MALAYSIA
An Economy Transformed

Australian Government
Department of Foreign Affairs and Trade
Economic Analytical Unit

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The Economic Analytical Unit (formerly the East Asia Analytical Unit) is part of the Department of Foreign Affairs and Trade and is responsible for publishing reports analysing major trade and economic issues of relevance to Australia.

The Economic Analytical Unit is staffed with six economists and has produced 35 major reports since its establishment in 1990. Executive Summaries of the reports and information on how to purchase reports are on the Unit's website.

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Southeast Asia
Capital
City
0 750 km
0 500 nautical miles
China
Taiwan
Hainan
Burma (Myanmar)
Thailand
Laos
Vietnam
Cambodia
Malaysia
Singapore
Brunei
Philippines
Indonesia
Papua New Guinea
Australia
India
Bhutan
Bang.
Federated States of Micronesia
South China Sea
Pacific Ocean
Indian Ocean
Philippine Sea
East China Sea
Java Sea
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Celebes Sea
Banda Sea
Timor Sea
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Flores
Andaman Sea
Gulf of Thailand
Gulf of Tonkin
Strait of Malacca
Luzon Strait
Tropic of Cancer
Equator
Borneo
Sumatra
Java
Celebes
Luzon
Mindanao
Kuala Lumpur
Bangkok
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EXECUTIVE SUMMARY

Malaysia is an economy on the move. The average income of Malaysians today is two and a half times higher than it was 15 years ago. Malaysia's impressive economic performance has pushed poverty down to levels lower than many economies in the region. Unemployment and inflation also are low, even by developed country standards. Some structural issues need addressing but, on balance, Malaysia's economic performance is a 'good news' story. Malaysia's economic development presents good prospects for robust trade and investment growth in the medium to long term with Australia.

FROM AGRICULTURE TO ELECTRONICS

The transformation began more than three decades ago, when the Malaysian Government embarked on a campaign to industrialise Malaysia. At Independence in 1957, Malaysia was reliant on tin, rubber and palm oil for its foreign exchange earnings. While palm oil earnings remain significant – Malaysia is the largest exporter of palm oil in the world – elaborately transformed manufactures in the shape of electronics and electrical products now dominate Malaysia's exports. In 2002, Malaysia was the world's fifth-largest exporter of semi-conductors. Large inflows of foreign direct investment have spurred the development of Malaysia's manufacturing sector.

Benefits of openness

Low average tariffs, modest inter-industry tariff dispersion and limited incidence of non-tariff barriers characterise Malaysia's trade regime and have assisted Malaysia's industrial development. Malaysia is the fourth most open economy in the world, measured by trade as a share of GDP. The relatively small size of the Malaysian economy – it has the population of Australia but output is only just larger than the Queensland economy – means exports have played a crucial role in sustaining rapid economic growth.

Growth and development

Economic growth and social development have gone hand-in-hand. Unemployment has been low and most Malaysians who want a job can find one. Inflation has been contained, ensuring Malaysian purchasing power has not been eroded. Per capita income in 2003 was more than two and a half times larger than the level 15 years ago; real per capita income was 70 per cent larger over the same period. Where nearly one third of Malaysians were living in poverty in 1980, only five per cent were doing so in 2002. Hardcore poverty – defined as half the poverty line income – is down to one per cent. Students are staying at school longer, more are pursuing tertiary education and, as a result, literacy rates have risen appreciably. Most of the country has access to basic services such as water, electricity and roads. Fixed line phone coverage is somewhat limited, but Malaysians have compensated for this by voraciously adopting mobile phone technology.

Learning the economic lessons

Until the Asian financial crisis, Malaysia was on track to achieve an eight-fold increase in real GDP by 2020, as outlined in the Vision 2020 statement, released in 1991. The Asian financial crisis highlighted the vulnerability of the Malaysian financial sector, and immediate steps were taken to strengthen the banking system and capital markets. The 2001 international dotcom contraction slowed growth significantly, prompting Malaysia to investigate ways to strengthen productivity and economic efficiency to cushion the economy from other external shocks.

LINKING AUSTRALIA AND MALAYSIA

The Australia-Malaysia bilateral relationship is diverse, but educational links in particular stand out. However, the level of Australian investment in Malaysia is modest despite generally favourable conditions.

The comfort factor

Many rules and regulations governing business in Malaysia are similar in nature to Australian legislation and regulations. Examples include tax, company and securities laws; listing rules on Bursa Malaysia and the Australian Stock Exchange; and financial reporting frameworks for companies. Like Australia, Malaysia uses the Torrens land title system and Common Law. Accounting standards in Australia and Malaysia are based on International Accounting Standards. Malaysia, supported by large oil reserves, has invested heavily in economic infrastructure – roads, airports and utilities – and these are at developed world standards.

The trade relationship

The commercial trading relationship between Australia and Malaysia is strong. Malaysia is Australia's tenth-largest trading partner and Australia is Malaysia's 14th largest trading partner. Key imports from Malaysia include information and communication technology products and petroleum. Key exports to Malaysia are agricultural products, mineral-based manufactures and education-related travel services. Few barriers exist on products traded between the two countries, though there are exceptions, such as fully assembled cars.

Education

Deep educational links exist between Malaysia and Australia. Malaysia is Australia's third-largest source of students and nearly 200 000 Malaysians have graduated from Australian universities. Australian-trained Malaysian graduates are in most sectors of the economy, particularly commerce, business and information technology; CPA Australia has about 8 000 Malaysian members. Of the five foreign campuses operating in Malaysia, three are Australian.

BEYOND MANUFACTURING

The Malaysian economy has been transformed and its financial institutions strengthened. But per capita income remains modest and China's industrial rise poses challenges for Malaysia's manufacturing base. Further income growth requires a better-educated workforce and a more entrepreneurial and competitive business environment.

The hand of government

The Malaysian Government has a strong presence in the economy. In 2004, the Malaysian Government oversaw 40 listed government-linked companies, accounting for around 34 per cent of the total market capitalisation of Bursa Malaysia. The combined assets of these companies are approximately RM232 billion or more than half of Malaysia's GDP. Petronas, the oil and gas giant and by far Malaysia's largest company, is wholly Government owned. Government controlled institutions have a majority equity stake in seven of the top ten listed companies and also hold 'Golden Shares' in strategic national companies such as Malaysian Airlines, Telekom Malaysia and Tenaga Nasional – an electricity company – which give the Government the final decision in the corporate direction of these businesses.

To raise efficiency and transparency in government-linked companies, the Malaysian Government introduced Key Performance Indicators and Performance-Linked Compensation for managers of these companies. There are indications that companies in less 'strategic' industries such as construction, property development and building materials may be short-listed for privatisation.

Bumiputera requirements

Part of the Malaysian Government's development agenda is to ensure more active *bumiputera* – mainly ethnic Malays and other indigenous groups – participation in Malaysia's economic community. Policies to encourage *bumiputera* involvement include awarding large government contracts to *bumiputera* companies; requiring new listings on Bursa Malaysia to have an initial 30 per cent *bumiputera* equity ownership; concessionaires in any privatisation allocating at least 30 per cent of contractual works to *bumiputera* contractors; requiring companies involved in privatisation to offer employment opportunities to *bumiputera* individuals; ensuring a minimum of 60 per cent of government procurement, contract work and other related projects is awarded to *bumiputera* entrepreneurs; and making available 18 funds for the exclusive use of *bumiputera* to obtain finance. Such policies can be restrictive on business activity and can focus entrepreneurial effort on rent-seeking behaviour. To this extent, the policies may be counterproductive and thwart the development of a vibrant and resilient *bumiputera* business community.

Cautious investors and bankers

Private investment – both domestic and foreign – is considerably lower than what it was prior to the Asian financial crisis. The Malaysian Government has used deficit financing to invest heavily, but this is not sustainable and private investment will have to increase if economic growth is to maintain its current momentum. Although the Asian financial crisis occurred seven years ago, bank lending to the corporate sector has remained subdued.

Strategies to improve private investment include special finance funds for small and medium enterprises and investment incentives for operations ranging from duck rearing to hotel development. More importantly, the Malaysian Government has taken steps to improve the business environment. These include strengthening the financial sector, removing the *bumiputera* ownership requirement for new manufacturing investment, investing in transport and communications infrastructure, and liberalising foreign exchange controls, stockbroking and funds management.

China's industrial rise

China's rise as a manufacturing superpower poses challenges to Malaysia's economy because China competes with Malaysia in around 70 per cent of Malaysia's product exports. Many Malaysian commentators view China as an opportunity rather than a threat, remarking that a strong China is good for the region and good for Malaysia. While few complementarities seem to exist between the two economies, exports to and imports from China have more than doubled since 2000. The Malaysian Government is promoting a "China plus one" strategy. This strategy envisages China as a base for low-skilled labour-intensive manufacturing with a second base in Malaysia to undertake more complex manufacturing and design.

Improving Malaysian skills

Improving the skills of Malaysians is a crucial part of the Malaysian Government's strategy to move to an economy producing high value-added manufactures and services. Malaysia's education levels are high among economies in the region, but a severe shortage of scientists, technology professionals and English, mathematics and science teachers is causing concern. Among other plans, the Malaysian Government is expanding the capacity of existing universities so that 30 per cent of the 17 to 23-year-old age group are in tertiary education by 2005. They also are adopting lifelong learning programs and adopting English in primary and secondary schools as the medium of instruction for mathematics and science.

OUTLOOK PROMISING

Malaysia's economic performance to date has been impressive and the outlook for continued high growth rates is good. As Malaysia embarks on the next stage of development, the complementarities between the Malaysian and Australian economies will provide even greater opportunities for deeper economic integration. The Malaysia-Australia free trade agreement scoping studies currently underway reflect the close commercial relationship and a shared vision of an even closer future. Australian companies are well placed to be a part of Malaysia's growing prosperity.

THE TRANSFORMATION

KEY POINTS

- **Since independence in 1957, the Malaysian economy has transformed itself from a commodity-based economy to one of the world's largest producers of electronic products.**
- **Malaysia now is a high middle-income, export-oriented economy.**
- **Malaysia is the fourth most open economy in the world, measured by trade as a share of GDP.**
- **Social indicators covering poverty, health, education and access to basic infrastructure have improved dramatically, in line with strong economic growth.**
- **Thanks to the underlying resilience in the economy and timely responses from government, Malaysia coped with the Asian financial crisis better than most other economies in the region.**
- **The Government maintains strong links with many listed companies, in several cases owning majority shareholdings. Greater private domestic investment would raise productivity and contribute to further increases in per capita income.**

The Malaysian economic story is a "good news" story. Malaysia is a high middle-income, export-oriented economy. Careful economic planning and management helped build Malaysia's strong economic performance since the 1970s, transforming the economy from a focus on commodity production to one of the world's largest producers of electronic and electrical products. The average Malaysian's quality of life also has improved in line with the stronger economic growth. The challenge now for Malaysia is to maintain this momentum.

HISTORICAL PERFORMANCE

Since independence in 1957, the Malaysian economy has transformed itself from a commodity-based economy to one of the world's largest producers of electronic products. Inflation has remained contained and compares favourably with other economies in the region. In 2002, the Malaysian economy was one of the most open in the world, as measured by trade as a share of GDP.

The focus of macroeconomic management through the 2001 to 2005 planning period is on low and stable inflation, an adequate level of national savings, a balance of payments surplus, a stable exchange rate, debt sustainability, fiscal prudence and strong and unencumbered external reserves (Economic Planning Unit, 2003).

Output

Prior to establishing the New Economic Policy in 1970, Malaysia predominantly was a commodity-based economy, relying on rubber and tin. There also was a program of import substitution, manufacturing consumer goods for the domestic market. The New Economic Policy saw a policy switch by the Malaysian Government, pursuing a two-pronged policy approach of export promotion and import substitution. By the mid-1970s, electronics, electrical products, textiles, clothing and food manufactures were all making export gains (Ariff, 1991). In part, the New Economic Policy provided a blueprint for an active policy to raise Malay participation in business. The Malaysian Government was aided in its development plans by an increase in oil revenue; between 1973 and 1977, total government revenue more than doubled, and the share of oil in the revenue take increased from 1.5 per cent to 11.4 per cent. Within 10 years, per capita income had more than quadrupled, albeit from a low base (Figure 1.1).

