backdrop of the US-led war on terrorism launched in 2001, Mahathir effectively tarred PAS with the brush of Islamic extremism. Following the untimely death of the party's leader, and his replacement by a hard-liner, PAS unveiled a program calling for the establishment of an Islamic state, a move that contributed to a significant decline in its parliamentary strength at the 2004 elections. Recent changes within the upper levels of the party hierarchy suggest that PAS is preparing to soften its line in hopes of winning back the support of more moderate Muslims…

People's Justice Party: Keadilan was formed in the late 1990s as the political vehicle of the *Reformasi* movement, which arose from outrage over the government's treatment of former Deputy Prime Minister Anwar. Although the party has been weakened as a result of government intimidation and its cooperation with the hard-line PAS, the return of Anwar to active politics might have a rejuvenating effect. That prospect has fueled speculation that Abdullah might call an early election before Anwar's ban expires in April 2008…

…more on these and other Players in the Political Players section

Political Players

Abdullah bin Ahmad Badawi (Prime Minister; Finance Minister)

Abdullah succeeded Mahathir as prime minister on October 31, 2003, and won his own mandate at the March 2004 elections, which resulted in a resounding victory for the BN alliance. He has strong connections to several factions within UMNO, but he has come under heavy criticism from his predecessor for his alleged mismanagement of the economy. He is by reputation averse to confrontation, a factor that could make him vulnerable to challenges to his authority, especially if he continues to use anti-corruption efforts to undermine his rivals.

He is regarded as rational, diplomatic, and pragmatic. Such qualities have helped him avoid making many enemies within UMNO, but they have also led some to question whether he can be a decisive leader. Although Abdullah has stated he will maintain the economic goals enunciated by his predecessor (such as achieving the designation of "fully developed economy" by 2020), his policies will focus on agricultural and smaller enterprises, rather than the large infrastructure projects favored by Mahathir, a tactical shift that has drawn sharp criticism from Abdullah's predecessor. More broadly, Abdullah has promoted a program of progressive Islam (dubbed *Islam Hadhari*) that is aimed at positioning UMNO to stave off a challenge by Keadilan for control of the country's political center, but has troubled religious conservatives both within UMNO and more broadly throughout Malaysia.

Born on November 26, 1939, in Pulau Pinang, Abdullah was educated at the University of Malaya. He concurrently holds the posts of prime minister, minister of finance, and president of UMNO. His previous experience in the executive branch includes stints as director, and later deputy secretary-general, of the Ministry of Sport, Youth, and Culture (1971–1978) and minister in the Office of the Prime Minister (1982). In addition, he has held the portfolios of Education (1984–1986), Defense (1986–1987), Foreign Affairs (1995–1999), and Home Affairs (1999–2003).

Abdullah's rise to the top began in 1991, when he returned to the Cabinet as foreign minister after finishing second only to Anwar in voting for UMNO's vice presidents in October 1990. Earlier, Abdullah had lost influence after supporting Razaleigh's challenge for the prime ministership in 1987, a move that prompted Mahathir to drop him from his post as minister of defense.

He encountered a setback in 1993, when Mahathir chose Anwar to replace Ghafar Baba as deputy prime minister, and Abdullah failed to gain re-election to an UMNO vice presidency. However, he won re-election in 1996, served effectively as foreign minister, and then succeeded Anwar as deputy prime minister.

Abdullah has sought to shore up his base of power within UMNO, and the results of party elections held in September 2004 indicated that he still had some way to go in that regard. Although he secured election as UMNO president, two members of the party's old guard faction were elected to fill the first and second vice presidential posts. The suspension of First Vice President Isa Abdul Samad by the party's disciplinary board in June 2005 increased tensions within UMNO, as Abdullah's political rivals accused the prime minister of conducting a witch hunt. Abdullah insists that he intends to press ahead with his anti-corruption campaign, a course that could provoke direct challenges to his leadership. The announcement of a delay in the holding of party leadership elections due in 2007 indicates that Abdullah is planning an early return to the polls in a bid to bolster his position by winning a fresh mandate.

Democratic Action Party (DAP)

Parti Tindakan Demokratik is a socialist party with origins in Singapore's ruling People's Action Party. The party gained two seats at the March 2004 general election to bring its total to 12, making it the largest opposition party in the current Parliament.

Formed on March 19, 1966, its primary political role is and has been to act as an advocate for the less wealthy among the minority Chinese community, from which it receives virtually all its support. The party's narrow ethnic focus gives it almost no chance of leading the government. Although DAP had initiated plans to broaden its base by nominating Malay and Indian candidates in elections during the 1980s, the policy was reversed in 1989 because party leaders feared the loss of their ability to serve as a vehicle for ethnic Chinese interests. DAP lost 11 of its 20 seats in Parliament in 1995, and in 1999, PAS overtook DAP to become the largest opposition party.

DAP joined the opposition Alternative Front (BA), which grew out of the *Reformasi* movement in 1999, but deserted the alliance in September 2001 over concerns about the Islamist orientation of PAS, the dominant party in the BA. In particular, Chinese Malayans are wary of PAS' support for laws based on Islamic principles, which include bans on such Chinese practices as eating pork, consuming alcohol, and gambling. Party leaders also sought to rise to power in 1987 in partnership with Razaleigh's Spirit of '46 Party, but that plan collapsed when many members of DAP defected to the Malaysian Chinese Organization (MCA) because of objections to Razaleigh's cooperation with PAS.

During the 1999 election campaign, the ruling National Front (*Barisan Nasional*, or BN) used the state news media to undermine DAP's support by stirring the ethnic Chinese community's fears of PAS' intentions. It warned that a BA government would bring economic decline, social instability, and an Iranian-style Islamic state. The Islamization threat played well among the large ethnic Chinese community, which had seen the result of economic collapse on the Chinese population of Indonesia. DAP's leader, the veteran Lim Kit Siang, and the party's deputy president, Karpal Singh, were both defeated in their individual contests. On December 2, 1999, Lim Kit Siang resigned as leader of DAP, taking full responsibility for the party's defeat, although he did agree to stay on as the party's national chairman.

Islamic Party of Malaysia (PAS)

The fundamentalist *Parti Islam sa-Malaysia*, formed in 1955, has long been UMNO's primary political rival. However, the long-term trend of growing support for the party has been reversed since the initiation of the US-led war on terrorism in late 2001. For many voters, the election of Hadi Awang, an avowed supporter of the establishment of an Islamic state, as party leader following the death of Fadzil Noor in 2002 appeared to lend credence to the government's claims that PAS posed a threat to domestic security and stability. The party suffered a crushing defeat at the March 2004 general election, losing 20 of its 27 seats in the Parliament, leaving it in second place, behind DAP, among the opposition parties. Although Hadi easily won re-election as PAS leader at party elections held in mid-2005, the simultaneous elevation of several reformist candidates to top positions in the party hierarchy suggests that PAS is embarking on a program to soften its image ahead of the next elections.

Although Islam is Malaysia's official religion, the constitution and the government insist on the protection of the rights of its non-Muslim population and retain much of the legal system inherited from the British. The growth of Islamic fundamentalism beginning in the late 1980s generated widespread criticism of the government's failure to promote Muslim values, and also resulted in increased support for PAS. In the 1990 general elections, PAS won seven parliamentary seats, in contrast to winning only one in 1986. In the same year, the party won 24 of the 39 seats in the Kelantan state elections, inflicting an embarrassing defeat on UMNO. PAS also achieved progress in the April 1995 parliamentary elections, finishing ahead of DAP in the popular vote (although it won fewer seats).

In the 1999 elections, PAS joined the ethnic Chinese DAP and the reformist Keadilan in the BA alliance, and emerged as the largest opposition party after nearly quadrupling its representation in Parliament to 27 seats. PAS made significant inroads in the northern Malay heartland, as disillusioned native Malays turned against Mahathir because of his treatment of former Deputy Prime Minister Anwar and other failings within UMNO. Challengers from PAS defeated four of the 10 UMNO ministers in Mahathir's former

Cabinet. When Parliament convened in December 1999, the 45 members of the opposition staged a boycott to protest what they termed the ruling coalition's "arrogance" and alleged violations of the constitution. It was the first time the entire opposition had ever walked out of a new parliamentary session before even taking their oaths of office.

In general, however, PAS has a weak record of cooperating with other parties. A limited cooperative arrangement with Razaleigh's Spirit of '46 Party forged in 1987 gradually eroded and finally ended when PAS attempted to revise Kelantan's state constitution to weaken the prerogatives of the sultan, a move opposed by Spirit of '46. The return to UMNO of Razaleigh and most other members of the Spirit of '46 Party in the 1990s marked a setback for PAS and its aspirations of gaining power. Razaleigh is now UMNO's representative in Kelantan, charged with winning back the state for UMNO, a task he very nearly accomplished at the March 2004 elections. Likewise, relations between PAS and DAP, its partner in the BA, became increasingly strained after the 1999 elections. In late September 2001, concerns about the strident religious tone of PAS led to DAP's formal withdrawal from the BA. Suspicion of PAS among the Chinese population has a long history. Objections to Razaleigh's cooperation with PAS prevented the formation of an alliance between DAP and the Spirit of '46 Party in the late 1980s.

The slight softening of the party's Islamic goals in 1999 did little to attract the votes of non-Muslims, prompting a shift to a more hard-line position. That trend was accelerated with the emergence of Hadi, the chief minister of the PAS government in the state of Terengganu, as the party's leader in mid-2002. However, the results of the 2004 elections indicate that the former UMNO supporters who flocked to the party in 1999 were in the main social conservatives, rather than fundamentalists, and returned to the UMNO fold as PAS adopted a less moderate position. Particularly telling was the fact that Hadi lost not only his parliamentary seat, but also control of the state government in Terengganu.

Malayan Businesses

Although the government exerts significant influence over the private sector, the growing Malay presence in business enhances the political importance of the business community. The government has assisted the change by using its privatization program to increase business ownership among Malays through a bidding process that favors the Bumiputra. Foreigners, Malayan Chinese, and Malays control the larger business enterprises through quasi-governmental financial institutions. Ethnic Chinese manage many large Malay-controlled businesses, which include the strong manufacturing sector, plus agriculture and resource extraction. Such enterprises are subject to close government scrutiny to ensure long-term economic contributions and have experienced tremendous growth since the early 1980s. Although most small businesses are still owned by Chinese, more Malays are gradually becoming involved in businesses at a variety of levels, and increasing numbers of educated Malays are finding management positions in larger firms.

As the importance of the Malay business grows, the Chinese community is investing an increasing proportion of its resources abroad. These moves are partly based on Chinese concerns about discrimination at the hands of Malays and partly on the fact that many Chinese see more opportunity for profit in China and elsewhere in the region, including expansion into the Philippines, Vietnam, Hong Kong, and the US.

Malayan Chinese Association (MCA)

The MCA is one of three major parties cooperating with UMNO in the BN coalition, which also includes the People's Movement (Gerakan) and the Malayan Indian Congress (MIC), along with various smaller parties. The MCA represents the interests of ethnic Chinese, particularly the affluent Chinese who are part of the Malaysian establishment. Originally it was established, in 1949, as a welfare organization that aimed to counter the influence of Communists in the Chinese community. In 1952, its Selangor branch entered into a pact with the local UMNO branch to contest local elections in Kuala Lumpur. After an electoral success there, the two parties joined with the MIC to contest federal elections. The three parties became the Alliance Party, the beginnings of a coalition that has ruled Malaysia in one form or another since 1957.

