

## Malaysia

<b>Status Index</b> (Democracy: 2.6 / Market economy: 3.9)		<b>6.5</b>	<b>Management Index</b>		<b>5.3</b>
<b>System of government</b>	Autocracy		<b>Population</b>	23.5 mill.	
<b>Voter turnout</b>	73 % (Parliamentary elections 1999)		<b>GDP p. c. (\$, PPP)</b>	8,750	
<b>Women in Parliament</b>	14.5 %		<b>Unemployment rate</b>	3.6 % (2000)	
<b>Population growth<sup>a</sup></b>	2.5 %		<b>HDI</b>	0.790	
<b>Largest ethnic minority</b>	26 %		<b>UN Education Index</b>	0.83	
			<b>Gini Index</b>	49.2 (1997)	
Data for 2001 – if not indicated otherwise. <sup>a)</sup> Annual growth between 1975 and 2001. Source: UN Human Development Report 2003.					

### 1. Introduction

The announcement that Mahatir Mohammad—head of Malaysia’s government since 1981 and wielder of strong political influence for the past two decades—will resign in fall 2003 may be a turning point in the country’s history. As Mahatir approaches the end of his many years in office, the verdict is mixed. The country’s political development is as disappointing as its economic achievements are impressive. For the most part, democratic institutions have been deprived of power. Violations of freedom of the press occur time and again. Freedom of assembly is restricted for political reasons. The number of arrests under the controversial Internal Security Act, which allows the government to detain individuals for up to two years by executive order, is on the rise—particularly in the fight against alleged Islamic terrorists.

Confidence in the judiciary’s independence has dropped sharply, particularly after Anwar Ibrahim, Mahatir’s one-time heir apparent, was put on trial. The period under study for this report (1998-2003) spans one of the most eventful and crisis-ridden periods in Malaysian history, including the Asian economic crisis and its aftermath. Malaysia ultimately weathered this period relatively well in economic terms and, remarkably, without a transfer of political power.

### 2. History and characteristics of transformation

In 1957, Great Britain granted Malaysia (then Malaya) independence. In 1963, Sarawak, Sabah (both located on the island of Borneo) and Singapore joined the federation now called Malaysia. Singapore was expelled in 1965. Malaysia is a

federation of 13 individual states, each of which has its own constitution (sultans or princes rule nine of the states), and a constitutional (elected) monarchy.

The federation's head of state is elected by the sultans and princes from among their ranks every five years. At the federal level, there is a bicameral legislature. Members of the House of Representatives or Dewan Rakyat are elected at least every five years in a first-past-the-post election from single-member constituencies. Some members of the Senate or Dewan Negara are elected by the state legislatures, and some are appointed by the head of state on the advice of the prime minister.

The relatively high degree of ethnic heterogeneity among the Malaysian population is a legacy of the colonial period. The British had fostered increased immigration of Chinese, who quickly developed Malaya's economic infrastructure as merchants and shopkeepers. When the country gained independence, Malays were a minority in their own territory. Therefore, an arrangement was made at Malaysia's outset that guaranteed the Malays political dominance. Today, it is an unwritten law that the president of the biggest Malay Party, the UMNO, is also the head of government. An alliance of parties soon developed, which included one party that represented Malay interests, one Chinese and one Indian. This alliance controlled the country's fate primarily through negotiations and agreements among its members.

This system collapsed in May 1969, when the Chinese party left the alliance after losing votes in the parliamentary elections, and violence between Malays and Chinese broke out in Kuala Lumpur, taking several hundred lives. New elections were held in 1971 after a brief interregnum in which a National Operations Council governed the nation. Since then, the parliamentary system has proved stable through regular competitive elections. The National Front or Barisan Nasional (BN), the multiparty coalition that has ruled since 1971 and which is dominated by the UMNO, usually holds a two-thirds majority in Parliament, allowing it to amend the constitution at will. Malaysia has made considerable progress in its economic development.

In response to the 1969 riots, the government began what is known as the New Economic Policy (NEP). The NEP lent momentum to market-oriented development but also gave special economic support to the Malays. In the 1980s, a broad-based privatization program was implemented, paving the way for a market economy.