The Malaysian Government announced Vision 2020 in 1991 following several years of slow growth relative to the 1970 to 1980 period. Vision 2020 outlined a broad plan for Malaysia to achieve developed economy status by the year 2020. Specific targets in the statement included increasing real GDP eightfold between 1990 and 2020 – translating to average annual growth of seven per cent – and increasing per capita income by a factor of four. In broader terms, attaining economic competitiveness involved sectoral diversification, productivity gains, technology usage, low inflation and entrepreneurship. The Government expected to support these goals through providing a supportive legal and regulatory environment, prudent fiscal and monetary policy management, supportive physical infrastructure and economic deregulation. The policy also stated that the Government would reduce its role in

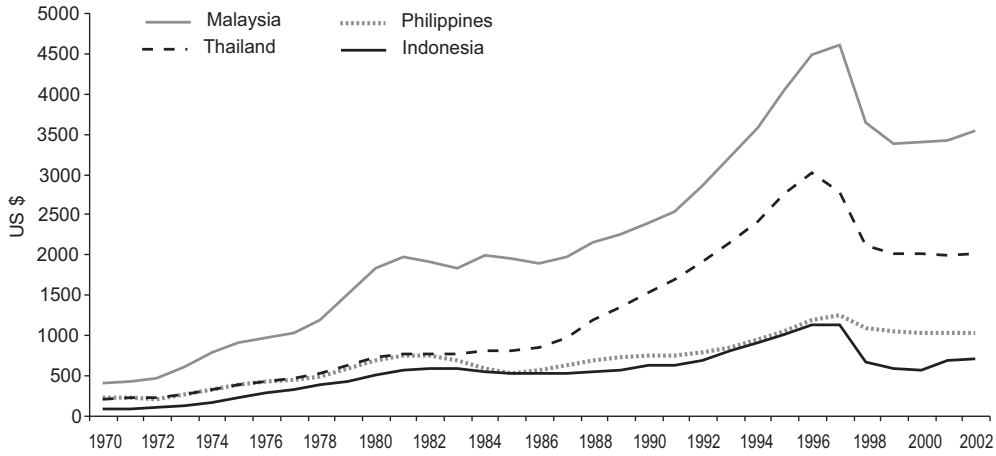
economic production and business, but left open the option to intervene if authorities deemed it necessary in order to achieve their goals. After announcing Vision 2020 and the requisite 'Master Plans', per capita GDP rose over 80 per cent in the seven years to 1997 (Figure 1.1).

Up until 1997, real GDP growth was ahead of schedule in terms of attaining an eightfold increase in real GDP by 2020. However, the Asian financial crisis saw real GDP fall dramatically in 1998. Since then, output has recovered, with the exception of 2001 where the international dotcom contraction adversely affected growth.

Figure 1.1

Per capita GNI grows strongly

GNI per capita, Malaysia, Thailand, the Philippines, Indonesia, US$ Atlas method, 1970 to 2002



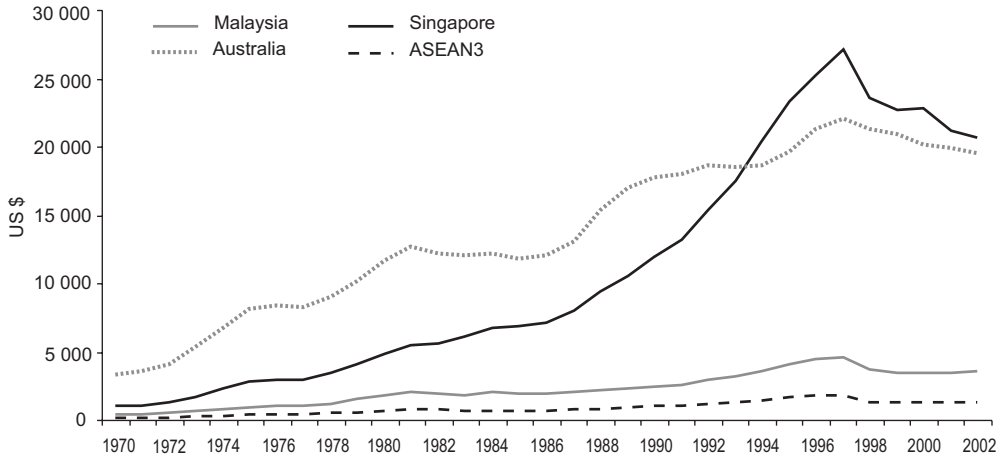
Source: World Bank, 2003.

Figure 1.2 shows how far Malaysia has come since 1970 but more importantly, how far it still has to go. Economic growth over the past three decades has been substantial enough to ensure per capita income is larger than Indonesia, the Philippines and Thailand. However, per capita income remains much lower than either Australia or Singapore, illustrating the scope of the task ahead for Malaysia to achieve its development goals.

Figure 1.2

Per capita GNI still lags Singapore, Australia

GNI per capita, Malaysia, ASEAN3, Australia, Singapore, US$ Atlas method, 1970 to 2002



Note: ASEAN3 includes Indonesia, the Philippines and Thailand.

Source: World Bank, 2003.

Manufactures growing in importance

In the past 25 years, Malaysia has developed rapidly from a commodity-based economy to one dominated by intermediate manufacturing (Figure 1.3). Manufacturing production accounted for almost one third of 2003 Malaysian output, up from around one quarter ten years earlier. Within manufacturing, output more than doubled in rubber compound, liquefied petroleum gas, integrated circuits and passenger cars between 1998 and 2003. Output of commercial vehicles more than quadrupled over the same period, although the import market for fully assembled vehicles essentially remains closed (Bank Negara Malaysia, 2004b). At present, over three quarters of foreign direct manufacturing investment approvals are in basic metal products, transport equipment and electrical and electronic products.[1]

Within manufacturing, the Malaysian economy is moving towards high technology and knowledge-intensive manufacturing. Since 1987 (the earliest year for which data is available), the electronics sector has grown more than eightfold in real terms, increasing its share of manufacturing output from 14 per cent in 1987 to 27 per cent in 2003.

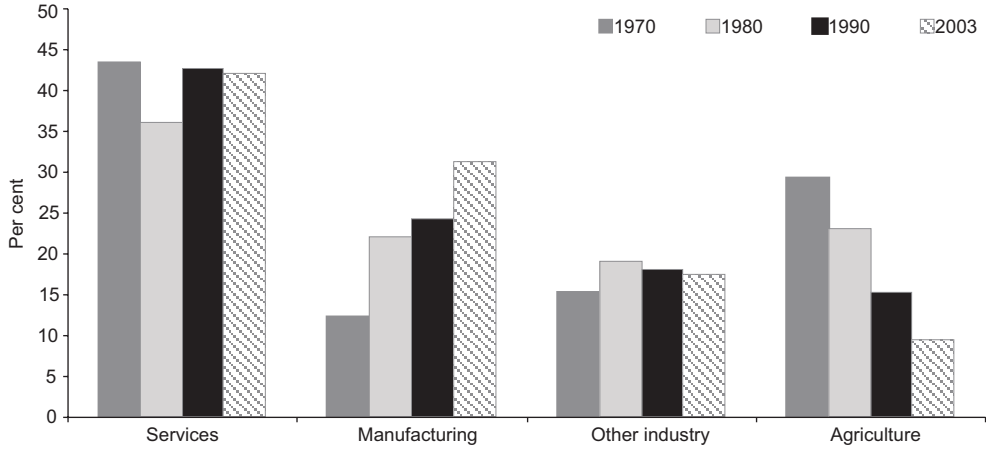
In 2003, manufactures accounted for 79 per cent of merchandise exports, of which 67 per cent were electrical and electronic products. Chemical products make up another seven per cent of exports, followed by machinery appliances and parts (four per cent) and wood products (four per cent).

1 Investment data are available for manufacturing only, and only for approvals.

Figure 1.3

Manufactures and services the most important industries

Malaysian industry output as a share of GDP, per cent, 1970 to 2003



Note: Other industry includes mining, construction and utilities.

Source: CEIC 2004; UNCTAD 2003.

Services

The service sector in Malaysia, as a share of GDP, has remained relatively flat over the past 30 years, at around 40 to 45 per cent of GDP (Figure 1.3). The largest sub-sector is wholesale and retail trade, restaurants and hotels. Retail and tourism were particularly vulnerable to the 2002 Severe Acute Respiratory Syndrome (SARS) outbreak but are starting to recover from this setback (Asian Development Bank, 2004a). As the Malaysian economy becomes more broad-based, it is moving towards promoted services sectors such as tourism, health, information technology, research and development, and training.

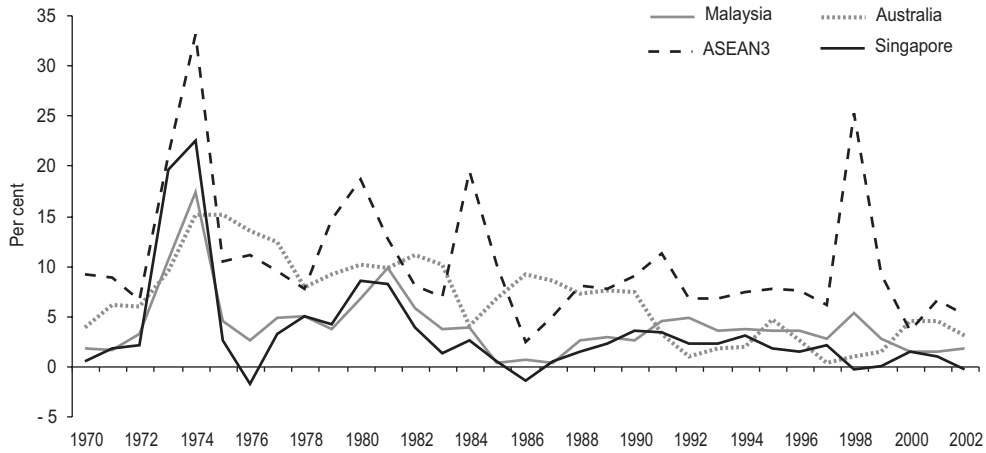
Inflation

Malaysian inflation since the 1970s compares favourably to other economies in the region (Figure 1.4). Inflation is well under control in Malaysia, having been below two per cent in each of the last four years to 2003 (Bank Negara Malaysia, 2004b). Prudent macro-economic policies, low imported inflation, stability of the exchange rate peg and excess capacity in some sectors of the economy helped achieve low and stable inflation (International Monetary Fund, 2004). The Malaysian Government has price controls on selected goods, including petrol, but the number of goods they cover is small.

Figure 1.4

Inflation contained

Inflation rate, Malaysia, ASEAN3, Australia, Singapore, per cent, 1970 to 2002



Note: ASEAN3 includes Indonesia, the Philippines and Thailand.

Source: World Bank 2003.

Openness

Malaysia's position as an open economy is well established. The relatively small size of the Malaysian economy – which has a population of 24 million and GDP per capita of US$3880 – means exports have played a crucial role in sustaining rapid economic growth (Figure 1.5). Overall, Malaysian trade accounts for 208 per cent of GDP and net exports contributed 2.0 percentage points to real growth in 2003 (Bank Negara Malaysia, 2004b).[2] In 2002, Malaysia was the fourth most open economy in the world – as measured by the export share of GDP – behind Singapore, Hong Kong and Luxembourg, arising from a strong focus on products that service the export market as well as a large import content in export production (International Monetary Fund, 2003). Malaysia has developed a strong comparative advantage in electronics and electrical product manufacturing for export, and currently is the world's fifth-largest exporter of semiconductors.