The MCA's influence in the coalition stems from UMNO's need for Chinese support in order to present a multiracial face in a country rife with ethnic tension. The MCA's leaders always have difficulty trying to appease both their UMNO partner and the Chinese community at large. For this reason, many less affluent Chinese lend support to DAP. While the MCA's success is limited by the very nature of the organization, it remains the second largest party in the House of Representatives, having won 31 seats at the March 2004 general election.

Ethnic tensions have contributed to growing dissatisfaction among all Chinese elements of the BN. The MCA joined DAP in questioning the government's policies on Chinese education. The Chinese have also been concerned about the erosion of their place in the economy as a result of government policies that favor ethnic Malays. Leaders of the Chinese parties are concerned about their future because of the decline of the Chinese population. The Malay population's faster rate of growth may reduce the percentage of Chinese from 26% to 20% by 2040. Mahathir has sought to reassure the Chinese of their permanent place in Malaysia in order to maintain Chinese participation in the BN, including giving several Cabinet posts to members of the Chinese parties.

Malayan Indian Congress (MIC)

A member of the ruling BN coalition, MIC was established in 1946, adapting its name from the Indian National Congress. It dropped some leftist inclinations in 1948 after the start of the Emergency in Malaya and eventually linked with UMNO and the MCA through the Alliance after their electoral success in Kuala Lumpur in 1952. MIC has remained the most junior partner in this tripartite arrangement ever since. MIC is the primary vehicle to express Indian interests in Malaysia, although it tends to be seen as out of touch with working-class Indians, many of whom are among the country's poorest people. MIC won all seven seats it contested in 1995 and 1999, but saw its total drop to just six seats in 2004. MIC leader Samy Vellu was a fixture in Mahathir's Cabinets, and has been retained by Abdullah in his long-held post of public works minister.

Najib bin Abdul Razak (Deputy Prime Minister; Minister of Defense)

Najib serves as vice president of UMNO and was named as deputy prime minister following Abdullah's promotion to the premiership. Both positions make him a strong candidate to eventually succeed to the prime minister's post, which was held by his father, Tun Abdul Razak, during 1970–1976.

Born on July 23, 1954, in Kuala Lipis, Pahang, Najib was educated at the University of Nottingham. Like his father, Najib has advanced himself by playing the role of the loyal party member and winning the confidence of the prime minister. His various government posts have included deputy minister of energy, telecommunications, and posts (1978–1980), deputy minister of education (1980–1981), deputy minister of finance (1981–1982), minister of youth and sports (1986–1990), and minister of defense (1990–1995). In 1995, Najib was promoted to the significant post of minister of education, a position generally regarded as a stepping-stone to the prime minister's position.

Najib has enemies within UMNO and a reputation for unbridled expediency. Although he initially backed the 1987 challenge to Mahathir by Razaleigh, he withdrew his support late in the campaign, a move that still rankles Razaleigh's followers. Nevertheless, his political instincts are thought to be sharper than Abdullah's. Despite being passed over as deputy prime minister in the aftermath of Anwar's departure, Najib remains powerful within UMNO and is still a leading future candidate to hold the top spot.

National Front (BN)—Minor Parties

While Malay members of UMNO occupy most key positions in the government, the party attempts to give the impression that its non-Malay partners in the BN also play an important role. Besides the MCA and MIC, the principal party cooperating with UMNO is Gerakan, which represents ethnic Chinese interests. Rivalries between the two Chinese parties in the BN weaken the political influence of both. The BN parties depend heavily on UMNO for financial support and for the votes of ethnic Malays in areas where the Chinese or Indian population might otherwise elect a member of the opposition.

Other parties within the BN include local state parties from Sabah and Sarawak. Mahathir's government suffered an embarrassing defeat in 1990, when the United Sabah Party (PBS), which had participated in the 1986 parliamentary elections as a BN member, withdrew from the Front on the eve of general elections and joined the opposition. However, in March 1994 the government persuaded opposition deputies in the Sabah legislature to defect from the PBS and support the Sabah National Front (SNF). As a result, the state government fell and was replaced by a coalition headed by the BN. In 1999, UMNO won a resounding victory in Sabah elections, effectively eliminating the influence of the PBS and leaving UMNO in control of every state except Kelantan. In an implicit admission of defeat, the PBS announced in late 2001 that it desired a return to the BN fold, but Mahathir responded coolly to the request. However, the PBS did join the BN coalition ahead of the 2004 elections.

People's Justice Party (Keadilan)

Parti Keadilan Rakyat was formed in 2003 through the merger of the National Justice Party (*Parti Keadilan Nasional*) and the People's Party Malaysia. In its original incarnation, Keadilan was the political vehicle of the *Reformasi* movement, which arose from outrage over the government's treatment of former Deputy Prime Minister Anwar. At the March 2004 election, Keadilan barely managed to maintain a place in the Parliament, winning just a single seat. At the time, it appeared that Keadilan's chief role would be to serve as a communication link with outside human rights organizations. However, the release of Anwar in September 2004, after his 2000 conviction on sodomy charges was overturned, holds the promise of breathing new life into the party. Anwar has indicated that he intends to re-enter the political fray from inside Keadilan, and his presence could have a galvanizing effect on the broader opposition. That prospect has fueled speculation that Abdullah might call an early election before the ban on Anwar's political activity expires in April 2008.

Keadilan's unique approach has been to seek a multiracial constituency in order to provide a third option for Malays unhappy with UMNO's conservative, rigid, and corrupt ways, as well as PAS' religious conservatism. In its early days, Keadilan sought to build support by focusing attention on corruption, cronyism, and bureaucratic improprieties in Mahathir's government. However, facing its first electoral challenge in 1999 with just nine days notice, Keadilan was unable to translate public disaffection with Mahathir into votes. Its call for greater democracy won a significant share of the vote in Kuala Lumpur, where government candidates had their majorities sharply reduced, but Keadilan failed to make an impact elsewhere. As a result, the party won only five seats, one by Wan Azizah Wan Ismail, Anwar's wife and the party's founder, who stood for election in her husband's former constituency.

However, the party fell on hard times in 2001, largely the result of Mahathir's campaign of intimidation. Six of the party's top leaders were arrested under the Internal Security Act (ISA) in April 2001. Government pressure has effectively taken the wind out of the sails of the reform movement, and several leading members have left the party. Keadilan suffered a crushing defeat in a by-election for a seat in the Perlis State Assembly in January 2002, a portent of its performance in the 2004 general election.

Razaleigh Hamzah

A former finance minister, Razaleigh led a revolt against Mahathir in 1987, and before that had unsuccessfully challenged Musa Hitam twice for UMNO's deputy presidency. However, after being tainted by the Bank Bumiputra scandal while he was finance minister (1976–1984), Razaleigh lost a close race in 1987 against Mahathir for UMNO's presidency, the position always held by the prime minister. He then left the party, eventually helping to form the Spirit of '46 and serving as its president until his return to the UMNO fold in 1996.

Born in 1936 in Kelantan, Razaleigh is the son of a former chief minister of Kelantan. He was educated at Queen's University in Belfast and Lincoln's Inn in London. His past experience included being chairman of Pernas (1971–1974) and chairman of the national oil company, Petronas, (1974–1976). In addition to the Finance portfolio, he also served as vice president of UMNO (1975–1986) and as minister of trade and industry (1984–1987). In 1999, Razaleigh became the leader of UMNO's effort in Kelantan to regain control of the state government, now held by PAS. Ironically, he became a defender of the federal status quo that he himself challenged in the 1987 elections.

Razaleigh's return to UMNO in June 1996, along with most members of his Spirit of '46 Party, revived his chances of regaining his former status as a senior leader of UMNO. He insisted that he rejoined UMNO to create greater unity among the Malays and does not seek a senior post, but as a member of Kelantan's royal family, many members of UMNO hold Razaleigh in high regard. If Abdullah faltered, Razaleigh could become prime minister.

United Malays National Organization (UMNO)

UMNO is the dominant member of the ruling BN coalition and the most powerful political party in the country, but its internal dynamics require constant attention, as the party is highly prone to factionalism. Abdullah's anti-corruption campaign, which has targeted top members of the party, has heightened factional infighting that, in combination with a brewing power struggle between Abdullah and Mahathir, raises some questions about UMNO's long-term unity.

In its current form, UMNO began in 1988. The original UMNO splintered in April 1987 when dissidents headed by Razaleigh and Musa opposed Mahathir's leadership in a bitter and closely fought contest. The narrow victory by the prime minister and his deputy, Ghafar Baba, was challenged in the courts, which ruled that while the election was legal, UMNO was not. Mahathir obtained permission from the registrar of societies to form the "New UMNO," while Razaleigh and his dissident faction, including former Prime Minister Abdul Rahman, applied to form another group, "UMNO Malaysia." The courts legitimized Mahathir's New UMNO and denied the dissidents' claim. Razaleigh eventually formed the Spirit of '46 Party, but rejoined UMNO in the mid-1990s, a development that helped to solidify both UMNO's and Mahathir's political power.

The economic difficulties of the late 1990s and Mahathir's battle with Anwar stimulated anti-UMNO sentiment among the population. The rise of the *Reformasi* movement and the emergence of Keadilan, which joined DAP and PAS in forming the BA alliance, presented a potentially viable challenge to UMNO's stranglehold on power. However, the opposition parties were given just nine days to campaign for the 1999 election, and the state-run media drowned out their message. There were daily attacks on Anwar in the newspapers and a videotape was produced that supposedly proved claims he had committed sexual improprieties. According to PAS, the BN even circulated a fake PAS newspaper, full of reports of how their leaders secretly favored Mahathir. There were no complaints of vote buying or intimidation in the election, but the opposition did complain that there were more than 200,000 phantom voters on the electoral lists that were used to swing marginal constituencies in favor of the BN.

The results of the 1999 elections, which saw UMNO's share of seats fall from 49% to just 37%, suggested that while the electorate was not prepared to take the risk of a completely new government at such a precarious economic juncture, it was prepared to fire a warning shot across Mahathir's bow. However, the replacement of Mahathir with the "gentler" Abdullah, as well as the renewed strength of the economy, left the reform movement with no potent issues on which to challenge the government in 2004. UMNO put in a spectacular performance at the 2004 election, gaining 38 seats and very nearly winning a parliamentary majority on its own.

Unfortunately, that result has done little to relieve tensions within UMNO. Party elections held in September 2004 saw two members of the party's old guard, which has balked at Abdullah's efforts to remake the party in his own image, voted into the top two vice presidential posts. One of those, First Vice President Isa Abdul Samad, was subsequently removed over his involvement in a vote-buying scam, and Isa's old-guard allies have accused Abdullah of conducting a witch hunt aimed at purging his political rivals from positions of power within the party.