In 1991, the NEP was replaced by a New Development Policy, which put more emphasis on distributive efficiency than the NEP had. With its "Vision 2020," the government aims to propel Malaysia into the ranks of the fully developed countries by 2020. However, no corresponding political development has been achieved. The state of political and civil liberties has deteriorated, particularly

under Mahatir's rule. Political action is still primarily shaped along ethnic lines. The government stokes fears that a change of governments would be tantamount to the Malays' loss of political dominance in their "own country" and undertakes everything it can to weaken the opposition.

### **3. Examination of criteria for democracy and a market economy**

#### **3.1 Democracy**

##### **3.1.1 Political organization**

(1) *Stateness*: There is no question of Malaysia's state identity. The government's monopoly on the use of force is without reservation. Although the definition of citizenship and who qualifies as a citizen of the state are to a great extent undisputed, ethnicity continues to play an important role. The Malay majority enjoys constitutionally established privileges in education, business and public office. Religion and state are not completely separate. For example, Islamic *sharia* law can be applied to civil matters between Muslims. Efforts to implement Islamic criminal law in individual states have failed due to the objections of the secular central government. The relationship between the state and Islam is becoming increasingly important in daily political affairs. An effective system of public administration, public safety and order are ensured.

(2) *Political participation*: Malaysia has established universal suffrage and the right to campaign for office. Elections are run correctly. However, the government respects the principles governing an open and competitive election process only within limits; it uses various measures to restrict the opposition parties' possibilities to campaign effectively.

The elected government has effective power to govern. There are no vetoing actors or political enclaves in the hands of the military. Problems exist in the implementation of the fundamental rights of political organizations and communication. State-run and private media are subject to government influence. In order to form, political and civic organizations must have the approval of the official Registrar of Societies, which has broad discretionary powers. The government can force labor disputes to be taken to the Industrial Court for arbitration; during this time strikes are forbidden, and anyone staging a strike is subject to imprisonment. The Court's decisions are binding. Freedom of information, speech and assembly exist only to the extent that their exercise does not have a "destabilizing" effect. Civic association is largely based on ethnic and/or religious affiliation.

(3) *Rule of law*: The separation of powers in Malaysia is inadequate. The executive branch usually controls a two-thirds majority of Parliament, so it easy

for it to make constitutional amendments. Although the judiciary sometimes tries to project an independent image, its actions can be disciplined by the executive, which can also influence the appointment of federal judges. There were indications of considerable manipulation of court proceedings by the government during the trial of Mahatir's former deputy prime minister and heir apparent, Anwar Ibrahim.

Corruption is a much talked-about problem. Corruption is facilitated in Malaysia by the close interconnection between politics and business and industry. Although cases of administrative corruption are apparently dealt with harshly and consistently, the prevailing feeling among the population is that fighting corruption among the governing elites is primarily a matter of political discretion. Political integrity is becoming increasingly important to the population. Opposition parties are successfully taking up the popular cause and presenting themselves as "clean" alternatives.

Civil liberties are not guaranteed across the board. Especially problematic and controversial in this respect is the Internal Security Act (ISA), which permits the police to incarcerate individuals for up to 20 days simply on suspicion. By decree of the minister of home affairs, this period can be extended to two years. More than 120 persons are currently being detained under the ISA. Reports of police torture are not uncommon. The human rights commission established by the government in 1999 is considered ineffective.

### **3.1.2 Political patterns of behavior and attitudes**

(1) *Institutional stability*: There are no obstacles to the interaction of the democratic institutions. In the past, conflicts between institutions, particularly between the executive and the judiciary or head of state, were resolved by granting the government new authority or restricting the authority of any institution that interferes with its actions. Parliament is the weakest democratic institution. It has little influence on political decision-making and does little to effectively regulate the actions of the executive. The judiciary is essentially effective, but is not invulnerable to political influence. Democratic institutions are not fundamentally compromised, but the extent to which they are respected, beyond formalities, is generally a matter of expedience, particularly on the part of the executive branch.

(2) *Political and social integration*: The Malaysian party system can be rated as stable despite its high degree of fragmentation; the governing Barisan Nasional alliance comprises twelve parties. Patronage plays an important role in political integration. The parties of the governing alliance are either ethnically or regionally oriented and, without exception, moderate. The system is further stabilized by the dominance of the United Malays National Organization, whose

leadership is the informal power center of the government. The party system is securely rooted in society and, to a great extent, replaces alternative forms of lobbying.