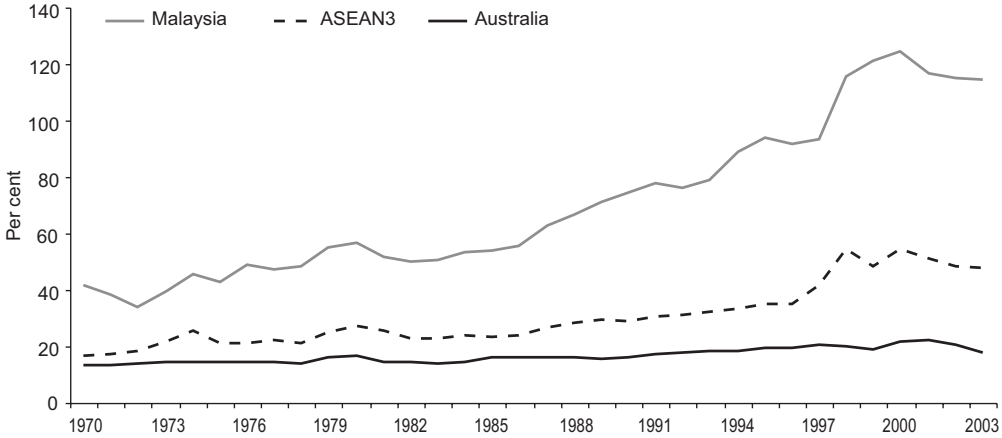
Malaysia generally has a healthy external sector. The current account has been in surplus for the past six years. In 2003, the foreign debt service ratio was 6.1 per cent of exports and the bulk of external debt – 82 per cent – was medium to long term obligations (Bank Negara Malaysia, 2004b). The World Bank considers Malaysia a "moderately" indebted nation and debt as a share of exports of goods and services is considerably lower than that for upper middle-income economies as a whole – 45 per cent compared to 100 per cent (World Bank, 2004). Net foreign reserves are increasing, covering nearly seven months of imports (Economic Planning Unit, 2004).

2 Trade can account for more than 100 per cent of GDP because GDP includes net exports, that is, exports minus imports, whereas trade is the sum of both imports and exports.

Figure 1.5

Exports growing rapidly

Exports of goods and services as a share of GDP, Malaysia, ASEAN3, Australia, per cent, 1970 to 2003



Note: ASEAN3 includes Indonesia, the Philippines and Thailand.

Source: CEIC, 2004; Australian Bureau of Statistics, 2004.

Government willing to use deficit spending

In the five years to 1997, the budget was in surplus, averaging 1.3 per cent of GDP. Since 1998, the Malaysian Government has shown itself willing to use the budget to mitigate adverse shocks such as the Asian financial crisis, the SARS epidemic and weak international demand. It has adopted a more expansionary stance to support growth, with the budget deficit averaging 4.5 per cent of GDP between 1998 and 2003. This has allowed the Government to maintain a stable macro-economic policy environment that facilitates economic growth (Asian Development Bank, 2004a).

The Government's current objective is to reduce the federal budget deficit by cutting expenditure, delaying tax cuts and improving the efficiency of the tax system by introducing, for example, a broad-based tax such as a goods and services tax to replace the sales and services taxes. The Government estimates a budget deficit of 4.5 per cent of GDP in 2004 and expects it to decline to 3.8 per cent of GDP in 2005. While the Government does not have a specific timeframe for a balanced budget, most analysts expect it to be around 2007. Detailed information on the budgetary impact of exemptions and implicit subsidies to enhance fiscal transparency is not readily available, with little information by outcome or by ministry. This makes it difficult to determine the sustainability of government expenditure (International Monetary Fund, 2004).

COPING WITH THE FINANCIAL CRISIS

The Asian financial crisis impacted greatly on the Malaysian economy. Growth fell sharply and unemployment rose significantly. Timely responses from government enabled the Malaysian economy to weather the Asian financial crisis better than other regional economies. To help strengthen Malaysia's financial and capital markets, the Government introduced the Financial Sector Master Plan and the Capital Market Master Plan, whose policies would be implemented between 2001 and 2010.

In contrast to several other economies in the Asian region – including the Republic of Korea – Malaysia did not require IMF assistance to cope with the aftermath of the regional financial meltdown. Nevertheless, they did implement measures consistent with IMF recommendations, such as fiscal restraint in the early stages of the crisis.

THE ASIAN FINANCIAL CRISIS

Before the 1997-98 Asian financial crisis, East Asia enjoyed enormous economic success. Since the 1960s, East Asian economies had grown faster than any other region's, and absolute poverty had declined significantly. Between 1975 and 1995, the poverty rate dropped 95 per cent in Malaysia, 90 per cent in Thailand, 82 per cent in Indonesia and 63 per cent in China. However, in many regional economies, financial sectors formed the weak link in development strategies. Because many financial sectors were protected from foreign and domestic competition, regulated poorly or subjected to government credit allocation and interest rate intervention, they often were inefficient, poorly capitalised and weak in managing risk. Private and state-owned banks dominated financial activity at the expense of capital markets and non-bank financial institutions. Banks often made capital available to favoured sectors and borrowers; lending was based more often on connections than sound credit risk analyses. Consequently, many financial institutions were highly leveraged after lending to risky private and public projects. Heavy, often undiscriminating, international capital flows into these financial sectors exacerbated risks.

The financial crisis seriously challenged Asia's spectacular growth and socioeconomic development. In six months from mid-1997, the currencies of Indonesia, the Republic of Korea, Malaysia, the Philippines and Thailand almost halved in value against the US dollar.

Net private capital inflows to these economies of US$63 billion in 1996 turned to outflows of US$20 billion in 1997, then US$45 billion in 1998, and a further US$26 billion in 1999; this credit contraction equalled 16 per cent of their combined, pre-crisis GDP. Capital flight and unhedged foreign debt held by domestic corporates helped escalate the currency crisis into a major financial crisis that threatened financial systems in Indonesia, Thailand and the Republic of Korea. By mid-1998, the crisis was affecting emerging markets from Russia to Venezuela, undermining growth in Japan and China, and even threatening international financial system stability.

Source: East Asia Analytical Unit, 1999.

Capital controls

The Malaysian authorities implemented controls on international capital flows in September 1998 in a bid to separate the influence of the currency on interest rate movements. It was hoped this would reduce speculative attacks on the currency and insulate the domestic economy from the effects of short-term speculative capital flows (East Asia Analytical Unit, 1999). At the time, these capital control measures were a controversial policy move, because of supposed incompatibility between restrictions on short-term capital flows and an open foreign direct investment regime. However, the Malaysian economy's openness, high-quality bureaucracy and lack of a balance-of-payments crisis allowed Malaysia the option of using these tools to stabilise the capital market (Asian Development Bank, 2004a).

Foreign direct investment capital, profits, wages, dividends, interest, and rental income earned in Malaysia were exempt from these controls. There also were no restrictions on payments to non-residents for imports of goods and services. Since September 1998, Bank Negara's confidence in the resilience of the financial system has enabled the gradual relaxation of capital controls.[3] Nevertheless, the sale and purchase of ringgit assets are the only ringgit payments allowed between non-residents (Bank Negara Malaysia, 2002, 2003, 2004a; Economic Planning Unit, 2004).

Financial and capital market reform

In mid-1998, the Government established three institutions to cope with the sharp increase in banks' non-performing loans, implement refinancing and restructuring, and strengthen the corporate reporting framework. The Government established the Corporate Debt Restructuring Committee to facilitate voluntary corporate debt restructuring between creditors and viable debtors. Danaharta, an asset management company, was established to buy non-performing loans from the banking system. Danamodal, a special purpose finance vehicle, was also established to recapitalise banks, strengthen the banking industry, and help consolidate and rationalise the banking system (East Asia Analytical Unit, 1999). Establishing Danaharta and the Corporate Debt Restructuring Committee also facilitated elimination of non-core business as part of debt restructuring agreements (Khatri, 2001). The work of these agencies is nearing completion – Danaharta will cease operations by end-2005 – and Malaysian authorities will rely more on market-based restructurings, including mergers, acquisitions and bankruptcy, which require a strong legal and corporate governance framework.

This approach met with a considerable degree of success. The Corporate Debt Restructuring Committee officially ceased operations in August 2002. During its period of operation, the Committee received RM67.6 billion worth of applications for debt restructuring, of which it successfully resolved around two thirds. Danamodal wound down on 31 December 2003. During its five-year operation, Danamodal injected RM7.6 billion into 10 financial institutions and at the completion of operations, had recovered RM6.6 billion of the capital investment. The remaining RM1 billion capital in one institution is expected to be fully divested in 2004 (Bank Negara Malaysia, 2004a). Danaharta completed

3 Bank Negara Malaysia – the Malaysian Central Bank – is independent within the Government, but works closely with other Government agencies to achieve macroeconomic policy objectives. It is considered one of the best regulators in Asia (Bank Negara Malaysia, 1999; East Asia Analytical Unit, 1999).

acquiring nonperforming loans from the financial sector in 2001, obtaining RM52.4 billion adjusted loan rights for its portfolio. As at end-2003, Danaharta had collected RM22.4 billion, or around 73 per cent of the total Danaharta expects to recover over its lifespan (Bank Negara Malaysia, 2004a). As at March 2004, Danaharta also had appointed Special Administrators across 73 companies to oversee the management of stabilisation and restructuring programs (Pengurusan Danaharta Nasional Berhad, 2004). In November 2003, Bank Negara Malaysia established the Small Debt Resolution Mechanism to facilitate the restructuring of non-performing loans of ongoing small to medium enterprises and to assist in their financing requirements (Bank Negara Malaysia, 2004a).

To strengthen the banking system further, Bank Negara Malaysia initiated a merger program for domestic banking institutions in 1999 to consolidate Malaysia's 54 domestic financial institutions into ten "anchor" banking groups (Bank Negara Malaysia, 2002). The acquisition of Bank Utama (Malaysia) Berhad by RHB Bank Berhad at the end of 2002 completed the process (Bank Negara Malaysia, 2003).

In April 2004, Bank Negara Malaysia introduced a new interest rate framework. The Overnight Policy Rate replaced the three-month intervention rate as the indicator of monetary policy stance. The Overnight Policy Rate has two roles. The first is a signalling device to indicate monetary policy stance; it serves as the primary reference rate in determining other market rates. The second is a target rate for the day-to-day liquidity operations of Bank Negara. Monetary operations of Bank Negara target the overnight interbank rate. Liquidity management aims to ensure the appropriate level of liquidity that would influence the overnight interbank rate to move close to the Overnight Policy Rate. The Monetary Policy Statement, released on a quarterly basis, announces changes to this rate. Should there be a change in the monetary policy stance between these periods an additional monetary policy statement would be issued.

Strengthened Malaysian bankruptcy laws give creditors greater protection. Restructuring undertaken under Danaharta and the Corporate Debt Restructuring Committee have enabled creditors to recoup some of their investments. Authorities have reduced companies' ability to impose restraining orders on creditors under Section 176 of the Bankruptcy Act. However, under Section 176, creditors cannot take action against debtors for up to two years (Economic Analytical Unit, 2002). The Malaysian Code on Takeovers and Mergers, introduced in 1998, was designed to improve corporate governance and make it a criminal offence to disseminate false or misleading information (Economist Intelligence Unit, 2004). Minority shareholders also have greater protection through lowering the class action requirement and strengthening the disclosure requirement of listed companies (East Asia Analytical Unit, 1999).