Malaysia
Country Conditions
Investment Climate

Overview

Openness to Foreign Investment

The Malaysian government encourages foreign direct investment, particularly in export-oriented manufacturing and high-tech industries, and in "back office" service operations, but retains considerable discretionary authority in approving individual investment projects. The government caps foreign investment shares in most sectors, but does permit 100% foreign ownership in the manufacturing sector. This is handled through the Malaysian Industrial Development Authority (MIDA) for most manufacturing projects and the Multimedia Development Corporation (MDC) for Multimedia Super Corridor (MSC)-status companies.

In keeping with long-standing public policies designed to increase "Bumiputera" (Bumiputera are literally "sons of the soil" but, in practical terms, this refers to the government's affirmative action policies favoring the majority Malay race) participation in the economy, the Malaysian government encourages or requires joint ventures between Malaysian and foreign companies in most sectors and, in many areas, limits foreign equity and employment. In most cases, international firms seeking to bid on Malaysian government tenders are only eligible to do so if their company has 30% Bumiputera ownership, or if they engage a Bumiputera middleman for the tendering process.

Malaysia actively woos foreign investment in the information technology industry, particularly in the Multimedia Super Corridor (MSC), a government scheme to foster the growth of research and development, and other high technology activities in Malaysia. Foreign investors who obtain MSC status receive a host of tax and regulatory exemptions in exchange for a commitment of substantial technology transfer. Many corporations are now using the MSC to outsource call center and back office operations, including HSBC and BMW, among others. In 2005, Malaysia announced that firms in the Bayan Lepas area of Penang may now apply for MSC status.

In the services sector, the government promotes foreign investment in information technology, hotels and tourism, environmental management, research and development (R&D), and training. Malaysia also welcomes foreign investment in biotechnology. Prime Minister Abdullah repeatedly has expressed strong interest in using biotechnology to help invigorate the agricultural sector in Malaysia. Investment in biotechnology figured prominently in the 2006 budget and is expected to be a lynch pin in the 9th Malaysia Plan (the government's five-year economic development plan), which will start in 2006.

Malaysia does not actively seek foreign investment in financial or professional services (other than "back office" operations that support foreign business activities) or foreign participation in agriculture (unless it is an agro-tourism linked project) or construction. Foreign investment also is restricted in the oil and gas industries. All foreign energy investment is conducted through production sharing contracts between foreign operators (including ExxonMobil, ConocoPhillips, Amerada Hess, Baker Hughes, Newfield, and Murphy Oil from the U.S., as well as Royal Dutch Shell) and Malaysia's national petroleum company, Petronas.

The Malaysian Industrial Development Authority (MIDA) screens all proposals for manufacturing projects in Malaysia, both foreign and domestic. MIDA determines whether a project is consistent with the Second Industrial Master Plan (1996-2005) and with other government strategic and social policies. MIDA opened a new Business Information Center this year that has information on investment, productivity, trade, and financing, as well as staff who can discuss a variety of manufacturing sectors. The center also has space for business meetings. MIDA is attempting to offer one-stop-shopping to potential investors. Still, applications for investment in other sectors are handled by the relevant regulatory agencies and may require multiple approvals.

Investment regulations are specified in the Promotion of Investments Act of 1986 (PIA) and the Industrial Coordination Act of 1975. The government pledged in 2004 to replace the PIA with a more concise law covering investments in both manufacturing and services, but has yet to do this. The PIA does not address services investment. The Securities Commission and the Foreign Investment Committee implement the regulations specified in the Malaysian Code on Takeovers and Mergers. The Foreign Investment Committee also formulates policy guidelines for foreign participation in non-manufacturing sectors. In an effort to streamline the investment approval process and to stimulate foreign investment, the Government reduced the oversight and approval authority of the Foreign Investment Committee (FIC) in 2003.

Foreigners may now hold 100% equity in any new manufacturing project, whether export-oriented or not, for which MIDA approves a license. This policy applies only to new projects (both green-field and expansion). In June 2003, MIDA announced that the policy permitting 100% foreign ownership in manufacturing had been extended indefinitely. Manufacturing investments approved under the liberalized measures are not subject to a divestment or dilution requirement. Those with prior investments must honor the initial conditions to which they agreed but may request that they be changed.

However, the private sector has new concerns about proposed guidelines for the Distributive Trade sector, put forward by the Ministry of Domestic Trade & Consumer Affairs (MDTCA) in 2005. These guidelines could mandate that foreign manufacturing, trading, etc. firms in Malaysia establish separate marketing/distribution arms of their companies for local sales purposes, and that these entities be subject to 30% Bumiputera ownership requirements, and other restrictions. The proposed guidelines would even be applicable to firms brought into Malaysia under a MIDA license as noted above, and thus could be in conflict with earlier investment agreements facilitated with international firms in Malaysia.

The Malaysian government has loosened foreign-held equity restrictions in some other industries. The GOM increased the level of foreign ownership allowed in telecommunications firms from 30% to 61% in 1998. The government stated at that time that foreign equity must be reduced to 49% after 5 years, but to date it has not required foreign divestment from telecommunications holdings. Foreigners are permitted to hold a 70% stake in shipping companies, 49% in forwarding agencies, and 51% in insurance companies (note: new companies entering the market may own up to 49% equity but those already in the market can request that their equity be increased to 51%).

The Malaysian government promotes the acquisition of economic assets by Bumiputera to encourage a more even distribution of wealth among races. The government often requires foreign and domestic non-manufacturing firms to take on Bumiputera partners (usually 30% of share capital) and to maintain a workforce that proportionately reflects Malaysia’s ethnic composition. If a company issues publicly traded stock on the Bursa Malaysia (formerly the Kuala Lumpur Stock Exchange), it is required to issue at least 30% of its initial offering to Bumiputera shareholders. The government relaxed requirements for subsequent issuances in August 2003.

Malaysia offers a number of incentives to foreign manufacturing investors, such as Pioneer Status and the Investment Tax Allowance. Historically these incentives have been linked to performance criteria such as export-percentage requirements, as specified in individual manufacturing licenses. For further detail on incentives for various sectors, check MIDA's website.

Project approval depends on many factors. MIDA may consider the size of an investment, the export-orientation of production, the type of financing (both local and offshore) required, capital/labor ratio, the potential for technological diffusion into the local economy, the ability of existing and planned infrastructure to support the effort, and the existence of a local or foreign market for the output. The criteria are applied in a non-discriminatory manner, except in instances where both local and foreign firms propose identical projects. All requests are handled on a case-by-case basis.

In an effort to insulate the Malaysian economy from risks posed by volatile short-term capital flows, and to eliminate offshore trading of the ringgit, the government imposed selective capital controls on September 1, 1998. Over the past 7 years, the government gradually relaxed controls on foreign direct investment flows, wages, dividends, interest, and rental income earned in Malaysia. In May 2001, the government eliminated one of the most controversial measures when it abolished a 10% tax on foreign investors' portfolio investment profits taken out of the country. On July 21, 2005, Bank Negara removed the ringgit from its peg of RM 3.80 to the dollar and shifted to a managed float based on a trade-weighted basket of currencies. As of December 2005, the ringgit is trading at approximately RM 3.77 to the dollar. To date, the ringgit has appreciated less than 1% against the dollar and many analysts believe that it is still undervalued by approximately 5%.

The only major remaining capital control is the restriction on the flow of currency across borders. Further information on the remaining capital controls, and economic and monetary policy developments in Malaysia, is available on Bank Negara Malaysia's website.

13 wholly foreign-owned commercial banks operate in Malaysia, and enjoy considerable market share. The government has expressed a desire to reduce the number of local commercial banks; common wisdom suggests that Bank Negara intends to reduce local commercial banks to between 4 and 6. Yet Bank Negara has continued to increase the number of Islamic banks for both local and foreign players: issuing 3 new foreign Islamic banking licenses in 2004; encouraging local banks to open Islamic subsidiaries; and, allowing foreign banks to take up to 49% equity in these subsidiaries. Foreign participation in new commercial banking operations otherwise remains restricted, with foreign equity limited to an aggregate 30% in any single domestic bank.

For many publicly listed local companies, only a minority portion of stock is available for trading. The principal shareholders (who are often government-linked agencies) frequently hold the majority portions of stock. Malaysia's privatization program slowed as a result of the 1997-1999 economic downturn. Since then the government has re-acquired a number of privatized entities, including the national air carrier, MAS, and Kuala Lumpur's light rail transit system. The government has made little movement towards restarting its privatization efforts, and its investment arm, Khazanah, now controls the majority of its shares in government-linked companies and is supposedly injecting more efficiency into the mix. Foreign participation in the last round of privatization was generally welcome. Foreign firms are able to participate in government-financed research and development programs.

A company is resident in Malaysia for tax purposes if its management and control is exercised in Malaysia, that is, if directors' meetings are held in Malaysia. Resident companies pay an income tax of 28% on all income, 38% in the petroleum industry. Payments made to non-residents for technical or management services and rental of movable properties are subject to withholding tax at the rate of 10%. The U.S. and Malaysia have not concluded a bilateral tax agreement and no negotiations are anticipated at this time. In 2005, the government passed legislation mandating a new Goods and Services Tax that is scheduled for implementation in 2007. Currently, very little is known about the government plans for that implementation and some observers are calling for its delay into force until more public discussion is possible.

Transparency of the Regulatory System

Malaysia has an open system of government, economic, and business regulation. For tax purposes, local and foreign enterprises are treated essentially the same.

One of the biggest complaints from foreign companies is the difficulty in obtaining work visas for expatriate personnel. The Malaysian government restricts the number of expatriate personnel employed by both foreign and domestic firms. A new foreign-invested project is allotted a certain number of "key posts," determined by the size of the investment, which may be occupied by foreigners in perpetuity. Beyond these automatic allowances, a firm wishing to employ expatriate personnel generally must demonstrate that there is a shortage of qualified Malaysian candidates and that a Malaysian citizen is being trained. In practice this is a difficult showing for firms to make. Manufacturing companies with foreign paid-up capital of at least U.S. $2 million receive automatic approval for up to ten expatriate posts. Manufacturing companies with paid-up capital of U.S. $200,000 to $2 million will receive automatic approval for up to five expatriate posts.

Foreign firms have complained that the procedures for obtaining work permits are time-consuming and burdensome. Due to the acute shortage of highly qualified professionals, scientists and academics, Malaysia has made some progress in simplifying permit approval for these categories of foreign personnel. With the present procedure, the foreign investor submits permit applications simultaneously with the project proposal to the relevant ministry (for example, MIDA for manufacturing, Bank Negara for financial services, Petronas for petroleum industry, etc). The ministry approves the applications with the project then forwards them directly to the Immigration Department for immediate issuance of the required documents. Permit-approval bodies now convene more often and have successfully computerized their operations, reducing the processing time. Nevertheless, anecdotal evidence suggests that significant problems remain. Furthermore, many companies complain about the lack of skilled labor and the difficulty in getting approval to bring in expatriates.

Industry also has concerns regarding the treatment of expatriate male spouses in Malaysia. When expatriate women are employed in Malaysia on legitimate work visas, their children are usually given proper 2-year dependent pass visas, but their expatriate husbands are often not given the same dependent pass visas. In several cases, expatriate husbands are only given the standard 90-day visitor visas, and are required to leave Malaysia and return, in order to get their visas extended. Department of Immigration officials responded to concerns about this policy by indicating that it was a "cultural issue" in Malaysia, and that "…men should be in the workplace and women should be at home."