The governing BN alliance received 56.5 % of the votes cast in the last parliamentary elections, in November 1999. The opposition alliance, which received 45 % of the votes, had focused its campaign primarily on demands for more democracy. The intentions of voters for the Islamist Partai Islam Se Malaysia (PAS), which was part of the opposition alliance, are questionable. Social self-organization runs strongly along ethnic and/or religious lines. Trust within the population but among the different ethnic groups is fragile. In any case, the government uses the threat of ethnic tensions to justify limiting basic rights such as freedom of speech and freedom of assembly.

## **3.2 Market economy**

### **3.2.1 Level of socioeconomic development**

Malaysia has made continued headway toward its goal of becoming a fully developed economy by 2020. Malaysia's level of development, indicated by the HDI of 0.782 (table on socioeconomic indicators of modernization), means that some freedom of choice is possible for the majority of the country's citizens.

Progress was made in fighting poverty despite the Asian economic crisis. The percentage of Malaysians living on less than \$2 a day dropped from 11.5 % in 1996 to 5.1 % in 2000. At 49, the Gini index for Malaysia was very high at the start of the period under study (1997), even for Southeast Asia. The unequal distribution of income has ethnic consequences; in particular, ethnic Indians have gained little from the country's economic growth. Distribution is also uneven in regional terms. The states of Kelantan, Terengganu and Sabah lag behind the others in economic development. Investment in the educational system takes high political priority.

### **3.2.2 Market structures and competition**

*Principles of free-market competition:* The principles of free-market competition are safeguarded. However, problems arise as a result of the sometimes close ties among politics, business and industry because of the ruling parties' considerable economic activity. Politicians with equity interests in companies try to steer economic development to their own advantage. Public invitations to tender lack transparency and contracts are not awarded according to economic merits alone. The political aim of the NEP, to increase the number of Malay-run companies, led to discrimination against companies owned by ethnic Chinese Malaysians. Price

controls exist in some sectors, such as food, telecommunications and energy. Licensing requirements restrict market access in the transport and telecommunications sectors.

*Formation of monopolies:* To date, government regulations to safeguard competition exist only in the telecommunications and multimedia sectors.

*Liberalization of foreign trade:* In principle, foreign trade is liberalized, yet important exceptions remain in “sensitive” areas. The average customs tariff rate is 9.48 %, and tariffs are higher for highly processed products. For example, tariffs in the high-prestige automobile sector are more than 100 %.

*Banking system and capital market:* Malaysia’s capital market is fundamentally sound. Nonetheless, there are barriers to access in the financial sector, particularly for foreign investors. A consolidation of the banking sector, which was pushed ahead by policy-makers, reduced the number of local banking groups from 51 to 10. The fundamental confidence investors have in the capital market was evident when fewer foreign investors than expected withdrew from the market after the capital controls that had been imposed in the wake of the Asian economic crisis were lifted.

### **3.2.3 Stability of currency and prices**

Policies on inflation and currency are being harmonized with other economic policy goals. For years, the Malaysian government has successfully developed a sound macroeconomic policy. However, national debt rose sharply over the last few years, reaching 70.5 % of GDP at the end of 2001 due to the fiscal policy undertaken to soften the impact of the Asian crisis.

### **3.2.4 Private property**

Property ownership rights and the regulation of property acquisition are well defined in principle. However, the inadequate independence of the judiciary often limits protection from government infringement of those rights, at least theoretically.

Since the wave of privatizations that began in the mid-1980s, private enterprises have formed the backbone of the economy. Nevertheless, the state is unofficially heavily involved in economic activity (see above). Privatization is often the result of political rather than economic considerations. Important sectors of the Malaysian economy, such as the Petronas oil company, remain under state control.

### 3.2.5 Welfare regime

There is no comprehensive state-sponsored social welfare system in Malaysia. Particularly in the poorer segments of the population, providing support against social risks still falls primarily to the family. The government invests 8 % of GDP in social welfare, health care and education. Basic medical care is available to all. There is no unemployment insurance.