During 2001 to 2003, the Government undertook reforms to Bursa Malaysia, the Malaysian stock exchange, as part of the Capital Market Master Plan to have an internationally competitive capital market. These reforms included: creating a single consolidated Malaysian exchange to concentrate liquidity and widen access to investments and products; creating a single clearing house; shifting to a fully electronic trading system on the Malaysia Derivatives Exchange Berhad; introducing a circuit breaker mechanism to promote market stability; giving greater access to initial public offerings;

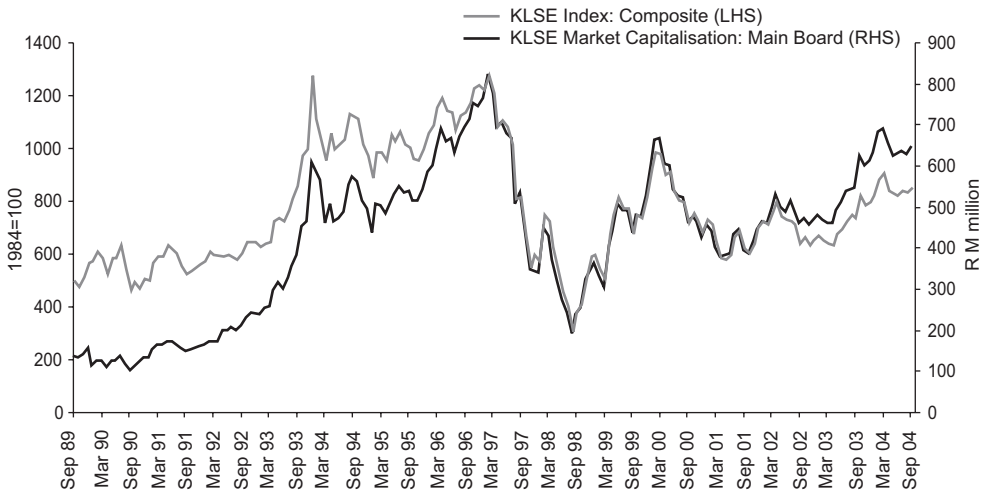
facilitating the listing of large companies; revamping listing requirements; and deregulating restrictions on intermediaries so as to broaden market reach and improve accessibility (Economic Planning Unit, 2003). In further developments, Bursa Malaysia was demutualised in January 2004.

These efforts have introduced a considerable degree of stability to Malaysian financial markets. Non-performing loans, measured on a six-month basis, have fallen from 8.1 per cent as at end-1998 to 6.2 per cent as at July 2004. Measured on a three-month basis, non-performing loans have fallen from 13.6 per cent to 8.3 per cent over the same period. The risk-weighted capital adequacy ratio of banks was 13.5 per cent in March 2004, up from 10.5 per cent in December 1997 (Bank Negara Malaysia, 2004b). At its nadir in August 1998, Bursa Malaysia was only one quarter of the value of the peak in February 1997, but has now regained about three quarters of its market capitalisation (Figure 1.6).

Figure 1.6

Financial markets recovering

Bursa Malaysia index and market capitalisation, index and RM million, 1989 to 2004



Source: CEIC, 2004.

PRIVATISATION AND GOVERNMENT-LINKED COMPANIES

Privatisation is another part of the Malaysian transformation story. Government businesses usually are established in response to significant transaction costs, such as contracting costs and insecure property rights, which give rise to natural monopolies. A government assumes control if it is concerned about guaranteeing an adequate supply of essential goods and services at reasonable prices. Governments also may establish these businesses in order to subsidise high-risk markets, and for political and distributional goals. However, in an environment with multiple calls on government funds, governments are coming under increasing pressure to improve the efficiency of their business interests.

Privatisation

The Privatisation Master Plan guides the Malaysian Government's privatisation program. Between 1983 and 2003, 474 privatisation projects were undertaken, transferring nearly 111,000 jobs from the Government payroll and raising over RM24 billion in revenue (Economic Planning Unit, 2004). The aims of the privatisation program are to enhance economic competitiveness and reduce the government's administrative and financial burden.

The privatisation process has slowed as fewer businesses are being made available for privatisation and private sector investment is yet to recover to pre-1997 levels. Deferred privatisations include Felda, a rural land developer and palm oil producer, as the Government assesses the impact of privatisation on plantation settlers who own more than half of the land managed by Felda (Asian Development Bank, 2004a). Sectors currently identified for further privatisation include water utilities, road and building construction, and waste management (Economic Planning Unit, 2003).

In Malaysia, concessionaires must allocate at least 30 per cent of contractual works to *bumiputera* contractors and offer employment opportunities to *bumiputera*, especially in the management, professional and technical areas. Employee training under the terms and conditions of the privatisation agreement also must be provided (Economic Planning Unit, 2003).

METHODS OF PRIVATE PARTICIPATION

Private participation in infrastructure and utilities occurs across a spectrum from management contracts to public-private partnerships to full sale or privatisation.

The willingness of private investors to own and operate infrastructure or utilities varies largely according to the risk profile of any particular project and regulatory requirements attached to private involvement. The value of the project to private investors depends substantially on the degree to which risk is shared between public and private interests. Increased project risk assumed by investors raises the cost of capital/required rate of return on investment accordingly.

Governments' reasons for encouraging private participation in utilities can range from securing better management to retiring debt.

Management contracts

Management contracts involve contracting out, or outsourcing, the day-to-day running and management of the enterprise. The involvement of the private sector in these enterprises, where contracts are linked to performance, can provide incentives for better performance drawing on private sector expertise.

Concession contracts

Under concession agreements (typically long-term leases), private operators have contractual rights to use utility assets to supply consumers and to obtain revenue from sale of the service. The operator usually manages and is responsible for capital expenditure, upgrades and maintenance.

Build Operate Transfer/Build Own Operate Transfer

These typically involve a private sector consortium designing, constructing and operating new facilities and providing services to government utilities or directly to customers according to a concession agreement between Government and the consortium. At the end of the concession, the consortium has earned profits from owning and operating the utility, and the asset reverts to the public authority.

Public-private partnerships

Public-private partnerships are where the Government leases a facility or network from private operators, in order to secure private capital up front to have the infrastructure built, upgraded or operated independently of public financial support. Examples of public-private partnerships are found in transport, particularly rail services, and in social infrastructure, such as health, education or law and justice facilities. In the case of social infrastructure, core service provision is usually retained in public hands.

Corporatisation

Often an intermediate step towards the sale of a state-owned utility, corporatisation involves the introduction of commercial objectives and management practices, and the removal of government direct or indirect financial support, but without a transfer of ownership.

Privatisation

Privatisation involves the transfer of state-owned assets to private ownership, either by capital market offering or trade sale, the latter being the most common form of privatisation of utilities (water supply, electricity distribution or telecommunications networks). The standard form of trade sale is a competitive tender, where a domestic or international buyer, who is usually already active in the same or a similar sector to that of the offered entity, bids for the state-owned utility.

Government-linked companies

Despite the rapid divestment, the Government still maintains a stake – although not necessarily a controlling one – in a large number of listed entities (Table 1.1). In 2004, the Malaysian Government oversaw 40 listed 'government-linked companies', accounting for around 34 per cent of the total market capitalisation of Bursa Malaysia. The combined assets of these companies are approximately RM232 billion or more than half of Malaysia's GDP (Abdullah, 2004). While there potentially is some argument for having government involvement in corporatised businesses such as utilities and telecommunications, government involvement in private companies such as Nestlé Malaysia appear harder to justify. Chapter 2 – *The Challenges Ahead* discusses reform of government-linked companies.

Table 1.1

Government share in listed companies substantial

Government shareholdings in top 19 listed companies, 2003

Name	Industry	Market capitalisation[a] (RM million)	Government shareholding[b] (per cent)
Malayan Banking (Maybank)	Banking	30 783	70
Tenaga Nasional	Generation, transmission and distribution of electricity	27 695	89
Telekom Malaysia	Telecommunications	24 582	88
Malaysia International Shipping Corporation	Shipping	14 228	85
Maxis Communications	Telecommunications	14 093	5
Petronas Gas	Natural gas	13 851	95
Plus Expressways	Operation of tolled expressways	12 150	88
Sime Darby	Plantations; tyre manufacturing; heavy equipment and motor vehicle distribution; property; energy; general trading and services	11 864	58
Public Bank	Financial/banking	11 537	8
British America Tobacco Malaysia	Manufacture, import and sale of cigarettes and other tobacco products	11 208	23
Resorts World	Tourist resort operations at Genting Highlands, covering leisure and hospitality	9608	n.a.
Genting	Leisure and hospitality; gaming and entertainment; plantations; property development/management; tours and travel; investments; manufacturing and trading in paper; oil and gas exploration	9438	n.a.
Commerce-Asset Holdings (Bumiputra-Commerce Bank)	Financial/banking	8535	67
YTL Power International	Power generation; sales of water; water treatment; disposal of waste water	6752	13
Hong Leong Bank	Financial/banking	6485	5
IOI Corporation	Cultivation/processing of oil palm and rubber; property development	5495	3

Name	Industry	Market capitalisation[a] (RM million)	Government shareholding[b] (per cent)
YTL Corporation	Power generation; construction; manufacturing and trading of industrial products; property development; hotel operation; sales of water; water treatment; disposal of waste water; Internet businesses	5309	25
Nestlé Malaysia	Manufacture, marketing and sale of food products	4807	21
Malaysian Airline System	National airline	4587	79
Total Bursa Malaysia market capitalisation		**491 198**	**25 (approx)**

Notes: a. Market capitalisation information as at 30 May 2003.

b. A broad definition was adopted for the calculation of the Government shareholding. It includes Khazanah (the Malaysian Government investment arm) and its subsidiaries, Permodalan Nasional Berhad (the National Trust Fund) and all the funds it manages, statutory bodies, Government agencies, corporations fully owned by the Government, the State Governments and their agencies.

Source: Australian Department of Foreign Affairs and Trade, internal research.

SOCIAL INDICATORS

Social indicators in Malaysia have improved with overall economic development. Universal access to potable water, electricity, telephones and roads is a stated Government objective.

Reducing poverty

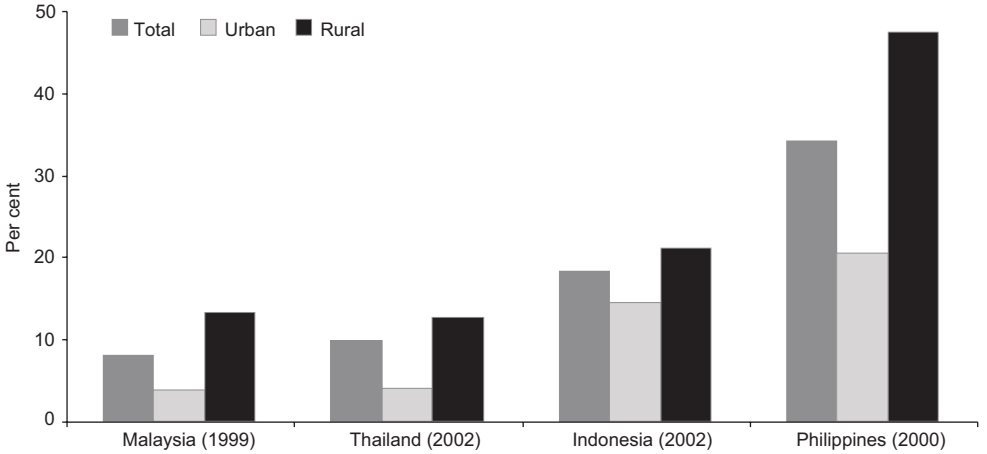
The incidence of poverty, determined using a poverty line income, fell from 32.1 per cent in 1980 to 5.1 per cent in 2002. The incidence of hardcore poverty, defined as half the poverty line income, fell from 6.9 per cent in 1985 to 1.0 per cent in 2002 (Economic Planning Unit, 1999, 2004).[4] Although differences in poverty between States remain – the incidence of poverty in Kuala Lumpur is 0.5 per cent whereas in Sabah the rate is 16.0 per cent – poverty has declined across the board in Malaysia. Considerably fewer Malaysians live in poverty relative to Indonesia, the Philippines and Thailand (Figure 1.7).

4 The poverty line income is an income sufficient to purchase a minimum basket of food to maintain household members in good nutritional health and have access to other basic needs such as clothing and footwear, house rental, fuel and power, transport and communications, health care, education and recreation (Economic Planning Unit, 2002).