The government also rigorously monitors hiring practices to ensure that all foreign employers strive to meet guidelines designed to ensure a racial balance in employment, especially in the areas of technology, management and the like. Malaysia's manufacturing and construction industries have, however, relied heavily on unskilled guest workers from Indonesia and, to a lesser extent, other Southeast Asian countries. In February 2002, the government instituted new regulations governing the employment of foreign workers in certain industries, including construction, manufacturing, and plantations, as part of an effort to reduce employment of illegal aliens. In 2005, the government repatriated about 400,000 workers illegally present in Malaysia.

U.S. companies have indicated that they would welcome improvements in the transparency of government decision-making and procedures, and limits on anticompetitive practices. For example, the government has not provided details of its proposed competition policy to local and foreign industry and has not sought public comment; despite the significant impact such legislation may have on business and consumers. A considerable proportion of government projects and procurement is awarded without transparent, competitive bidding.

Capital Markets

The government is committed to broadening and deepening domestic capital markets. With that in mind, the government released in 2001 the 10-year Financial Sector Master Plan and Capital Markets Master Plan. (Please see the following website links for more information: www.bnm.gov.my and www.sc.com.my). The Financial Sector Master Plan, produced by the central bank, Bank Negara, aims to develop a more competitive and resilient financial system by building competitive domestic banks. The Plan defers the introduction of new foreign competition in conventional banking until after 2007. (As of end 2005, established foreign companies held approximately one quarter of all banking assets). The Plan provides for some liberalization in the insurance industry, including lifting existing restrictions on employment of expatriate specialists, raising caps on foreign equity, and opening the reinsurance industry to foreign competition.

The Capital Markets Master Plan, released by the Securities Commission in February 2001, stipulated that foreign participation limits would be liberalized by 2003, at which time foreigners would be permitted to purchase a limited number of existing stock-broking licenses and take a majority stake in unit trust management companies. Despite this pledge, the government has not changed the rules to permit foreign majority ownership in local companies in this sector. The maximum foreign equity stakes remains fixed at 49% in stock-broking firms and 30% in unit trust management companies. Foreigners may hold up to 70% in fund management companies managing both local and foreign funds. The government issued 5 licenses to foreign brokerage houses in 2005. It also allowed one global fund manager to enter the Malaysian market (In 2004, the government had announced it would issue a total of 5 fund management licenses).

Since 1998, the Central Bank had progressively lowered deposit and lending rates. Daily average interbank deposit rates fell from 10.74% in January 1998 to 2.70% in November 2005. On November 30, 2005, Bank Negara raised the overnight policy rate by 30 basis points to 3.0%. This was the first rate increase since 1998 and was enacted in response to rising inflation. (In April 2004, Bank Negara implemented a new interest rate framework, reflecting a move towards a more market-based approach in determining interest rate. The overnight policy rate replaced the three-month intervention rate as the indicator of the Central Bank's stance on monetary policy, and as the target rate for the day-to-day liquidity operations of the Bank). As of December 2005, the average lending rate is 6.25%. The average lending rate has dropped from 11.51% in January 1998 to 6.0% at the end of 2004.

Bank Negara also relaxed certain rules on how banks compute their lending rates, namely removing the cap on lending rates for most lending products. The new framework was enacted to give banks more flexibility to create structured and customized products. Bank Negara still prescribes certain limits on interest rates used by banks, specifying a minimum rate for fixed deposits, and maximum rates for credit cards and certain home loans.

Foreign investors and foreign companies have access to credit on the local capital market. On April 1, 2005, the government abolished the 3:1 gearing ratio requirement imposed on foreign-controlled companies for domestic borrowing. It has also allowed foreign-controlled companies to seek any amount of ringgit credit without Bank Negara's approval

Though the government has significantly relaxed capital controls since their imposition in September 1998, and the ringgit remains fully convertible, the government continues to control the flow of currency. Local currency may not be sent abroad to purchase imports, nor may it be received from abroad in compensation for exports. Unless prior permission is sought, no one may carry more than one thousand ringgit into or out of the country with the exception of border traders, who may carry up to RM 10,000 (U.S. $2,631) or the equivalent in foreign currency. A resident of Malaysia may carry no more than U.S. $2,500 or the equivalent in any foreign currency out of the country, although a non-resident may carry out any amount of foreign currency up to the amount he or she brought in.

Foreigners may trade in securities and derivatives. The Malaysian government has an adequate regulatory system to facilitate portfolio investment. In the wake of the 1997-1998 regional financial crisis, Malaysia took steps to improve accounting transparency and corporate governance. Publicly listed companies must submit quarterly reports that include a balance sheet and income statement within two months of each financial quarter's end. Companies must submit audited annual accounts for public scrutiny within four months of each year's end. To promote professionalism, the number of corporate directorships any individual may hold has been limited to 25. All public and private company directors are required to attend classes on corporate rules and regulations.

Legislation also regulates equity buybacks, mandates book entry of all securities transfers, and requires that all owners of securities accounts be identified. A Central Depository System (CDS) for stocks and bonds established in 1991 makes physical possession of certificates unnecessary. All shares traded on the Bursa Malaysia (formerly the Kuala Lumpur Stock Exchange or KLSE) must now be deposited in the CDS. Short selling of stocks is not permitted, though the government is considering lifting this ban.

The domestic banking system came under acute stress as a result of the regional economic crisis of 1997-98. In 1998, the government undertook measures to re-capitalize distressed banks, to remove non-performing loans from banks' books, and to restructure loan agreements. The government established a national asset management company, Danaharta, in June 1998 to purchase, manage, and dispose of non-performing loans (NPLs) in the banking sector. By March 2001, Danaharta had acquired some RM 48 billion (U.S. $12.6 billion) in non-performing loans, equal to approximately 44% of NPLs in the banking system. In March 2004, Danaharta indicated its plans to recover some RM 30.94 billion (U.S. $ 8.1 billion) from restructured NPLs. Danaharta ceased purchasing NPLs in 2001 and has since been focusing its efforts on implementing debt recovery plans. In December 2005, Danaharta announced that it had completed its goals and closed up shop. System-wide, the risk-weighted capital adequacy ratio of banks was 13.3% as of September 2005.

Foreign/Free Trade Zones/Ports

Malaysia has Free Zones (FZ's) in which export-oriented manufacturing and warehousing facilities may be established. Raw materials, products and equipment may be imported duty-free into these zones with minimum customs formalities. The zones are divided into Free Industrial Zones (FIZ), where manufacturing and assembly takes place, and Free Commercial Zones (FCZ), generally for warehousing commercial stock. Companies that export not less than 80% of their output and depend on imported goods, raw materials, and components may be located in these FZ's.

Goods sold into the Malaysian economy by companies within the FZ's must pay import duties. If a company wants to enjoy Common External Preferential Tariff (CEPT) rates within the ASEAN Free Trade Area, 40% of a product's content must be ASEAN sourced. In addition to the FZ's, Malaysia permits the establishment of licensed manufacturing warehouses outside of free zones, which give companies greater freedom of location while allowing them to enjoy privileges similar to firms operating in a FZ. Companies operating in these zones require approval/license for each activity. The time needed to obtain licenses depends on the type of approval and ranges from 2-8 weeks.

Ports, shipping and maritime-related services play an important role in Malaysia since 90% of its international trade is sea borne. Currently there are 13 FIZs and 12 FCZs in Malaysia. In June 2006, the Port of Klang Free Zone will open as the nation's first fully integrated FIZ and FCZ.

Statistics

The U.S. has consistently been the largest foreign investor in Malaysia, with significant presence in the oil and gas sector, manufacturing, and financial services. An American Chamber of Commerce 2005 survey puts cumulative U.S. investment in Malaysia at more than US $30.0 billion. According to the Malaysian Industrial Development Authority, the U.S. accounted for the third greatest number of new manufacturing foreign investment project applications in terms of value by September 2005, with approved projects valued at U.S. $478 million.

U.S. firms with significant investment in Malaysia's petroleum sector include: Exxon/Mobil (which participates in upstream and downstream activities), Caltex, ConocoPhillips, Dow Chemical and Eastman Chemicals (all of which have investments in downstream activities). Major semiconductor manufacturers, including Freescale, Texas Instruments, Intel, Western Digital, StatsChipPac, National Semiconductor, and others have substantial operations in Malaysia, as does Dell Computers. Virtually all major Japanese consumer electronics firms (Sony, Fuji, Panasonic, Matsushita, Hitachi, etc.) have facilities in Malaysia.

Policies

Conversion and Transfer

Despite the imposition of selective capital controls, Malaysia's currency remains fully convertible. Importers and exporters have sufficient access to foreign exchange. Ringgit earned by foreigners in the form of salaries, interest payments, and dividends may be converted into foreign currency for repatriation abroad. All payments to other countries must be made through authorized foreign exchange dealers in foreign currency.

Effective April 1, 2004, the government increased the allowable maximum of retained foreign currency export proceeds held in foreign currency accounts by resident exporters and approved operational headquarters to U.S. $100 million from the previous U.S. $70 million. Resident and non-resident travelers may carry no more than RM 1,000 into or out of Malaysia. Residents may not carry out foreign currency more than the equivalent of RM 10,000 (U.S. $ 2,632). Non-residents may carry in any amount of foreign currency, but are required to declare currency amounts in excess of USD $2500. Non-residents may carry out any amount of foreign currency up to the amount they carried in.

Performance Requirements

Fiscal incentives granted to both foreign and domestic investors historically have been subject to performance requirements, usually in the form of export targets, local content requirements and technology transfer. Performance requirements are usually written into the individual manufacturing licenses of local and foreign investors.

The major tax incentives for companies investing in the manufacturing sector are the Pioneer Status or Investment Tax Allowance. Eligibility for Pioneer Status or Investment Tax Allowance is based on certain priorities, including the levels of value-added, technology used and industrial linkages. Such eligible projects are termed as "promoted activities" or "promoted products." Applications for Pioneer Status should be submitted to the Malaysian Industrial Development Authority (MIDA).

The government gives major incentives to companies that locate in the Multimedia Super Corridor (MSC), mainly in high technology sectors and Back Office Operations. The incentives include: Pioneer Status or Investment Tax Allowances and eligibility for R&D grants. Applications should be made through the Multimedia Development Company (MDC).

In the May 2003 Economic Stimulus Package, the Malaysian government extended the full tax exemption incentive to firms with "Pioneer Status" (companies promoting products or activities in industries or parts of Malaysia to which the government places a high priority) to fifteen years from ten years and those with "Investment Tax Allowance" status (companies promoting products or activities in industries or parts of Malaysia to which the government places a priority, but not as high as Pioneer Status) to ten years from five years. In general, however, if a firm (foreign or domestic) fails to meet the terms of its license, it risks losing any tax benefits it may have been awarded. In extreme cases, a firm could lose its manufacturing license. The government has stated that in the long term, it intends gradually to eliminate most of the fiscal incentives now offered to foreign and domestic manufacturing investors.

The 2006 budget made some modifications to the general rules, including provisions for carrying forward unabsorbed losses for companies with Pioneer status, extending the application period for incentives for promoted areas, and extending the scope of incentives for multimedia activities.