### 3.2.6 Strength of the economy

GDP growth is relatively high. The macroeconomic data are partly positive, partly only moderately positive, but seem reliable. The current global economic slowdown presents a big problem for export-oriented Malaysia, where the ratio of goods and services exports to GDP was still 117 % in 2001.

### 3.2.7 Sustainability

The basic outline of a social network for offsetting poverty and social risks exists. Private solidarity networks bear most of the burden. Government spending for social welfare accounted for only 1.4 % of GDP on average for the period from 1991-1997.

Although environmental concerns receive lip service, they tend to take a back seat to economic growth. Investment in education is relatively high, at about 5 % of GDP on average, or 19 % of the national budget. The government has recognized that Malaysia's economic survival in the global market is only possible if the population is sufficiently well trained and educated. Nine year of school attendance is compulsory. Private universities are allowed since very recently.

## 4. Trend

(1) *Democracy*: Malaysia lost some ground on its way to developing a democracy based on the rule of law, particularly in the wake of the Asian economic crisis and the fight against international terrorism since September 11, 2001. The trial of Anwar Ibrahim illustrated the legal system's susceptibility to political manipulation. The brief phase of economic contraction in 1998 and the government's crackdown on suspected terrorists both resulted in substantial restrictions on civil liberties and civil rights. The number of arrests made under the controversial Internal Security Act increased. Prominent opposition politicians are among the detainees. The opposition Barisan Alternatif (BA) alliance, which gave the ruling BN a serious run for its money in the 1999 elections, fell apart. The main reason for its disintegration was a difference of opinion between the

Islamist PAS and the moderate Chinese-oriented Democratic Action Party (DAP) about the political role of Islam. The government's response to crises shows that stability takes precedence over democracy and that its confidence in the capacity of democratic process is weak.

(2) *Market economy*: The level of development improved slightly in the last few years. The HDI for Malaysia was 0.760 in 1995 and increased to 0.782 in 2000, despite the effects of the Asian economic crisis. The institutional framework of the Malaysian economy improved during the period under review. Reforms were implemented and are being implemented in corporate governance. The banking system was consolidated, and Malaysia is beginning to develop a regulatory system to safeguard competition. Both the telecommunication and the multi-media sector are forerunners in this respect. But the protection of competition still ranks second behind "national interests". It is problematic in this respect that the decision on whether a certain behavior is causing competitive disadvantages lies with the responsible minister, not with the regulation authority.

Growth is steady. At the margin, the growing national debt, which is meant to deal with the negative effects of the Asia crisis, might pose a problem (70,7 % of GDP at the end of 2001). Foreign debts amounted to 51.8 % at the end of 2001.

**Table: Development of socioeconomic indicators of modernization**

	<b>HDI</b>	<b>GDI</b>	<b>GDP index</b>	<b>UN education index</b>	<b>Political representation of women</b>	<b>GDP per capita (\$, PPP)</b>
1998	0.772	0.762	0.73	0.79	12.2	8,137
2001	0.790	0.784	0.75	0.83	14.5	8,750

Sources: UNDP, Human Development Report 2000, 2003.

**Table: Development of macroeconomic fundamentals**

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
GDP growth, in %	-7.4	6.1	8.3	0.4	5.2 (est.)
Export growth, in %	-7.3	16.8	17.0	-8.8	7.0 (est.)
Import growth, in %	-26.6	12.8	26.2	-7.6	10.0
Inflation, in % (CPI)	5.3	2.8	1.6	1.4	1.3
Unemployment, in %	3.2	3.4	3.6	3.6	n. a.
Budget deficit, % of GDP	1.8	3.2	5.8	6.7	5.2
Current account balance, in billions of \$	9.539	12.606	8.401	6.859	4.934

Source: ADB Outlook 2001 und 2002; Department of Statistics, Malaysia (internet).

## **5. Transformation management**

### **5.1 Level of difficulty**

The baseline position of the Malaysian economy is good. With a per capita income of \$9,068 (PPP), Malaysia is on the threshold between the middle-income and high-income countries. In education, as well, Malaysia is closing in on the top group (UN education index 0.8). Malaysia's main burden remains the segmentation of the society in ethnic groups, which helps to explain the disparity between the nation's economic and political transformation. The fact that the Chinese minority is economically much more successful than the Malayan majority does not make things easier. Another factor that shows the level of difficulty in the process of political transformation is the cleavage between Muslims and non-Muslims.