Figure 1.7

Poverty levels lower than in other developing South-East Asian economies

Population in poverty, Malaysia, Thailand, Indonesia and the Philippines, per cent of population, latest year available



Notes: For Malaysia, the data represents share of households.

Source: Asian Development Bank, 2004b.

Improving education

Public expenditure on education increased from 5.7 per cent of GDP in 1980 to 7.9 per cent in 2001 (Table 1.2). Primary education participation has been over 90 per cent for more than two decades. Secondary and tertiary education has experienced the biggest gains in education participation. Secondary school enrolments were less than 50 per cent of the relevant age group in 1980 but are now nearly 70 per cent; with students staying at school longer, the adult literacy rate improved between 1990 and 2001. The increase in tertiary enrolments is even more dramatic, increasing from seven per cent of the relevant age group in 1990 to 26 per cent in 2001 (see also Chapter 3 – *Education: Tackling a Constraint to Growth*).

Table 1.2

Expenditure, participation and literacy increase

Selected education indicators, Malaysia, Australia, Singapore and ASEAN3[a], 1980, 1990, 2001

	1980	1990[b]	2001
Public expenditure on education, per cent of GDP			
Malaysia	5.7	5.1	7.9
Australia	5.2	4.9	4.6
Singapore	2.7	3.1	n/a
ASEAN3	2.3	2.5	3.2
Primary school enrolments, per cent of relevant age group[c]			
Malaysia	92.6	93.7	95.2
Australia	112.0	107.7	102.4
Singapore	107.7	103.7	n/a
ASEAN3	106.0	108.5	106.9
Secondary school enrolments, per cent of relevant age group[c]			
Malaysia	47.7	56.3	69.6
Australia	71.2	81.7	153.8
Singapore	59.9	68.1	n/a
ASEAN3	40.7	49.1	69.9
Tertiary school enrolments, per cent of relevant age group			
Malaysia	4.0	7.0	26.0
Australia	25.0	35.0	65.0
Singapore	8.0	19.0	n/a
ASEAN3	14.3	18.0	27.3
Adult literacy rate, per cent of population aged 15 and over			
Malaysia	n/a	80.7	87.9
Australia	n/a	99.0	99.0
Singapore	n/a	88.0	92.5
ASEAN3	n/a	86.6	92.7

Notes: a. ASEAN3 comprises Indonesia, the Philippines and Thailand.

b. 1991 for tertiary school enrolments.

c. Number of pupils enrolled regardless of age as a percentage of the total population in the relevant age group. Hence some percentages are greater than 100.

Sources: CEIC, 2004; World Bank, 2003, 2004; United Nations Development Program, 1992, 2004.

Improving health

Improved nutrition, greater access to safe drinking water and food quality control contributed to measured improvements between 1980 and 2002 in life expectancy at birth and infant mortality rates (Table 1.3). Nevertheless, at two per cent of GDP in 2002, public expenditure on health is lower than the 3.7 per cent average for other upper middle-income economies (World Bank, 2004).

Table 1.3

General health improves

Selected health indicators, Malaysia, Australia, Singapore and ASEAN3[a], 1980, 1990, 2002

	1980	1990	2002
Public expenditure on health, per cent of GDP[b]			
Malaysia	n/a	1.5	2.0
Australia	7.0	7.8	6.2
Singapore	n/a	n/a	1.3
ASEAN3	n/a	n/a	1.1
Infant mortality rate, per '000 live births			
Malaysia	31.0	16.0	8.0
Australia	11.0	8.0	6.0
Singapore	11.0	7.0	3.0
ASEAN3	60.0	46.0	28.0
Life expectancy at birth, years			
Malaysia	66.9	70.5	72.8
Australia	74.4	77.0	79.2
Singapore	71.5	74.3	78.4
ASEAN3	59.9	65.3	68.6

Notes: a. ASEAN3 comprises Indonesia, the Philippines and Thailand.
b. 2001.

Sources: Economic Planning Unit, 2003; dxData, World Bank, 2003; OECD, 2003.

Greater access to basic services

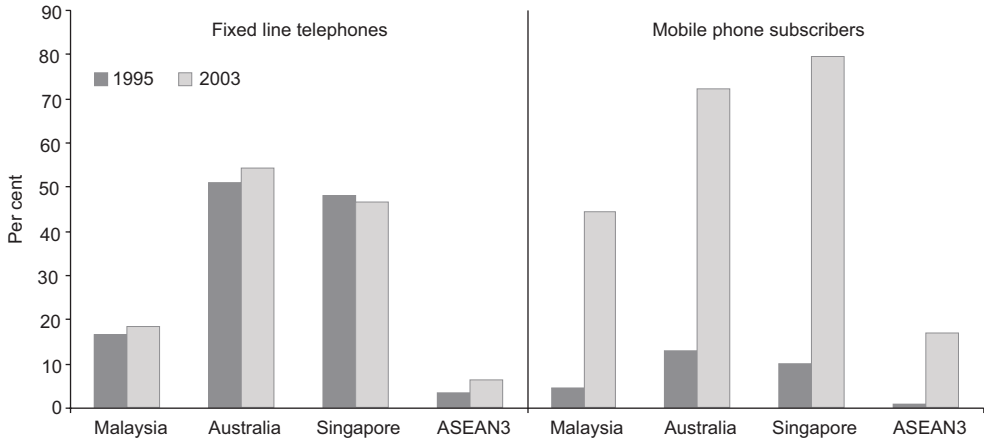
More than 90 per cent of Malaysian households have access to electricity and water, contributing to improved health and poverty outcomes.[5] The slow pace of fixed line connection relative to consumer communication requirements has seen an explosion in mobile phone usage (Figure 1.8). In 2003, mobile phone subscribers made up 70.9 per cent of all telephone subscribers (International Telecommunication Union, 2004). As at March 2004, there were 46.2 mobile phone units per 100 Malaysians, compared to 1.1 in 1992.

5 Data on electrification – that is, the number of people with access to electricity as a share of the total population – for Indonesia, Philippines and Thailand are not readily available. The electrification rate of Australia and Singapore is 100 per cent (United Nations Economic and Social Commission for Asia and the Pacific, 2003).

Figure 1.8

Mobile phones: a popular choice

Fixed line telephones and mobile phone subscribers per 100 people, Malaysia, Australia, Singapore and ASEAN3[a], per cent, 1995 and 2003[b]



Notes: a. ASEAN3 comprises Indonesia, the Philippines and Thailand.
b. Data for Indonesia, Singapore and the Philippines is 2002.

Source: International Telecommunication Union, 1996, 2004.

LOOKING AHEAD

Malaysia's transformation from a commodity-based economy at the time of its independence to a largely export-oriented manufacturing economy has been a remarkable achievement. The International Monetary Fund and the Asian Development Bank acknowledge Malaysia's "strong economic performance", "prudent macro-economic policy" and "significant progress in reforming the financial and corporate sectors and enhancing the business climate". The economic transformation has been matched by a marked improvement in all social indicators, itself evidence that the benefits of progress are widely distributed, contributing to social harmony during a time of significant change.

The rapid growth has come off a low base and so, notwithstanding progress to date, Malaysia's economy is today roughly the size of the Queensland economy, or one fifth the size of Australia's economy. Further factor productivity gains are required to maintain growth in per capita incomes. The Asian Development Bank highlights the need for more private investment and the International Monetary Fund points out that skill mismatches are an ongoing concern. Increased private sector investment will improve the productivity of capital and an increase in the quality and reach of education would enable improved labour productivity. The following chapter considers these and other challenges that Malaysia faces as it pursues its development goals.

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THE CHALLENGES AHEAD

KEY POINTS

- **Several challenges face the Malaysian economy as it moves to the next stage of economic development.**
- **Private domestic investment must be higher if economic growth is to be sustained. At present, there is an over-reliance on government investment, which is deficit-financed and over the longer term, unsustainable.**
- **The Government is responding by focusing on education, strengthening the financial system and reviewing the way government services are delivered.**
- **Malaysia is placing greater emphasis on economic diversification, encouraging growth in the service sector, strengthening the agricultural sector and encouraging movement up the value-added chain.**
- **Malaysia is well positioned to take advantage of the global increase in foreign direct investment and this will be necessary to sustain growth.**

As the Malaysian economy matures, it is less likely to achieve the nine per cent growth rates in nominal GDP seen over the past decade. Attaining growth rates of seven per cent appears more probable, which still is strong relative to developed economies. The Malaysian Government has identified several priority areas for policy attention to ensure Malaysia is able to realise its goal of acquiring developed country status by 2020.

MORE DOMESTIC PRIVATE INVESTMENT NEEDED

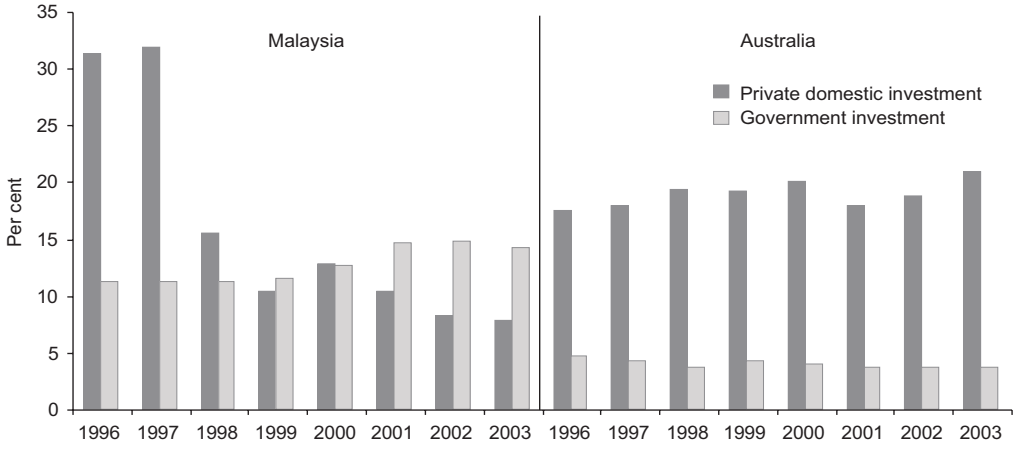
Malaysia traditionally has received most of its capital in the form of foreign direct investment, in large part due to its open capital regime (Asian Development Bank, 2004). Savings rates in Malaysia continue to be some of the highest in the world. Nevertheless, private investment contributed only 0.1 percentage point to real GDP growth of 5.2 per cent in 2003, compared with the public investment contribution of 0.7 percentage points (Bank Negara Malaysia, 2004b).

The Malaysian Government is reducing its public investment commitments to help reduce the budget deficit. More private investment therefore is required to provide the basis for continued strong economic growth, particularly in light of the economic dependence on government capital spending in the past five years (Figure 2.1) (Asian Development Bank, 2004). The economy has not always relied on government investment. In the years prior to the 1997 Asian financial crisis, for example, private investment was nearly three times the size of public investment (Figure 2.1). The Malaysian Government recognises private investment must increase to sustain economic growth and aims to encourage private investment by increasing access to credit, providing better incentives to small business and relaxing Foreign Investment Committee guidelines (Economic Planning Unit, 2003).

Figure 2.1

Government takes over as the major investor in Malaysia

Public and private investment as a share of GDP, Australia and Malaysia, per cent, 1996 to 2003



Source: CEIC, 2004; Australian Bureau of Statistics, 2004.

Domestic private investment often has failed to live up to the expectations of successive Malaysia Plans. The Vision 2020 statement pointed out that domestic investors might have felt the Government had not devoted as much effort to foster domestic investment as they devoted to foreign investment. The difference in incentives partly stems from the type of industries promoted. Large international firms typically dominate the electronics and electrical manufacturing industry, an industry actively promoted by the Malaysian Government.