To find details for particular incentives for various manufacturing and service sectors, please look at the Incentives for Investment section of the MIDA website. For more detailed information on the Multimedia Super Corridor, see its website.

Legal Framework

Expropriation and Compensation

The Embassy is not aware of any cases of uncompensated expropriation of foreign-held assets by the Malaysian government. The government's stated policy is that all investors, both foreign and domestic, are entitled to fair compensation in the event that their private property is required for public purposes. Should the investor and the government disagree on the amount of compensation, the issue is then referred to the Malaysian judicial system, which has proved capable of enforcing property and contractual rights.

Dispute Settlement

Malaysia is a signatory to the UN-sponsored Convention on the Settlement of Investment Disputes and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The domestic legal system is open and accessible. Past cases of foreign investment disputes, which have been rare, have generally been handled satisfactorily by existing dispute settlement mechanisms. Many firms choose to include mandatory arbitration clauses in their contracts. The U.S. Embassy is aware of one contractual dispute with a U.S. company where the Malaysian firm chose not to honor mandatory arbitration clauses as stated in their contract. Resolution of that case is pending.

Should local administrative and judicial facilities fail to satisfy claimants, the dispute is submitted to the International Center for Settlement of Investment Disputes (ICSID) under the aegis of the United Nations. The government has set up the Kuala Lumpur Regional Center for Arbitration under the auspices of the Asian-African Legal Consultative Committee to offer international arbitration, mediation, and conciliation for trade disputes.

Right to Ownership and Establishment

In June 2003, MIDA announced that the policy permitting 100% foreign ownership in manufacturing had been extended indefinitely for new projects (both expansion and Greenfield). Those with prior investments must honor the initial conditions to which they agreed but may request that they be changed. 70% foreign ownership is permitted in local fund management companies working with both local and foreign clients and dealing with both institutional and unit trust funds. 49% foreign ownership is permitted in brokerage companies. The government issued five licenses to foreign global fund managers in 2005. It also allowed one foreign brokerage house to enter the Malaysian market (in 2004, the government had announced it would issue a total of 5 foreign brokerage licenses).

Malaysia has also temporarily eased equity restrictions on licensed telecommunications companies. Under measures announced in May 1998, foreign ownership in telecommunications companies may reach as high as 61%, but the government also had stated that foreign ownership in the sector must be reduced through divestiture or dilution to no more than 49% after 5 years. Presently, we have not seen government efforts to enforce any such divestitures or dilution.

Under the Insurance Act of 1996, foreign insurance subsidiaries were required to incorporate their operations locally by June 30, 1998. However, the government has granted individual extensions to this deadline and has yet to move against companies not in compliance. Foreign shareholding exceeding 49% is not permitted unless the Malaysian government approves higher shareholding levels. As part of the 1997 WTO Financial Services Agreement, Malaysia committed itself to allowing existing foreign shareholders of locally incorporated insurance companies to increase their shareholding to 51%. Currently, new entry by foreign insurance companies is limited to equity participation in locally incorporated insurance companies at a maximum of 49%.

Certain financial sectors have additional barriers to entry. For example, the government severely restricts establishment in the financial service industry. No new conventional banking or insurance licenses are being issued, other than those for re-insurance firms. (In December 2000, the government reissued a banking license to the Bank of China. That license had been surrendered in 1959.) Foreign banks wishing to enter this market may purchase equity in existing financial institutions but that equity is limited to an aggregate of 30%. In February 2000, the government fostered substantial consolidation of the banking industry into 10 “anchor” banks in an effort to create stronger, more competitive domestic institutions that might better withstand future fluctuations in the global financial market. All financial institutions completed their merger plans into 10 anchor banks by March 2002. Analysts believe that in the years ahead there will be further consolidation among domestic banks, bringing the number of anchor banks down to between 4 and 6.

In a recent development, Bank Negara has hinted that it might allow foreign banks to open more branches, and it may announce a new policy in late December 2005. However, most observers believe that any liberalization for banks in this area would come with certain requirements. For example, for each additional branch that Bank Negara allows a foreign bank to open in a major urban area, they also might be required to open a certain number of branches in rural areas.

Malaysia has a significant Islamic banking sector, accounting for 11% of assets in the banking system. Almost all banks, both local and foreign, offer Islamic products. On October 14, 2004, the government issued three new Islamic banking licenses to Middle Eastern Islamic banks. The government encourages all commercial banks operating in Malaysia to set up full-fledged Islamic banking subsidiaries in which foreigners may take a 49% equity stake. Similarly, the government is currently evaluating proposals for up to 4 new licenses for Islamic insurance (Takaful) and foreign investors are allowed up to 49% equity in local companies that win these licenses.

The Malaysian government maintains broadcast content quotas on both radio and television programming. 80% of television programming must originate from local companies owned by ethnic Malays. However, in practice, local stations have been granted substantial latitude in programming because of a lack of suitable local programming. Radio programming must also consist of 60% locally originated content. The Communications and Multimedia Act of 1998 transferred responsibility for regulating broadcasting from the Ministry of Information to the Ministry of Energy, Telecommunications, and Multimedia, now renamed the Ministry of Energy, Water and Communications. Foreign ownership of radio and television stations is not expressly forbidden but not likely to be approved.

International firms have concerns about the lack of advertising content guidelines, and how some advertisers misrepresent their products and services through advertising. Advertising falls under the purview of multiple ministries and agencies, complicating the adoption of a single set of advertising regulations and enforcement procedures for all stakeholders in this process.

The government's recent actions regarding content quotas also have not been consistent. In October 2004, the Malaysian Communications and Multimedia Commission introduced new content code for advertising, hoping it would perhaps lead to relaxation of the 80% rule for television advertising. There was, however, no change in overall content rules for television advertising. Also, in 2005, the Minister of Culture made calls for a new tax on foreign films to aid the local film industry.

Under the terms of the Petroleum Development Act of 1974, the upstream oil and gas industry is controlled by the parastatal, Petroleum Nasional Berhad (Petronas), the sole entity with legal title to Malaysian crude oil and gas deposits. Foreign investment takes the form of production sharing contracts (PSCs). Non-Malaysian firms are permitted to participate in oil services either in partnership with local firms or as contractors. They are restricted to a 30% equity stake if they are incorporated locally. Ownership of agricultural land is restricted to Malaysian citizens.

Historically, non-export-oriented foreign firms that had negotiated temporary exemptions from general equity limits were required to restructure within a definite timeframe. A restructuring program could involve taking on new local partners, giving existing local partners a greater equity share, or floating shares on Bursa Malaysia, formerly the Kuala Lumpur Stock Exchange (KLSE). The government's goal at that time was to reduce foreign ownership of most firms producing for the domestic market to 30%. However, as mentioned previously, in June 2003, the government extended indefinitely the policy permitting 100% foreign ownership in new investment and expansion of existing investments in manufacturing.

Private entities, both foreign and domestic, have the right to acquire, merge with, and take over business enterprises according to the Foreign Investment Committee (FIC) guidelines of 1974. However, the acquisition or disposal of five percent or more of interests in any local financial institution requires the prior approval of the Minister of Finance.

Patents registered in Malaysia generally have a 20-year duration from date of filing, which can be extended under certain circumstances. The length of time required for patent registration averages five years, due to a shortage of qualified personnel in the Patents and Trademarks Department of the Ministry of Domestic Trade and Consumer Affairs. The Malaysian government has hired more patent examiners, with a goal of reducing average registration time to three years. Although the processing time for trademark registration may be as long as 2 years, industry groups have not complained widely about infringement. Copyright protection extends to computer software and lasts for the author's lifetime and 50 years after his or her death. The Copyright Act includes enforcement provisions allowing government officials to enter and search premises suspected of infringement and to seize infringing copies and reproduction equipment.

Protection of Property Rights

Malaysia is a member of the World Intellectual Property Organization (WIPO), the Berne Convention, and the Paris Convention for the Protection of Industrial Property. In 2003 Malaysia amended its laws to allow it to join the Patent Cooperation Treaty (PCT). Malaysian law provides copyright protection to all works published in Berne Convention member countries regardless of when the works were first published in Malaysia. Malaysia is also a member of the WTO and a party to the Trade Related Intellectual Property (TRIPS) agreement.

The Optical Disc Act of 2000 established a licensing and regulatory framework for manufacturing copyrighted work and controlling piracy. Manufacturers of optical discs are required to obtain licenses from both the Ministry of International Trade and Industry and the Ministry of Domestic Trade and Consumer Affairs. Malaysia's production capacity for optical discs far exceeds local demand plus legitimate exports, and pirated products believed to have originated in Malaysia have been identified throughout the Asia-Pacific region, North America, South America, Africa, and Europe. Malaysia has remained on the USTR Special 301 Watch List since October 2001, in particular due to its failure to substantially reduce pirated optical disc production and export. The International Intellectual Property Association (IIPA) estimates 2004 industry losses in Malaysia due to piracy at $188 million, with piracy rates at 63% for business software, 52% for music, and 50% for movies.

A special task force, chaired by the Minister of Domestic Trade and Consumer Affairs and including representatives from all ministries and agencies with responsibility for IPR, has overseen the expansion of enforcement staff and a more vigorous program of raids on sellers of pirated products. The Ministry is expected to add over 700 more enforcement officers in 2006 to complement the existing 1400 officers. Government and industry cooperation also has expanded. The government also made some headway in tackling the judicial backlog for infringement cases. Malaysian courts have imposed deterrent sentences, fines and/or penalties for the offenders. The Minister of Domestic Trade and Consumer Affairs has pledged the creation of a specialized IP court by mid-2006.

A number of U.S. consumer product companies also have suffered significant losses due to the manufacture and sale of counterfeit products in Malaysia. The volume is difficult to determine because of the broad range of products affected, which includes printer cartridges, motor oil, household cleaning agents, shampoo and skin care items, herbicides, and batteries. Counterfeiters have improved the quality of packaging and marketing so that consumers are misled into purchasing the products. The products have caused harm to individuals, and damage to automobiles and household goods. Some of the pirated goods are produced in Malaysia, while many are brought into the country from China, Thailand and India.

The Malaysian government has mandated the use of hologram stickers as a primary tool in helping its enforcement agents identify counterfeit goods. The Ministry of Domestic Trade and Consumer Affairs began requiring their placement on optical disc products in 2003, and, in 2005, the Ministry of Health implemented a similar requirement for pharmaceuticals and traditional medicines. U.S. industry groups opposed the mandatory requirement schemes because of concerns about cost and efficacy of this "one-size-fits-all" approach, and have called on the Ministry of Health to continually review the effectiveness of the directive.

Environmental Issues

Despite many environmental laws and adherence to many international environmental agreements, the enforcement of regulations is often lax, particularly for domestic businesses. Many environmental groups have pressured the government to act, and the dangers created by excessive logging in east Malaysia and smoke problems stemming from illegal burning in Indonesia have heightened government concerns about environment protection. Other environmental issues are air pollution from industrial and vehicular emissions and water pollution from raw sewage.