There is a definite tradition of civic organizations, but their activities are heavily restricted by the government. Malaysia combines a large governmental capacity with inadequate rule of law.

### **5.2 Reliable pursuit of goals**

Malaysia's transformation policy is a long-term one. The government sets strategic priorities. The highly successful New Economic Policy (NEP) from 1971–1991 was a sort of “affirmative action” program, aimed primarily at improving the relative position of Malays in Malaysian society. It was followed in 1991 by the more generally growth-oriented New Development Policy and the

“Vision 2020” plan, which expressed the goal of becoming a fully developed nation in economic terms by 2020.

With respect to the economy, the government’s reform policy is stable. However, backward steps have been made in the rule of law and the fundamental primacy of political decision-making, which does little to bolster confidence among economic actors over the long term. The government is pursuing a reliable, predictable policy line, although the introduction of controls on capital flows during the Asian economic crisis was a surprise to most observers. It remains to be seen what effect the transfer of leadership from Mahatir Mohammad to Abdullah Ahmad Badawi in fall 2003 will have in this respect.

### **5.3 Effective use of resources**

The government’s use of available personnel, financial and organizational resources is largely efficient. The current budget deficit is the result of efforts to deal with the Asian economic crisis. The government is already pursuing a course of consolidation. Yet there are repeated indications that funds are primarily benefiting “well-connected” businesspeople because of ties between the governing parties and business and industry. Long-time finance minister and political heavyweight Daim Zainuddin was toppled in 2001 by accusations that he had used public money to help out ailing companies belonging to friends.

The government is usually able to achieve its reform goals. It provides public services that match the development needs of the economy and society and promote development. The government’s efforts to check corruption are inadequate. The low level of political development has an adverse effect in this respect. For example, Malaysia does have an anti-corruption office, but when a member of the opposition published classified documents revealing that investigations into two high-ranking politicians had not led to indictments despite probable cause, the opposition politician was convicted of betraying official secrets and sentenced to two years in prison. There were no consequences for the incriminated politicians. Whether a corruption case is prosecuted—especially one involving high-level politicians—still appears to be a matter of the government’s discretion.

### **5.4 Governance capability**

Leading politicians are capable of learning and replacing failed policies with innovative ones. The problems that resulted from the government-initiated industrialization in the mid-1980s led to a huge wave of privatizations. The decision on instruction in public schools in Malay instead of English is currently

being reconsidered, particularly in the natural sciences. The government is even openly addressing the problems caused by the NEP.

However, the government's creative drive sometimes results in the misallocation of resources, financing prestige projects that will not contribute in any way to economic productivity. One such example is the highly controversial Bakun dam project. The close connections among politics, business and industry also often result in misallocation of resources. It remains to be seen to what extent reforms in corporate governance will help. In principle, the reformers' actions show political acumen, but it is not clear what the long-term consequences will be if democratic reforms are not undertaken.

### **5.5 Consensus-building**

The key decision-makers agree that a market economy should be developed in Malaysia. However, on the question of building democracy, conflicts exist between government and opposition, as well as within the opposition itself. The opposition attacks the government's lack of democratization and its money politics—an issue that includes questions of political order. Within the opposition, there is a rift between the PAS, which wants Islam to play a greater role in Malaysian politics, and the rest of the parties, which are more secular. Ethnic segmentation poses a persistent problem.

The government's response is to defuse conflicts between ethnic groups by involving them in the government and prohibiting actions that appear to increase tensions. In addition, a special promotion policy is in place for the Malay population, which is supposed to help stave off resentment toward the ethnic Chinese Malaysians, who are generally more successful economically. Yet the ethnic Indian minority, which threatens to fall even further behind, has received no such attention from the government.

The government has no doubt been successful in strengthening or maintaining sense of community among the Malays. The active policy of promoting Malays has also resulted in increased inequality within the Malay population, because funds and economic rights are not allocated evenly among all Malays. The willingness of other ethnic groups, in particular the Chinese, to provide for the whole of the population is due primarily to their understanding that it contributes to the nation's stability, i.e. to keeping ethnic conflicts from erupting.