The Malaysian Government has links with 40 listed companies and the largest business in Malaysia – Petronas – is wholly Government owned. "Government investment" in reported statistics includes government investment in these companies and therefore could potentially yield higher rates of return than investment in, for example, a wholly government-owned utility. In recognition of the importance of Government-linked companies for the economy, the Government introduced *Performance Linked Compensation* and *Key Performance Indicators* to improve efficiency (see also *Privatisation and Government-linked companies,* below).

In the Vision 2020 statement, the Government recognised the neglect of small and medium-sized enterprises, but felt that, with Government support in training, technology and infrastructure, they could be one of the primary foundations for future industrial growth. So far, the results are not particularly promising. Part of the problem is that the technical capabilities of the small and medium scale industries are not high and consequently, multinational corporations do not outsource to them, even though the Government regards the development of local businesses as complementary to the global supply chain of foreign manufacturers (*New Straits Times,* "Govt welcomes FDI while promoting domestic trade", 4 August 2004, p. B2). To help close this technical capability gap, the Government is looking at improving the skills for design and development, R&D and logistics. In general support terms, the Malaysian Government is talking about establishing training institutes emphasising mechanisation and automation, rationalising and consolidating different financial support programs, investment and tax incentives, developing specific programs for productivity improvement, improving and making use of standards mandatory, and enforcing a policy of gradual increase in local content requirements in Government projects (Economic Planning Unit, 2003). Several programs are in place to assist small and medium enterprises, including:

- the Small and Medium Industries Development Corporation which provides assistance to exporting businesses
- the Industrial Linkage Program which helps businesses to be reliable suppliers of parts, components and services to lead companies
- the Global Supplier Program which helps businesses become competitive suppliers of parts and components to multinational corporations

Bank Negara Malaysia has allocated a total of RM5.6 billion for five special funds for small and medium enterprises: Fund for Small and Medium Industries 2 (RM2 billion), New Entrepreneurs Fund 2 (RM1.15 billion), Fund for Food (RM1.3 billion), *Bumiputera* Entrepreneurs Project Fund (RM0.3 billion) and Rehabilitation Fund for Small Businesses (RM0.8 billion) (Bank Negara Malaysia, 2004a). In the

2005 budget, total funds available for the Fund for Small and Medium Industries 2 and the New Entrepreneurs Fund 2 was increased to RM4.5 billion and RM2 billion, respectively. Bank Negara established an SME Special Unit in May 2003 to provide advisory services, facilitate loan applications, disseminate information, and become a one-stop shop for small and medium enterprise financing.

In 2004, the Malaysian Government gave the Malaysian Industrial Development Authority added responsibility for promoting the services sector, although licensing and approvals in services still fall under the auspices of other departments. Typically, small and medium enterprises are concentrated in service industries – in Australia, 71 per cent of small businesses are service providers – and the promotion of services may go some way to strengthening small and medium enterprise participation in the economy (Australian Bureau of Statistics, 2002).

MORE FOREIGN DIRECT INVESTMENT NEEDED

Foreign direct investment played a large part in Malaysia's development. Foreign direct investment inflows averaged over six per cent of GDP during the 1990s, encouraged by Malaysia's open foreign direct investment regime and by incentives laid down in the Promotion of Investments Act 1986. The rapid development of the electronics sector ensured strong inflows of foreign direct investment in the decade before the Asian economic crisis, enhancing Malaysia's industrialisation process. At its peak in 1992, foreign direct investment accounted for 8.7 per cent of GDP (Figure 2.2).

Figure 2.2

Foreign direct investment is lower than in the 1990s

Foreign direct investment inflows as a share of GDP and gross fixed capital formation, per cent, 1980 to 2003

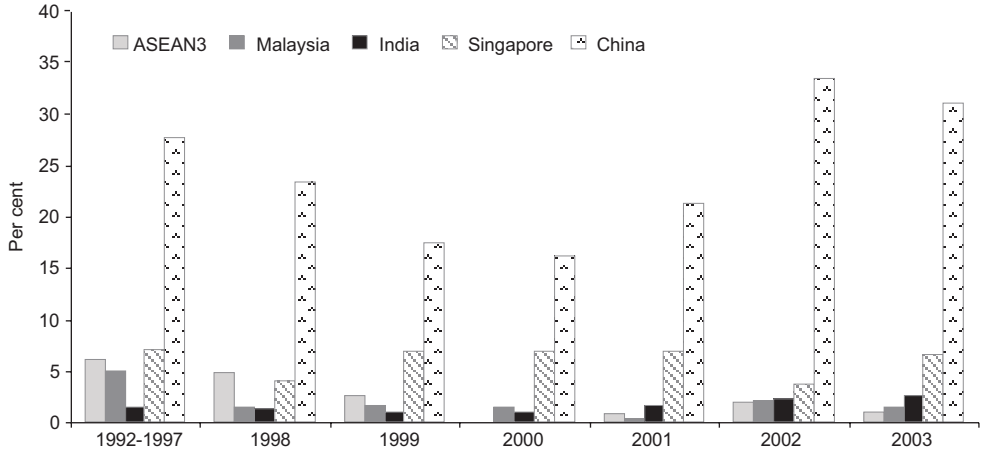
Source: UNCTAD, 2004b; CEIC, 2004.

After suffering a setback following the Asian financial crisis and again in 2001 when foreign direct investment around the world contracted, foreign direct investment is returning to Malaysia, although it is yet to attain pre-crisis levels. Crucially, Malaysia has to compete with China and India for foreign investment funds (Figure 2.3). Malaysia needs to move further along the value-added chain because they are no longer competitive in labour-intensive manufacturing. However, unless low rates of domestic capital formation change, Malaysia must inevitably rely more heavily on foreign direct investment (see Chapter 4 – *A Supporting Environment*).

Figure 2.3

Malaysia struggling to attract foreign direct investment

Foreign direct investment as a share of foreign direct investment for all developing countries, selected countries, per cent, 1992 to 2003



Source: UNCTAD, 2004b.

CHINA'S INDUSTRIAL RISE

In general, Malaysians view China's industrial rise as an economic opportunity, rather than a threat. A prosperous China is good for Malaysia and for the region, as it generates demand for the goods and services the region produces. In particular, Malaysia could take advantage of China's growing incomes by tapping the market for tourism, education and franchising. Trade between Malaysia and China has increased dramatically over the past four years. After hovering between two and three per cent between 1987 and 1998, trade with China now accounts for 7.1 per cent of total Malaysian trade.

China's main comparative advantage is labour-intensive manufacturing, an area Malaysians feel they should move out of given their current stage of economic development. Businesses already have moved most of their labour intensive processes offshore to either China or Vietnam and the general feeling is that this process is largely complete. Industries requiring skilled labour – such as design and complex manufacturing processes – stayed in Malaysia. The Malaysian Government is promoting a "China plus one" strategy, that is, have China as a base for low-skilled labour-intensive

manufacturing, with a second base in Malaysia that undertakes more complex manufacturing. Although labour costs are not competitive with China, on an overall "cost of doing business" basis – such as low political risk and stability – Malaysia compares favourably.

Despite these positives, the threat of China's industrial rise is real. Less than 20 per cent of Malaysia's net exports complement Chinese net import demand, indicating a relatively low level of integration with the supply chain for Chinese industry (Economic Analytical Unit, 2003). Malaysia's main complementary exports to China are energy, and China is a net exporter of a wide range of goods that satisfy Malaysian net demand for imports. However, outside energy, Malaysia has not yet positioned itself to benefit significantly from exports to the growing Chinese economy.

Competition between Malaysia and China for export sectors is comparatively high, with over two thirds of Malaysia's net exports by value competing with China (Table 2.1). Although the Malaysian economy has repositioned itself strongly in a range of manufacturing sectors to meet changing international demand, the sectors where Malaysia is strengthening its presence often overlap with China's strengthening areas of comparative advantage, such as office machines (Economic Analytical Unit, 2003). However, between 1996-97 and 2000-01, Malaysia increased its net exports by half in the sectors that compete with China, despite a 58 per cent increase in Chinese net exports. This suggests that, to date, Malaysia has successfully competed with China in several exporting areas and, with a new strategy to move up the value-added chain, could limit direct competition with China in the future.

Table 2.1

China–Malaysia competition intensifying

Competition from China in Malaysian export sectors between 1996-97 and 2000-01

	Number of products[a]	Malaysian net exports 1996-97 (US$ bill)	Malaysian net exports 2000-01 (US$ bill)	Chinese net exports 1996-97 (US$ bill)	Chinese net exports 2000-01 (US$ bill)
Competition from China[b]	296	20.3	30.3	73.1	115.5
(per cent of total net exports)		52	64	64	70
Malaysia expanding regardless	173	11.1	24.1	41.6	70.9
e.g. Office machines and parts		5.9	14.2	3.6	8.6
Video and digital cameras; mobile phones		-0.4	1.7	-0.5	2.4
Malaysia contracting	123	9.3	6.2	31.5	44.7
e.g. Stereos and video recorders		4.3	3.5	3.0	4.8
Total Net Exports	383[c]	39.1	47.3	114.4	164.8

Notes: [a] Products analysed at Harmonised System 4-digit level, covering 1270 products.

[b] Total number or value of Chinese net exports of products that both China and Malaysia exported on a net basis in 1996-97.

[c] 2001-02.

Source: Economic Analytical Unit, 2003.

THE GOVERNMENT'S RESPONSE

In an effort to strengthen areas of the economy, the Malaysian Government has developed strategies for the financial system, education, tourism, agriculture, manufacturing, manufacturing support services and foreign investment.

Strengthening the financial system

Reforms to the financial system have been ongoing since the Asian financial crisis (see Chapter 1 – *The Transformation*). Maintaining financial system strength is a stated policy priority for the Malaysian Government (Bank Negara Malaysia, 2004a). However, rather than looking to become a regional financial centre, the Government wants the finance sector to facilitate economic growth by preserving financial stability and contribute to growth in its own right by becoming more efficient and competitive. Domestic saving is high because of compulsory contributions to the Employees Provident Fund. This adds to liquidity, but is invested more in portfolio funds rather than channelled into fixed capital formation.

LABUAN INTERNATIONAL OFFSHORE FINANCIAL CENTRE

Labuan was declared an International Offshore Financial Centre on 1 October 1990. The Labuan International Offshore Financial Centre hosts international business activities in banking, insurance, corporate funding, investments and trust management, professional services and related activities. The Centre is under the regulation of the Labuan Offshore Financial Services Authority.

The International Offshore Financial Centre is characterised by low taxes, zero or marginal exchange-control requirements, a high level of confidentiality for borrowers and lenders and few regulations or restrictions on the flow of funds. Licenced offshore banks can accept deposits and grant loans in foreign currency. No tax is imposed on the income of offshore companies that are not trading companies and net profits from offshore trading activities conducted from Labuan are taxed at a concessionary rate of three per cent or a fixed sum of RM20 000. No taxes are withheld for dividends paid by an offshore company, distributions from an offshore trust, royalties received from an offshore company by a non-resident, interest earned on deposits with offshore banks and interest earned on loans to Malaysians. No inheritance, death or estate duty is levied.

As of September 2004, there were 52 offshore banks (with assets of US$16.2 billion), 101 offshore insurance and insurance related companies (with assets of US$914 million), 30 trust companies, 15 fund managers (with US$2.0 billion funds under management), 56 leasing companies (with assets of US$6.3 billion) and 3 money brokers operating in the Labuan International Offshore Financial Centre.

Source: Labuan Offshore Financial Services Authority, www.lofsa.gov.my; Economist Intelligence Unit, 2004.

Banks

Further consolidation of the banking sector is being actively encouraged by the Malaysian Government, although, unlike the first phase of consolidation, this will not be mandatory (*Bloomberg*, 'Malaysia's Banks Must Merge to Be Competitive', October 7 2004). At present, none of the four major banks – which share 55 per cent of all loans between them – is large enough to compete globally, although the managing director of Khazanah Nasional Bhd., the investment arm of Malaysia's government, has indicated three of them could look to acquire regional assets (*Bloomberg*, 'Malaysian State-Backed Banks May Buy Rivals Abroad', October 4 2004). As part of the shake-up of government-linked companies, two of the government-linked banks also may merge to create a larger, global Malaysian bank (*The Edge Malaysia,* 'Reforming the GLCs and Khazanah', July 12 2004, p. 58). If this occurs, there will be pressure for the other smaller banks to merge.