Infrastructure

Malaysia's central location in the Asia Pacific region makes it an ideal gateway to Asia and the ASEAN markets. Air cargo facilities are well developed in the five international airports - the Kuala Lumpur International Airport (KLIA), Penang International Airport and Langkawi International Airport in Peninsular Malaysia, Kota Kinabalu International Airport in Sabah, and Kuching International Airport in Sarawak. Malaysia's ultra-modern Kuala Lumpur International Airport (KLIA) is the nation's largest, located 50 kilometers south of Kuala Lumpur. Cargo import and export procedures are fully automated at KLIA.

Kuala Lumpur is served by a number of international airlines, though no U.S. airlines fly to Malaysia directly. Additional international connections are available via Singapore, from which there is a joint Malaysian Airlines/Singapore Airlines air shuttle service. Direct flights are available from the U.S., Europe, the Middle East, and Asia. Within Malaysia, the national airline - Malaysian Airlines (MAS) - provides frequent service to all major cities, as does low-cost competitor Air Asia.

Peninsular Malaysia's network of well-maintained highways link major growth centers to seaports and airports throughout the peninsula and provide an efficient means of transportation for goods. To complement these highways, a Kuala Lumpur-Bangkok rail service known as the ASEAN Rail Express (ARX) has been initiated with the aim of expanding it to become the Trans-Asia Rail Link that will include Singapore, Vietnam, Cambodia, Laos and Myanmar before ending up in Kunming, China.

International telephone service from Malaysia is adequate and more investment is being undertaken to keep up with the very rapid increase in demand. GSM is the Malaysian standard for digital cellular communications. One of its cellular providers is GPRS enabled, while the other two are 3G spectrum holders. The later have commenced their 3G pilots and it should be commercially deployed early 2005.

Broadband Internet access is widely available in most major hotels. Offices and residential customers gain dial-up or broadband Internet access via ISDN, ADSL, SDSL, WiFi and/or WiMax. WiFi/WiMax Internet access are mushrooming in coffee outlets in metropolitan Kuala Lumpur and other major cities. Malaysia's dial-up Internet penetration rate is at 13.8%, whereas its broadband subscribers penetration rate is at 1.6%. Residential broadband access pricing has been slashed recently, and we should see more uptakes in the near future.

Political Violence

Malaysia has experienced little political violence since ethnic rioting in 1969, which led to the establishment of the National Economic Policy, a program designed to give the Bumiputera majority a larger stake in the economy. Prime Minister Abdullah Badawi assumed power in late 2003 on the retirement of his predecessor, Mahathir Mohamad, and was returned with a large parliamentary majority in peaceful elections in March 2004.

Corruption and other Bureaucratic Obstacles

The Malaysian government considers bribery a criminal act and does not permit bribes to be deducted from taxes. Nevertheless, corruption remains a serious concern. The Anti-Corruption Agency (ACA) began operations in 1967, but does not play a significant role. Since June 1997, senior state-level officials have been required to declare their assets to the ACA upon taking office. Foreign businessmen are asked to report any individuals who ask for payment in return for government services. ACA investigations are sometimes reported in the newspapers, but are rarely targeted at high-ranking officials or business representatives with well-connected companies. Prime Minister Abdullah declared after assuming office that the fight against corruption was one of his priorities, but by 2005 the battle had slowed. There were a few high profile prosecutions in 2004 but little more in 2005. For example, by the end of 2005 the government has done little to implement recommendations from an April 2005 royal commission on police reform. Complaints of police abuse and corruption remain widespread, prompting Abdullah to order another independent commission to conduct hearings.

Transparency International, a nonprofit organization, ranked Malaysia 39th among 158 countries in its 2005 Corruption Perceptions Index. Malaysia's score of 5.1 on a scale of 0 (corrupt) to 10 (clean) was an improvement from the 5.0 in 2004 (Malaysia's ranking was also 39th last year). Nonetheless, Malaysia placed ahead of such countries as South Korea, China, Thailand, the Philippines, Vietnam and Indonesia, though well behind others such as Singapore, Hong Kong, Taiwan and most of Western Europe. The Malaysian chapter of Transparency International is the Kuala Lumpur Society for Transparency and Integrity.

International Agreements

Bilateral Investment Agreements. Malaysia has bilateral investment guarantee agreements with over 70 economies and has double taxation treaties with 60 countries. Malaysia's double taxation agreement with the U.S. is currently limited to air and sea transportation. Malaysia has a limited investment guarantee agreement with the U.S. under the U.S. Overseas Private Investment Corporation (OPIC) program. Efforts to negotiate a more comprehensive bilateral investment treaty would require resolution of several issues, the most important of which is differing interpretations of national treatment.

OPIC and other Investment Insurance Programs. Since 1959, Malaysia has qualified for the U.S. Overseas Private Investment Corporation (OPIC) insurance programs. However, given Malaysia's political stability, attitude toward foreign investors, and available dispute settlement mechanisms, few investors have sought OPIC insurance in Malaysia.

Labor Conditions

The government of Malaysia reported that labor market conditions in 2004 remained about the same as the year before with 3.6% unemployment (the official full employment rate is 4.0%). Unemployment for 2005 is slightly better at 3.5%. Still, the government announced in November 2005 that Malaysia has approximately 60,000 unemployed university graduates.

The regional economic downturn in 1997-1998 had led to retrenchments that mostly affected Malaysia's substantial foreign workforce. At that time, the government put a freeze on hiring new foreign workers. In February 2000, the government lifted the freeze on foreign workers except for some specific jobs. During the slowdown of 2001, the government again announced it would reduce hiring of foreign workers. In 2004, the government announced it would forcibly repatriate all illegal workers in Malaysia and the repatriation program was implemented in early 2005.

At the end of May 2005, total registered foreign workers numbered 1.62 million -- a 10.2% increase over 2004. They were employed in the following sectors: 31% were employed in manufacturing sector, 27% in plantations, 26.5% in services, and 15.5% in construction. The majority of the foreign workers are from Indonesia (69.4%), followed by Nepal (10.2%), India (6.2%), and Vietnam (4.6%). In July 2005, the government increased the levy on foreign workers in the services and plantation markets by 50%. The real rate of wage increases in the manufacturing sector was 1.8% in 2004 as compared to 2.8% in 2003. The government no longer seeks to entice labor-intensive companies to establish operations in Malaysia, and reserves its fiscal incentives for higher value-added projects.

Malaysia is a member of the International Labor Organization International Labor Organization (ILO). Labor relations in Malaysia are generally non-confrontational. A system of government controls strongly discourages strikes. Some labor disputes are settled through negotiation or arbitration by an industrial court, though cases can be backlogged for years. Once a case is referred to the industrial court, the union and management are barred from further industrial action.

While national unions are proscribed, there are a number of national confederations of unions. The government has prevented some trade unions, such as port workers' unions, from forming national federations. There are no labor unions in the electronics sector. Employers and employees share the costs of the Social Security Organization (SOSCO), which covered 10.2 million workers as of December 2004. No welfare programs or government unemployment benefits exist; however the Employee Provident Fund (EPF), which employers and employees are required to contribute to, provides retirement benefits for workers in the private sector. Civil servants receive pensions.

Sources: MALAYSIA COUNTRY COMMERCIAL GUIDE FY 2006, US & FOREIGN COMMERCIAL SERVICE AND US DEPARTMENT OF STATE; PRS Data files.

Malaysia
Country Conditions
Climate for Trade

Trade Barriers

Tariff and Non-tariff Barriers

The Government of Malaysia operates a system of import licensing. Import licenses are required for a number of items, including arms and explosives; motor vehicles; heavy construction equipment; certain drugs and chemicals; plants; timber; soil; tin ore, slag or concentrates; and various essential foodstuffs. Prohibited imports include any "indecent or obscene" articles and certain poisonous chemicals.

Imports of meat and poultry are regulated through licensing and sanitary controls. All imported beef, lamb, and poultry products must originate from facilities that have been approved by Malaysian authorities as "halal," or acceptable for consumption by Muslims.

Malaysia has an export licensing system. For some products, such as textiles, export licenses are used to ensure compliance with bilateral export restraint agreements. For other products, such as rubber, timber, palm oil, and tin exports, special permission from government agencies is required. Export duties ranging from 5% to 15% are imposed on the principal commodities of timber and palm oil. A flat rate of 10% export duty is imposed on petroleum.

Malaysia is not party to the plurilateral WTO Government Procurement Agreement, and as a result foreign companies do not have the same opportunity as some local companies to compete for contracts, and in most cases are required to take on a local partner before their bids will be considered.

Malaysia's services sector, which constitutes about 56% of the national economy, remains highly protected. At a September 2005 WTO meeting, Malaysia joined other developing economies in protesting proposals to change WTO rules in order to accelerate the liberalization of services in developing countries. In sectors such as telecommunications, legal services and direct selling, foreign firms are limited to a 30% share in local operators. Other services, including architecture and engineering, can only operate as a joint-venture participant, and accounting and taxation firms can only operate through affiliates.

Protection of intellectual property rights is also a trade barrier for certain industries. For a full report on trade barriers in Malaysia, please visit the U.S. Trade Representative's report.

Taxes and Fees Assessed on Imports

Tariffs are the main instruments used to regulate the importation of goods in Malaysia, and the simple average applied normal trade relations (NTR) tariff rate is 8.56%. Import duties range from 0% to 50% and can be found on the US-ASEAN Business Council's website (note: the site provides both CEPT rates under AFTA, as well as NTR rates applicable to U.S. goods, and Malaysia follows the Harmonized Tariff System (HTS) for the classification of goods). The higher rates apply to luxury goods and protected sectors. The level of tariff protection is generally lower on raw materials and increases for those with value-added content or which undergo further processing. Seventeen percent of Malaysia's tariff lines (principally in motor vehicle, construction equipment, forestry, logging, agricultural, and minerals sectors) are also subject to non-automatic import licensing, designed to protect import-sensitive or strategic industries. The Malaysian government continually reviews tariff rates in line with its objective of achieving a more open and liberal economy, and applied tariff rates have fallen over the past ten years.

In 2004 and again in 2005, Malaysia lowered some of the substantial import duties to which foreign-made automobiles and motorcycles were previously subject. At the same time, the government applied equally high excise taxes, leaving the tax burden on imported vehicles virtually unchanged. In October 2005 the government issued the New Automobile Policy framework that eventually could enhance competition; for example, the framework eliminated a 50% rebate on the auto excise tax for which only national car manufacturers were eligible.

Further information about tariffs may be found on the website of the Royal Malaysian Customs.

In addition to import duties on specific classes of goods, a general sales tax of 10% is levied on most imported goods. However, the sales tax is not applied to machinery used in export-oriented production. In 2007, a Goods and Services Tax (GST) will replace the current sales and service taxes. The rate of the GST has yet to be determined, as have goods that are tax exempt.

International Agreements

Malaysia has pursued bilateral and regional free trade arrangements in complement to its active participation in the World Trade Organization. Malaysia's specific objective in concluding FTAs is to maintain the country's competitive position vis-à-vis its neighbors. Malaysia also requires that the FTAs it negotiates include elements of trade and investment cooperation that allows its industry to build capacity through technical cooperation and collaboration.