### **5.6 International cooperation**

The Malaysian government is rather selective in its cooperation with international donors. Prime Minister Mahatir was one of the spokespersons in the debate about

“Asian values” and continually takes a stand against alleged attempts of Western nations to force their values upon Malaysia. Malaysia is a member of the Asian Development Bank, the IMF and the World Bank, but keeps the option open to act on its own authority. For example, during the Asian crisis, Malaysia rejected IMF reform measures, pursuing its own course and imposing controls on the flow of capital.

In this way, the government gives the international community an impression of limited predictability. Even in cases in which one must assume that Malaysia will go its own way, one can nevertheless predict roughly which direction it will take. The rating agencies give Malaysia an investment grade rating across the board for its long-term government bonds denominated in domestic currency.

Malaysia is actively cooperating within ASEAN and is one of the main proponents of an Asian Free Trade Area (AFTA). In addition, Malaysia was one of the initiators of the Zone of Peace, Freedom, and Neutrality (ZOPFAN), that aims to reduce intraregional tensions within Southeast Asia.

## **6. Overall evaluation**

This report comes to the following conclusions with respect to the baseline conditions, current status and evolution, and management of affairs by the actors:

*(1) Baseline conditions:* The baseline conditions for transformation were rated as positive overall. Functional and efficient market-economy structures existed before the period under review, but they were often marked by too close a connection among politics, business and industry. The Malaysian government must also be rated as very efficient. Malaysia’s main difficulty in transformation lies in overcoming the considerable ethnic heterogeneity that is crippling the political system; this is often used as justification for putting off democratic reforms. In addition, tensions between Islamist and secular tendencies have recently become increasingly prevalent, dividing the opposition and giving the government yet another excuse for restricting political and civil liberties.

*(2) Current status and evolution:* During the period under review, Malaysia made no progress toward political development. The trial of Anwar Ibrahim, which was largely politically motivated, aroused the ire of many citizens, but the wave of protests was not enough to threaten the ruling coalition’s majority in the 1999 elections. From a positive point of view, one could note that political stability remained intact. In the fight against international terrorism, the government stepped up its use of repressive instruments, such as restrictions on freedom of the press and detentions under the Internal Security Act. The oppositional Barisan Alternatif alliance fell apart, not least due to the dispute over the role Islam should play in Malaysian policy.

Malaysia's market-economy transformation moved forward during the period under review, particularly through its handling of the Asian economic crisis. Reforms in corporate governance were introduced, one of which gave more rights to minority shareholders. The banking sector was consolidated and the problem of irrecoverable loans now seems manageable. The intention to implement reforms to protect fair competition is another positive development. After suffering an economic contraction of 7.4 % in 1998, Malaysia has gotten back on track for growth. However, it has not yet achieved the same growth rates across the board as it did before the Asian economic crisis. A side effect of the relatively weak economy was the expansion of the budget deficit over the past few years.

## **7. Outlook**

The change at the head of government in October 2003 will be a key factor for Malaysia's development. It remains to be seen whether Mahatir's designated successor, Ahmad Abdullah Badawi, will be able to hold a similarly strong position. The political problems Mahatir leaves to his successor are not insignificant. The government has not been entirely uninvolved in the increase in Islamist tendencies. Badawi has a stronger Islamic background than his predecessor.

The phenomenon of Islamization in Malaysia is associated with the unresolved matter of overcoming the prevailing tendency to think in ethnic categories, as Islam is primarily the religion of the Malays. The policy of "affirmative action" over the past years has not yielded only positive results. Some observers believe they now see an increasing subsidy mentality among the Malays. The tolerance that other ethnic groups have shown toward the Malays' privileges is waning. It is doubtful that the newly introduced "national service year" can achieve its purpose: to instill a sense of the common good into Malaysia's young people.

Malaysia's greatest economic challenge stems from the rise of China, which is increasingly competing with Malaysia for market share and foreign direct investment. Malaysia has recognized this threat and is revamping its economic structure to place greater emphasis on the IT sector. A continued economic crisis would severely test the current government's legitimacy. What effects would this ultimately have? Would it spark a push toward democratization or would it ignite an all-out government crisis due to a flare-up of ethnic conflicts or an attempt to Islamize the nation? These will be decisive questions.