THE AUSTRALIAN AND MALAYSIAN FINANCIAL SECTOR

Bursa Malaysia, the Malaysian stock exchange, is the largest of the ASEAN members in terms of market capitalisation and the 20th largest in the world. However, Bursa Malaysia represents only 27 per cent of the market capitalisation of the Australian Stock Exchange. Looking at the size of asset bases, the entire Malaysian commercial banking sector represents only 60 per cent of the asset base of National Australia Bank, Australia's largest commercial bank.

The size difference should not necessarily preclude closer cooperation between financial market regulators in Australia and Malaysia. In August 2004, Bursa Malaysia and the Malaysian Securities Commission completed a successful visit to Australia for meetings with their Australian counterparts.

There are numerous funds in Australia with a mandate to invest in Asia and an objective of Bursa Malaysia's visit was to highlight the benefits of investing in Malaysian stocks. Another objective of the visit was to learn more about the Australian Stock Exchange's listing experience – the Australian Stock Exchange listed in 1998 – and see whether any useful lessons could be applied to the proposed listing of Bursa Malaysia in 2005.

The Malaysian Securities Commission and the Australian Securities and Investments Commission signed a Memorandum of Understanding for assistance and mutual cooperation in July 1998. The 2004 visit by the Malaysian Securities Commission aimed to observe what type of company regulatory framework their Australian counterpart had in place and whether this could be applied to the Malaysian situation.

Although primarily a 'fact-finding' and marketing mission, the visit's success underpins the potential for regulators in both countries to work more closely together in the future.

The financial system is stronger than it was before the crisis, but gaps remain, such as the size of non-performing loans for smaller banks and conservative lending policies on the part of bankers. The Small Debt Resolution Committee, introduced in November 2003, facilitates the restructuring of non-performing loans of small and medium enterprises. Bank Negara also sets targets for commercial banks and financing companies for lending to small to medium enterprises, the *bumiputera* community and the purchase of low and medium cost housing (Bank Negara Malaysia, 2004a). Domestic banks maintain a conservative lending policy, even though it is seven years since the Asian financial crisis. The crisis still is fresh in the banking sector's mind, especially those exposed to the corporate sector, and it may be some time before banks are confident enough to engage with the corporate sector in a significant way. Banks expanded their outstanding loans by only 4.8 per cent in 2003, compared with the Government's target of 8.0 per cent (Economic Intelligence Unit, 2004). In the meantime, domestic businesses are taking advantage of a maturing bond market to meet their financial requirements.

The Employees Provident Fund

With accumulated contributions of RM174.5 billion in 2002, the Malaysian Employees Provident Fund is the 28th largest provident and pension fund in the world. In 2002, total investments of the Fund came to RM203.7 billion. The Fund is a form of forced saving, with 20 per cent of earnings deposited in the fund – 9 per cent from employees and 11 per cent from employers. The resources available in the Employees Provident Fund relative to the size of the financial market are a cause for concern because of their potential to influence Malaysian financial markets. In addition, offshore investment can only account for five per cent of funds available, which means the Fund is unable to take full advantage of higher returns elsewhere.

The ringgit peg

Currently, conditions are not putting pressure on the Malaysian Government to revalue or float the ringgit. The terms of trade have declined over the past three years, but only by four per cent.[6] Although the ringgit appears undervalued at the current peg, it is much easier to support an undervalued currency than an overvalued one, because all the monetary authorities have to do is provide ringgit to the foreign exchange market. In its 2004 Article IV consultation, the International Monetary Fund saw no reason to revalue the peg at this time, citing a large current account surplus, comfortable level of reserves, low inflation, a relatively sound financial system, manageable external debt, and a gradually diversifying economy (International Monetary Fund, 2004).

[6] Malaysian terms of trade information are not available prior to 2001.

FIXED VERSUS FLOATING EXCHANGE RATES

Under a fixed exchange rate regime, monetary authorities must continually intervene in the foreign exchange market to clear any excess demand for, or supply of, domestic currency, thereby subtracting from or adding to liquidity in the domestic money market. This means capital flows rather than monetary policy influences domestic monetary conditions, interfering with the ability of domestic macroeconomic policy tools to pursue domestic policy goals.

There are several advantages to having a floating exchange rate, including the ability to adjust automatically to changes in the economic environment. One example is the response to a decline in the terms of trade, that is, where the price of exports falls relative to the price of imports. Under a floating regime, the economy would be cushioned from the adverse impact by an exchange rate depreciation, making exports more competitive on world markets. To avoid an economic contraction in a fixed exchange rate environment requires the use of macroeconomic policy tools, which in turn assumes policymakers have assessed the situation correctly (www.rba.gov.au/education/exchange_rate.html). Problems also might arise with an overvalued currency because, in this case, a government would have to supply foreign currency to the foreign exchange market, which would eventually deplete their foreign exchange reserves.

As Malaysia continues to liberalise its capital markets, capital flows will become more sensitive to interest rate differentials. A floating exchange rate will help adjust for these day-to-day changes in the demand for ringgit.

Some Malaysian commentators argue that the ringgit peg provides stability and certainty to business decisions, assisting long-term strategic decisions. Another reason the Malaysian Government is not moving hastily is the Chinese renminbi peg to the US dollar. The discussion above on China's industrial rise revealed that a large number of Malaysian exports compete with Chinese exports on world markets. A revaluation of the ringgit peg without a corresponding change in the renminbi peg therefore could have ramifications for the competitiveness of Malaysian exports vis-à-vis Chinese exports.

Despite current support for the peg, in the longer term the International Monetary Fund thought that a move toward greater exchange rate flexibility would be beneficial for Malaysia if it were well prepared, pursued from a position of strength, and carefully sequenced (International Monetary Fund, 2004). In reality, Malaysia's external debt, trade balance and inflation rate will determine whether the Malaysian authorities make any changes to the current system (Economist Intelligence Unit, 2004).

Strengthening education

Although the labour market remains highly flexible overall, some commentators are concerned about skill mismatches – evidenced in part by the recent rise in unemployment of university graduates – and skills shortages (International Monetary Fund, 2004). Science and technology professionals are in short supply and up until 2004 were the target of policies to attract experts back to Malaysia (Economist Intelligence Unit, 2004). There also is a shortage of English, mathematics and science teachers (Economic Planning Unit, 2003).

Improving the quality of the Malaysian workforce is a key component of the Government's forward agenda to support a knowledge-based economy (Economic Planning Unit, 2003). The Malaysian Government is hoping to ameliorate the skill shortage by adopting lifelong learning programs, adopting English in primary and secondary schools as the medium of instruction for mathematics and science and expanding the capacity of existing universities. The Government aims to have 30 per cent of the 17 to 23-year-old age group in tertiary education by 2005. In 2002, the Government announced the introduction of academic achievement as the main selection criterion for entrance into public institutions of higher learning. Specific initiatives have helped match the skills of graduates to those sought by employers and all institutions of higher learning are required to undertake annual tracer studies on their graduates. Industry involvement in training is encouraged.

The Government introduced a structured mandatory Continuing Professional Education program in financial markets, designed to enhance the technical knowledge and skills of licenced representatives. The Government also introduced a Capital Market Graduate Training Scheme to increase the supply of skills to the Malaysian capital market (Economic Planning Unit, 2003). Chapter 3 – *Education: Tackling a Constraint to Growth,* has a more in-depth look at the Malaysian education system and the steps the Government is taking to strengthen education.

Promoting tourism

In 2002, Malaysia attracted more tourists than any of the other ASEAN economies, although expenditure per person was only higher than Burma and Cambodia (Figure 2.4). This is a direct result of the large number of Singaporeans making day trips into Malaysia (see below). Excluding Singapore from other ASEAN tourist arrivals, Malaysia attracts nearly 5 million fewer visitors than Thailand. Tourism is a priority area for development in Malaysia. Investment incentives are available on the establishment of medium and low cost hotels (up to a three star hotel), the expansion or modernisation of existing hotels, the establishment of tourist projects, the expansion or modernisation of tourist projects, the establishment of recreational camps and the establishment of convention centres (Malaysia Industrial Development Authority, 2004). The Special Fund for Tourism and Infrastructure, established in October 2002, has RM400 million available for investment in tourist products.

Tourism accounted for 4.2 per cent of employment in 2002. Initiatives to improve the quality of tourist services include human resource development and training through the National Tourism Human Resource Development Council and the National Vocational Training Council, and improving standards set out in the National Occupational Skills Standard.

AUSTRALIAN AIRLINES

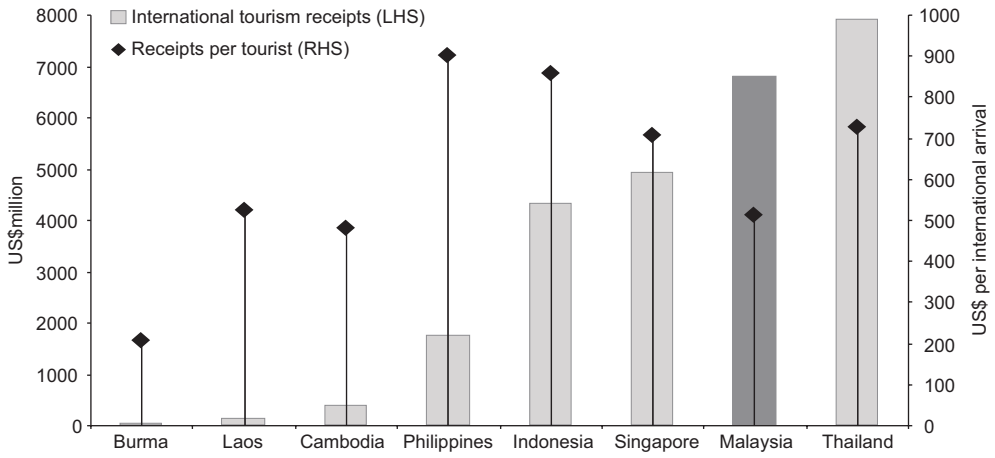
Australian Airlines – a wholly owned subsidiary of Qantas – commenced scheduled services to Sabah on 29th June 2003. Sabah was seen as a new holiday destination for the Australian market and, as it did not have a direct service from Australia, it was a niche that Australian Airlines could 'own'. This involved creating 'destination awareness' – that is, inform Australians of the attractions Sabah had to offer – and 'branding' Sabah as a new and exciting destination. Australian Airlines works closely with the local airport to create facilities that are in keeping with Qantas Group requirements relating to service delivery, efficiency and security.

Tourism is an important sector for the relatively undeveloped Malaysian states of Sabah and Sarawak, which are located on the island of Borneo. Direct flights from Australia by Australian Airlines already are having an impact – a factor specifically recognised by the Sabah Tourism Board. Between January and August 2003, visitors from Australia to Sabah totalled 7668, or 2.2 per cent of total international visitor arrivals. In contrast, between January and August 2004, visitors from Australia had more than tripled, to 23 857, accounting for 4.7 per cent of international tourist arrivals (www.sabahtourism.com).

Figure 2.4

Malaysia gets the numbers, but not necessarily the dollars

International tourist receipts and receipts per tourist, 2002



Source: World Bank, 2004.