Malaysia is a member of the ASEAN Free Trade Area (AFTA), which aims to reduce trade barriers among the member countries over a 15-year period. A key AFTA objective is for the six original ASEAN members (Malaysia, Indonesia, Singapore, Thailand, the Philippines, Brunei) to reduce import duties to 5% or less by 2010, with newer members (Vietnam, Laos, Burma, and Cambodia) to do the same by 2015. By 2003, 99.26% of Malaysian goods included in the AFTA Common Effective Preferential Tariff (CEPT) scheme were subject to duties of less than 5%; of these products, 60.4% were subject to zero tariff.

As a member of ASEAN, Malaysia is currently negotiating free trade agreements (sometimes referred to as "Economic Partnership Arrangements") with China and India. An ASEAN-Korea FTA is under consideration. In general, a two-track process is envisaged for these FTA negotiations: bilateral FTAs between China, Japan and India with selected ASEAN countries with a common set of rules of origin, followed by a region-wide CEP to be implemented by 2012.

Malaysia and Japan signed an Economic Partnership Arrangement in December 2005, and Malaysia is negotiating FTAs with Australia and New Zealand that are expected to be finalized in 2006. The U.S. and Malaysia signed a Trade and Investment Framework Agreement in May 2004. The TIFA established a Trade and Investment Council (TIC) that meets several times a year to discuss ways to improve the bilateral trading relationship. Malaysia is also a member of the Asia-Pacific Economic Cooperation (APEC) group.

Source: MALAYSIA COUNTRY COMMERCIAL GUIDE FY 2006, US & FOREIGN COMMERCIAL SERVICE AND US DEPARTMENT OF STATE.

Malaysia
Country Conditions
Background

Geography

Malaysia comprises the peninsular states formerly known as Malaya and the East Malaysian states of Sabah and Sarawak on the island of Kalimantan (Borneo). Its economic and strategic importance stems from its geographic position. Located on the Malacca Strait and straddling the South China Sea, Malaysia encompasses access to vital commercial and military sea routes in Europe, the Middle East, and Africa on one side and East Asia, Japan, and the west coast of the US on the other. Peninsular Malaysia consists of coastal plains surrounding heavily forested mountains and is separated from East Malaysia by 644 kilometers of the South China Sea. Its tropical climate fosters the production of agricultural products, including palm oil, rubber, timber, pepper, and cocoa. It also contains significant reserves of petroleum, natural gas, and tin. However, since the 1980s, Malaysia has become a manufacturing center. It is among the world's leading exporters of microchips, electronic components, air conditioners, and other high-tech manufactured products.

During January, the capital, Kuala Lumpur, has an average low temperature of 22°C and an average high of 32°C, and averages of 14 days of significant precipitation. During June, average low and high temperatures are 22° and 33°C, respectively, and it receives an average of 13 days of significant precipitation.

History

9th–14th Centuries: The Malay peninsula was ruled by a succession of Buddhist and then Hindu dynasties.

15th Century: The rise of the state of Malacca as a major regional entrepôt, under the rule of a Muslim prince, hastened the conversion of Malays to Islam.

1511: A Portuguese fleet conquered Malacca, marking the start of European expansion into Southeast Asia.

1641: The Dutch took over control of the area from the Portuguese.

1795: The British, who had already established control in Penang in 1786, took over the peninsula, initiating the extensive immigration of Chinese and Indian professionals, merchants, and laborers, and dramatically changing the demographics of this previously Malay region.

1942–1945: During World War II, Japan's invasion and occupation interrupted British colonial rule and set in motion Malay demands for independence from Great Britain.

1948: Local Communists, virtually all Chinese, launched a long, bitter guerrilla war, more over the role of Chinese Malays in the political process than an attempt to create a socialist state; the rebellion led the government to declare a state of emergency that would last until 1960.

1957: In response to growing popular demand for independence that began during World War II, the UK granted independence to the Federation of Malaya under the leadership of Tunku Abdul Rahman, who became prime minister; a significant feature of the new regime was a political compact giving Malays charge of the government and military, and leaving the economy primarily in Chinese and Indian hands.

1963: The British colonies of Singapore, Sarawak, and Sabah joined Malaya to form Malaysia.

1965: In the face of significant Malay-Chinese political divisions, Singapore was forced out and became an independent republic.

1969: After significant rioting and racial conflict that stemmed from election results in May, democracy was suspended for two years.

1970: Tun Abdul Razak succeeded Tunku Abdul Rahman as prime minister.

1971: The Alliance, a coalition of ethnically based parties (UMNO, the Malaysian Chinese Association/MCA, and the Malayan Indian Congress) was replaced as the country's dominant political organization by the National Front (BN), a broader coalition of 13 parties, still controlled by UMNO.

1976: Datuk Hussein Onn, another UMNO leader, became prime minister after the death of Abdul Razak.

1981: Mahathir bin Mohamad became the first non-aristocrat to become prime minister; his controversial policies and assertiveness caused a major split in UMNO.

1988: When UMNO was declared illegal because of registration irregularities, its leader, Mahathir, formed the New UMNO party.

1989: The Malaysian Communist Party (MCP) signed a peace agreement with Malaysia and Thailand, ending all domestic insurgency.

1990: The BN, including the New UMNO (which had reverted to being called simply UMNO) held off a serious challenge by the opposition.

August 1994: The government banned the Islamic fundamentalist group al-Araqam and arrested over 100 of its members on charges that the group was organizing its own rebellious armed forces.

September 1994: A delegation headed by the secretary of the ruling BN traveled to China to establish official relations with the Chinese Communist Party.

April 1995: In the general elections, Mahathir led the BN to a major victory, winning 166 out of 192 seats, considerably more than the two-thirds majority required to make constitutional changes, and the BN also gained control of the assemblies in 10 of 11 states, losing only in Kelantan, a conservative Muslim sultanate controlled by PAS.

September 1998: Mahathir sacked Anwar Ibrahim, who had served as his deputy as well as his finance minister, after a rift between the two over economic policy, since Anwar supported IMF intervention in the economy (as the Asian financial crisis heated up), but Mahathir was opposed.

November 14, 1998: US Vice President Al Gore, on a visit to Kuala Lumpur, publicly acclaimed the people supporting Anwar Ibrahim with street demonstrations, bringing a fierce reaction from Malaysian officials, who denounced US interference.

January 8, 1999: Prime Minister Mahathir appointed Foreign Minister Abdullah Ahmed Badawi deputy prime minister and returned Daim Zainuddin to his post as finance minister, both to replace Anwar Ibrahim. Syed Hamid Albar was appointed foreign minister.

February 18, 1999: Mahathir banned government subscriptions to the *Far Eastern Economic Review (FEER)*, *Asiaweek*, and the *International Herald Tribune,* saying they were critical of the country and accusing them of favoring his rival, the jailed former Deputy Prime Minister Anwar Ibrahim.

April 1999: Wan Azizah Wan Ismail, wife of Anwar Ibrahim, launched Keadilan with the object of exposing corruption and cronyism in the BN and ousting Mahathir. Anwar was found guilty and sentenced to six years in jail on a charge of corruption, for using his position to cover up accusations of sexual misconduct.

September 1999: Mahathir lifted the controls on capital movements that he had put in place a year before in an effort to bring stability to the Malaysian financial markets. About 10,000 of Anwar's supporters gathered at Kuala Lumpur's National Mosque to protest the government's treatment of Anwar. The four key parties in an opposition coalition—Keadilan, PAS, DAP, and Parti Rakyat Malaysia—known as the Alternative Front (Barisan Alternatif) announced their support for Anwar as their candidate for prime minister in the upcoming elections, but with an interim prime minister while he remained in jail. Seven of Anwar's allies were jailed after mass protests spurred by allegations that he had been poisoned in prison.

October 1999: The government announced a spending increase and an income tax cut.

November 10, 1999: After hastily calling off a planned trip to South Africa for a Commonwealth meeting, Prime Minister Mahathir announced general elections would be held within a month.

November 29, 1999: Amid allegations of voting irregularities, Mahathir was re-elected, but his UMNO party lost seats in Parliament, but the ruling BN coalition gained seats and retained its two-thirds majority.

December 20, 1999: The opposition members of Parliament walked out on the first day of sessions, accusing the BN of violating the constitution in summoning Parliament before the Cabinet had even met.

August 8, 2000: After taking over his own defense to tell the court that he as a victim of plotting by Mahathir, Anwar Ibrahim was found guilty of sodomy and received an additional nine years in jail.

March 8, 2001: Ethnic violence erupted between Indians and Malays in the Petaling Jaya area of Kuala Lumpur, an area comprising five villages that are home to about 2,000 families, mostly poor laborers or squatters. This was the most intense ethnic conflict seen in Malaysia since hundreds the bloody violence between Malays and Chinese in 1969.

June 2001: Since the 1999 elections, the main opposition centered on the Islamic PAS party, which spreads its message through mosques and quasi-religious lectures, but to win support from the Chinese community and shift closer to UMNO, the party appointed the first ethnic Chinese to its policy-making body.

July 15, 2001: Police broke up a demonstration by 500 at the Kamunting detention camp to protest the use of the Internal Security Act (enacted in 1960 by the British) to lock up six Anwar supporters without trial.

September 2001: Both the Malaysian government and the Islamic opposition condemned the terrorist attacks on the US, but also condemned the US military action in Afghanistan.

June 22, 2002: Mahathir declared that he would resign from his post in October 2003.

July 18, 2002: The UMNO won the parliamentary elections, but the Kedah parliamentary seat went to PAS.

August 2002: After the imposition of stringent laws against illegal immigrants, providing for whipping and prison terms, an exodus of foreign workers began.

September 2002: Despite a unanimous Federal Court ruling that a 60-day detention order lodged by the police against four opposition leaders and activists was unlawful, they remained in prison since the Court had no power to change an order based on the Internal Security Act.

October 27, 2002: Keadilan agreed to merge with the Malaysian People's Party (MPP).

June 24, 2003: Mahathir announced a minor Cabinet reshuffle after two senior MCA leaders resigned.

August 2003: The Court of Appeal rejected Anwar's final attempt to overturn his sodomy conviction.

October 2003: The US Senate voted to withhold $1.2 million in military aid until Malaysia improved its tolerance of religious diversity, following Mahathir's tirade against Jews, causing an international furor.

October 31, 2003: After 22 years in office, Mahathir turned over the reins of government to his chosen successor, Abdullah bin Ahmad Badawi.

March 21, 2004: The National Front, including Prime Minister Badawi's UMNO party, won a landslide victory in general elections.

September 2004: The Malaysian Federal Court, in a surprise ruling, overturned the 2000 sodomy conviction against former Deputy Prime Minister Anwar Ibrahim; he had been sentenced to nine years imprisonment on that charged and had been previously sentenced to six years in prison, in 1999, for abuse of power; because Anwar had served his time on the first charge, he was immediately released from custody, but since the first conviction still stands, he is barred from holding an elected office until 2008.

December 25, 2004: Malaysia was hit in the Asian tsunami disaster; its death toll was 68; the disaster led to Malaysia's decision to delay the deportations of thousands of illegal immigrants, mostly from Indonesia.

March 2005: Malaysia reached a production-sharing agreement with Royal Dutch/Shell covering two exploration blocks that Indonesia claims as being within its territorial waters. Indonesia authorized oil exploration in a long-disputed offshore area of the Sulawesi Sea.

June 2005: First Vice President and federal territories minister Isa Abdul Samad was suspended from his post for six years by the UMNO disciplinary board after he was found guilty of being involved in a vote-buying scam during the party's leadership elections in September 2004. At PAS internal elections, a raft of reformers were elected to key posts at the expense of some of its most ardently conservative clerics; although the party's conservative president, Hadi Awang, was re-elected without opposition.

December 6, 2005: Prime Minister Badawi received something of a boost when Hanafi Mamat, the candidate of the UMNO-led and governing National Front (BN) coalition won a hotly contested by-election for the Pengkalan Pasir constituency seat in the Kelantan state assembly.

November 2006: Riot police intervened to block hundreds of Muslims preparing to storm a Christian church (because they had heard rumors that Muslim youths were being baptized inside). The government began allowing non-Malaysians to purchase property valued at up to $71,000 for personal use without approval.

Social Conditions

Ethnic and Racial Divisions. The constitution provides for equal protection under the law and prohibits discrimination against citizens based on religion, race, descent, or place of birth. Ethnic Malays represent more than half the population, and most of the rest are either Chinese or Indian. Policies give preference to ethnic Malays and other indigenous peoples (together known as *Bumiputra*) in control of some industries, housing, the awarding of government contracts, university entry and educational scholarships, and other areas. Despite such efforts, the average wealth of Malays is substantially less that the Chinese minority. Differences between Malays and Chinese, both cultural and economic, constitute the primary threat to stability. The unwritten compromise underlying the formation of Malaya was that the Chinese would retain their economic holdings, while the Malays would exercise dominant political and administrative power and control. Over time, and particularly after the racial rioting in 1969, the Malays have pressed for greater economic power, while resisting Chinese demands for increased political influence. In 1971, the New Economic Policy (NEP), the original compact instituted at the birth of Malaya, was restructured to give Bumiputra economic and educational advantages intended to bring them into the advancing national economy. However, the Chinese and Indians were not provided with equivalent and reciprocal access to the political process, which continues to be a source of major discontent among these minorities. Chinese demands became more concerted in the wake of government adjustments to try to control the economy after the financial crisis of the late 1990s and as the Malay community became more divided over the fate of Anwar Ibrahim. The constitution grants everyone essentially the same rights, but in practice, federal laws pertaining to indigenous people (some among the country's poorest) vest almost total power in the Ministry of National Unity and Social Development to protect, control, and decide issues concerning minority groups. Although the constitution guarantees freedom of religion, religious minorities, which include large Hindu, Buddhist, Sikh, and Christian communities, generally face government restrictions on their worship. Islam is the official religion; the practice of Islamic beliefs other than Sunni Islam is severely limited.

Regional and Class Divisions. Peninsular Malaysia is divided by a north-south mountain range that has separated the population into what have become modern and traditional groupings. Since the western part of the country was the site of British outposts and is the residence of most of the Chinese and Indian populations, it has historically been more outward-looking. The east coast, particularly the northeast, has retained more of its historical character and become the center of fundamentalist Islam, but the vast majority of the population lives in the west. There is also a cleavage between the peninsula and the states on the island of Kalimantan. Sabah and Sarawak joined the Federation of Malaysia in 1963 to balance the inclusion of the largely Chinese state of Singapore. They retained many state prerogatives in Malaysia's constitution. With Singapore's departure in 1965, much of the rationale for their being part of Malaysia disappeared, but they remain and continue to have a unique relationship with the federal government, enjoying many more rights than the peninsular states do. In addition to this source of tension, Malays remain a minority in Sabah and Sarawak, which is populated by related ethnic groups such as the Kadazans, Dyaks, and Ibans, along with a substantial Chinese population. Industrialization, education, and public sector participation in the economy, together with preferential treatment for Malays in hiring and licensing, have reduced the economic disparity between the Malays and Chinese. The urban Malay middle class, business class, and work force developed and grew after the NEP, a form of affirmative action, was initiated in 1971. The share of national wealth held by Malays exceeded 20% in 1999, compared with about 2% in 1970. Despite the Malays' improvement in living standards, the economic disparity between them and the Chinese fosters Malay nationalism, which some Malay and Islamic politicians seek to exploit in efforts to wrest control from the multiracial BN.

Education. Education is free and compulsory for all children up to the age of 15. Attendance at the primary level is nearly universal, and attendance rates at the secondary level are very high as well. For Muslim children, religious education according to a government-approved curriculum is compulsory. The government spends close to 20% of its budget on education. Malaysia has one of the highest literacy rates in the region (about 89%).

Health. The government provides most health services. The general state of public health is quite good and has improved notably; the infant mortality rate stood at 18 per 1,000 live births in 2005, and the average life expectancy is about 72 years. Those in rural areas often suffer from such problems as malaria outbreaks and insufficient health facilities and services, but the health care system is one of the best in Asia.

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Background Note: Malaysia, December 2006
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Government

Malaysia is a constitutional monarchy, nominally headed by the Yang di-Pertuan Agong , customarily referred to as the king. Kings are elected for 5-year terms from among the nine sultans of the peninsular Malaysian states. The king also is the leader of the Islamic faith in Malaysia.

Executive power is vested in the cabinet led by the prime minister; the Malaysian constitution stipulates that the prime minister must be a member of the lower house of parliament who, in the opinion of the Yang di-Pertuan Agong, commands a majority in parliament. The cabinet is chosen from among members of both houses of parliament and is responsible to that body.

The bicameral parliament consists of the Senate (Dewan Negara) and the House of Representatives (Dewan Rakyat). All 70 Senate members sit for 3-year terms, which are normally extended for an additional 3 years; 26 are elected by the 13 state assemblies, and 44 are appointed by the king. Representatives of the House are elected from single-member districts by universal adult suffrage. The 219 members of the House of Representatives are elected to parliamentary terms lasting up to 5 years. Legislative power is divided between federal and state legislatures.

The Malaysian legal system is based on English common law. The Federal Court reviews decisions referred from the Court of Appeal; it has original jurisdiction in constitutional matters and in disputes between states or between the federal government and a state. Peninsular Malaysia and the East Malaysian states of Sabah and Sarawak each have a high court.

The federal government has authority over external affairs, defense, internal security, justice (except civil law cases among Malays or other Muslims and other indigenous peoples, adjudicated under Islamic and traditional law), federal citizenship, finance, commerce, industry, communications, transportation, and other matters.

Political Conditions

Malaysia's predominant political party, the United Malays National Organization (UMNO), has held power in coalition with other parties since independence in 1957. The UMNO coalition's share of the vote declined in national elections held in May 1969, after which riots broke out in Kuala Lumpur and elsewhere, mainly between Malays and ethnic Chinese. Several hundred people were killed or injured. The government declared a state of emergency and suspended all parliamentary activities.

In the years that followed, Malaysia undertook several initiatives that became integral parts of its socioeconomic model. The New Economic Plan (NEP), launched in 1971, contained a series of affirmative action policies designed to benefit Malays and certain indigenous groups (together known as bumiputera or "sons of the soil"). The Constitution was amended to limit dissent against the specially-protected and sensitive portions of the Constitution pertaining to the social contract. The government identified intercommunal harmony as one of its official goals. The previous alliance of communally based parties was replaced with a broader coalition -- the Barisan Nasional (BN) or National Front. The BN won large majorities in the 1974 federal and state elections.

Dr. Mahathir Mohamad was Prime Minister between 1981 and 2003, leading UMNO and BN to successive election victories. Mahathir emphasized economic development during his tenure, in particular the export sector, as well as large scale infrastructure projects. Mahathir attributed the success of the Asian tiger economies to the "Asian values" of its people, which he believed were superior to those of the West. Mahathir sharply criticized the International Monetary Fund (IMF), international financiers such as George Soros, and Western governments during the sharp economic and financial crisis that affected Asia in 1997-8, and denied that the downturn was due to the failures of corruption and "crony capitalism."

The end of Mahathir's tenure was marred by a falling out with his deputy and presumed successor, Anwar Ibrahim. In September 1998, Mahathir dismissed Anwar and accused him of immoral and corrupt conduct. Although Anwar was convicted on both charges in 1999 and 2000, the trials were viewed as seriously flawed. Malaysia's Federal Court eventually freed Anwar after overturning his immoral conduct conviction in September 2004.

Mahathir stepped down as prime minister in October 2003 after 22 years in power, and his successor, Deputy Prime Minister Abdullah Ahmad Badawi, was sworn into office. Abdullah called elections and won an overwhelming victory in March 2004, with Barisan Nasional taking 199 of 219 seats in the lower house of parliament. UMNO itself won 110 seats. The Islamic opposition party (PAS), which had made electoral inroads in 1999, was reduced to six seats in parliament and lost control of the state of Terengganu. The left of center Democratic Action Party (DAP), with predominately urban ethnic Chinese support, won 12 seats in parliament, and party chairman Lim Kit Siang became Leader of the Opposition in parliament.

Since taking office, Abdullah, an Islamic scholar, has promoted the concept of "Islam Hadhari" or "civilizational Islam," emphasizing the importance of education, social harmony and economic progress. Abdullah continues to place increased focus on rural development, including the agricultural sector. Unhappy with the cancellation of various development projects begun under the previous administration, Mahathir publicly criticized Abdullah on multiple occasions in 2006; however Mahathir's attacks were blunted when he failed to be elected as a delegate to the UMNO party convention in November.

Foreign Relations

Malaysia views regional cooperation as the cornerstone of its foreign policy. It was a founding member of the Association of Southeast Asian Nations (ASEAN) and served as the group's chair most recently in 2005-6. It hosted the ASEAN Summit and East Asia Summit in December 2005, as well as the ASEAN Ministerial and the ASEAN Regional Forum in July 2006.

Malaysia is an active member of the Asia Pacific Economic Cooperation (APEC), the Organization of the Islamic Conference (OIC), the Non-Aligned Movement (NAM), and the United Nations. It is the current chair of the OIC and has also chaired the NAM. Malaysia hosted the APEC Leaders' Meeting in 1998.

Malaysia is a frequent contributor to UN and other peacekeeping missions, including recent deployments to East Timor, Indonesia, Pakistan, Sierra Leone, Kosovo and Lebanon.

U.S.-MALAYSIAN RELATIONS. The United States and Malaysia share a diverse and expanding partnership.

Economic ties are robust. The United States is Malaysia's largest trading partner and Malaysia is the tenth-largest trading partner of the U.S. Annual two-way trade amounts to $45 billion. The United States is the largest foreign investor in Malaysia. American companies are particularly active in the energy, electronics and manufacturing sectors. The cumulative value of U.S. private investment in Malaysia exceeds $20 billion.

The United States and Malaysia launched negotiations for a bilateral free trade agreement (FTA) in June 2006. If the on-going negotiations are successful and the agreement is approved by Congress, Malaysia will become the largest U.S. trading partner with an FTA except for the NAFTA countries.

The United States and Malaysia enjoy strong security cooperation. Malaysia hosts the Southeast Asia Regional Center for Counterterrorism (SEARCCT), where over 1,100 officials from multiple countries have received training. The United States is the largest foreign provider of training courses at the center. The U.S. and Malaysia share a strong military-to-military relationship with numerous exchanges, training, joint exercises and visits.