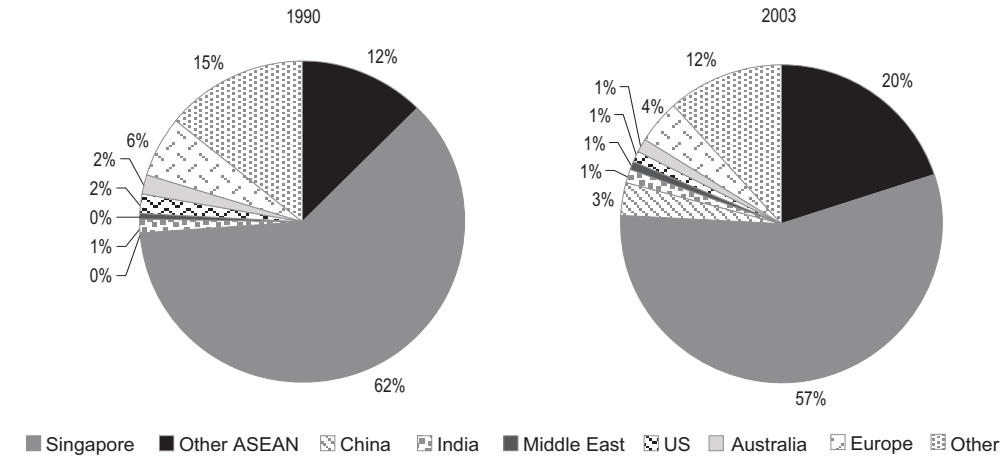
In 2003, Singapore was the largest source of tourists, representing 57 per cent of the total number of visitors (Figure 2.5). Most of these visits are short-term 'over-the-border' shopping trips, with Singaporeans staying 4.3 nights on average compared with 7.2 nights for visitors as a whole. The other ASEAN economies accounted for a further 20 per cent of arrivals. The Malaysian Government sees potential in tourism on several fronts, with the private sector providing the tourist products and the Government providing the infrastructure. Promoted tourism products include eco-tourism, agro-tourism, cultural and heritage tourism and cruises, yachting and boating. To increase the number of tourists and the amount they spend, Mega Sales Carnivals, a nationwide sale involving around 5000 retailers, are held thrice-yearly. The Government hopes to establish more event-related activities to bolster tourist numbers.

Islam is the predominant religion in Malaysia, making it attractive to visitors from the Middle East. While total tourist numbers from the Middle East still are small relative to other inbound travellers, Tourism Malaysia has made a concerted push to attract tourists from this region, arranging special tour packages to cater to the needs of Middle Eastern tourists, increasing flight frequencies to Malaysia and producing documentaries and publishing pamphlets on Malaysia in Arabic. Malaysia sees potential for tourists from this region to stay longer and spend more. Malaysia also is hoping to tap the greater numbers of Chinese nationals venturing overseas. There is a large Chinese-Malaysian community in Malaysia – approximately 25 per cent of the population are ethnic Chinese – providing visitors from China with a familiar environment. There already is movement on this front. In 1990, less than 0.1 per cent of tourists into Malaysia originated from China, compared with 3.3 per cent of total inbound travellers in 2003.

Figure 2.5

Singapore dominates tourist numbers

Malaysian tourist arrivals by origin, per cent of all arrivals, 1990 and 2003



Note: Numbers marked "0" are less than 1 per cent.

Source: CEIC, 2004.

Strengthening agriculture

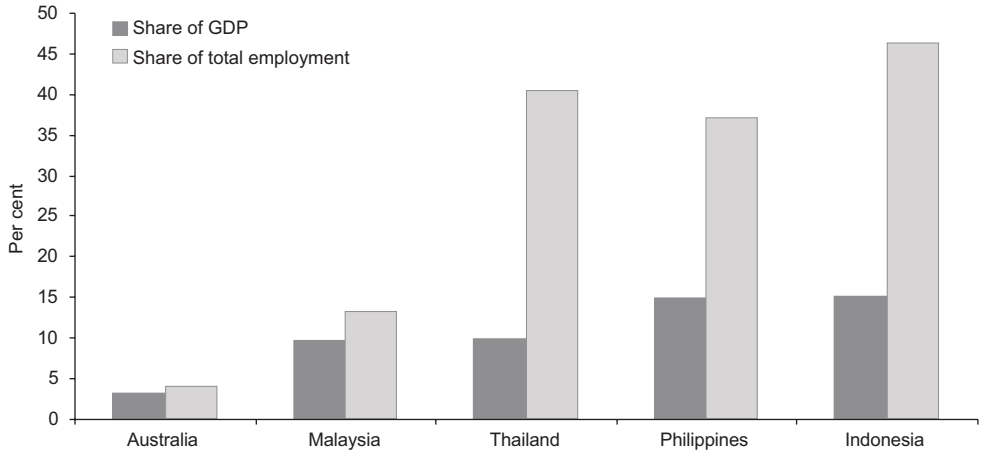
The re-engineering of traditional agriculture is one of the main policy planks of the Malaysian Government, as outlined in the 2005 Malaysian budget speech. As the Malaysian economy develops and incomes rise, labour intensive agricultural production will become uneconomic. Agricultural labour also will be less readily available as workers move into higher-paying employment elsewhere. In early 2004, the Malaysian Government identified productivity improvements in the agricultural sector as an important mechanism for delivering economic benefits to the rural Malaysian population while strengthening the agricultural sector's economic contribution. The Government's push to modernise agriculture includes greater commercial orientation, wider adoption of new technologies and modern management systems, and greater participation by the private sector.

In Malaysia, agriculture employs 14.3 per cent of the workforce (1.4 million workers) of which 327 490 are registered foreign workers (Figure 2.6; Economic Planning Unit, 2003). This compares with 4.0 per cent of Australian employment, 37.0 per cent of Filipino employment, 42.5 per cent of Thai employment and 46.3 per cent of Indonesian employment. The share of GDP also is smaller than in Indonesia, the Philippines or Thailand. With the exception of large palm oil and rubber plantations, most of Malaysia's agricultural industry remains small-scale, with few opportunities at present to take advantage of economies of scale production. Increasing the productivity of this sector therefore could have a considerable impact on rural incomes. According to the 2005 budget speech, Malaysia's current agricultural policy has two objectives: increase income and reduce dependence on imports, particularly food.

Figure 2.6

Agriculture a small share of the Malaysian economy

Agricultural employment and output shares, per cent of employment and GDP, selected countries, 2003



Source: CEIC, 2004; Australian Bureau of Statistics, 2004.

At present, most agricultural growth comes from plantation-grown primary commodities such as palm oil, rubber and timber. The Government would like to see more diversified growth in agriculture, particularly in large-scale food production. The Government identified eight priority sectors in agriculture for development – food manufacturing, fruit cultivation, livestock rearing, fish breeding, agro-based small and medium scale businesses, cottage industries, handicraft and aquaculture.

Many companies regard the agricultural sector as high-risk and to combat these perceptions, the 2005 Malaysian Budget includes incentives such as a 100 per cent deduction on capital expenditure, Pioneer Status or Investment Tax Allowance for 5 years and Reinvestment Allowance for 15 years. Food production incentives include a tax deduction equivalent to actual investment or group relief for companies investing in subsidiaries, and a 100 per cent tax exemption for a period of 10 years for the subsidiary. To encourage more capital intensive agricultural production, the 2005 budget has tax incentives for capital expenditure on machinery and equipment used in agriculture.

Modern farming techniques, large-scale commercial farming, high-tech inputs and intensive land use are among efforts to increase agricultural output. The Ministry of Agriculture and Agro-based Industries estimates smallholders with an average land area of only 1.2 hectares currently contribute 70 per cent of food production. Freeing up access to agricultural land is another issue. Most land designated for agricultural use comes under State jurisdiction or is reserved for Malays only.

Malaysia has a policy of seeking to be self-sufficient in food by 2010. However, Malaysia does not have a strong comparative advantage in agriculture and self-sufficiency would deny the benefits of trade. One of the advantages of producing high-value-added exports is it enables Malaysians to purchase lower-value products, such as foodstuffs, with fewer resources than it would take to produce them under self-sufficiency. For this reason, policies to achieve self-sufficiency that distort resource allocation result also in a level of national income lower than it otherwise would be.

Moving up the value-added chain

The Malaysian Government is encouraging growth in value-added activities encompassing both agriculture and manufacturing. The challenge in achieving this aim is ensuring the necessary investment and skill set is available.

In agriculture, the Government wants to promote greater value-added supply chain activities, such as processing, logistics, packaging, developing brand names, securing new markets and strengthening delivery systems. Allowances are available for some processed agricultural products, rubber-based products – for example, latex products, tyres and dry rubber products – and palm oil products – for example, margarine, cocoa butter substitutes and oleochemicals. Tax incentives are available for new companies providing cold-chain facilities and services for refrigerated and perishable agricultural goods. As part of this push, Malaysia is looking to establish itself as a “Halal Hub”, processing halal products for export to third countries, using its established halal logo certificates. In the 2005 Budget Speech, producers of halal products received investment and tax incentives to encourage new investment in this sector.

Manufacturing remains important to the Malaysian economy because of the contribution it makes to export earnings and employment. The Malaysian Government's policy is to encourage high technology and knowledge-based industries. The Malaysian Government also is looking to strengthen the complete manufacturing chain, that is, research and development, custom manufacturing, high-volume manufacturing, customer development, business development and product distribution. To do this requires access to adequate and efficient support services such as product and software development, design and prototyping, packaging, regional establishments, logistics and export services (Economic Planning Unit, 2003). To promote the manufacture of high-quality Malaysian goods capable of penetrating export markets, the Government provided double deduction on expenses incurred to obtain international quality standards in the 2005 budget.

In order to move successfully to a more innovative economy with a strong research and development base, private and public universities will need to improve their research base and collaborate with industry to commercialise research output. This in turn requires stricter enforcement of intellectual property rights. Although the legal foundation exists for these rights, enforcement has at times fallen short of expectations (Asian Development Bank, 2004).

Research and development spending also will have to improve throughout the rest of the economy. Although the Government approved nearly RM1 billion in research and development grants between 2001 and 2003, total research and development expenditure was only 0.4 per cent of GDP between 1996 and 2002, compared with 1.5 per cent for Australia, 2.1 per cent for Singapore and 3.0 per cent for the Republic of Korea (Table 2.2). Malaysia has a shortage of scientists and engineers in research and development compared with developed countries. To encourage the commercialisation of research and development, the 2005 Budget Speech proposed locally-owned companies which invest and own at least 70 per cent equity in a company that undertakes commercialisation projects be granted tax deductions equivalent to actual investment, and a company that undertakes commercialisation projects be granted Pioneer Status of 100 per cent for ten years.

Table 2.2

Much to do in R&D

Expenditure and researchers in R&D, selected countries, 2002

	Expenditure on R&D	Researchers in R&D
	% of GDP 1996-2002	**per million people 1990-2001**
Republic of Korea	3.0	2880
Singapore	2.1	4052
Australia	1.5	3439
Malaysia	0.4	160
Thailand	0.1	74
Philippines	-	156

Source: World Bank, 2004.

Encouraging foreign direct investment

The Foreign Investment Committee guidelines cover local and foreign investment interests and are the mechanism to implement *bumiputera* ownership policy. To enhance Malaysia's appeal to foreign investors, the Malaysian Government released revised guidelines – effective on 21 May 2003 – covering the acquisition of properties and interests in business, mergers and takeovers. The major change is the threshold requiring Foreign Investment Committee approval for acquisitions of property or business, which doubled to RM10 million. Under these guidelines, the Foreign Investment Committee takes on a monitoring role, with the onus on investors to demonstrate they have fulfilled their obligations as stipulated in the guidelines. Except for the shorter processing time goal and elimination of some approval duplication the revised guidelines have not simplified procedures.

As of May 2003, companies already listed in Malaysia no longer need a 30 per cent ethnic *bumiputera* (mainly ethnic Malay and excluding ethnic Chinese and Indian) shareholding quota. However, new companies seeking listing need a 30 per cent *bumiputera* shareholding upon listing, but this 30 per cent *bumiputera* shareholding does not need to be maintained after listing.

As of June 2003, 100 per cent foreign equity holding is allowed for all investments in new manufacturing projects and for investments in expansion/diversification projects by existing companies. This policy change applied to all manufacturing activities in Malaysia, irrespective of the level of exports that result from them. For those businesses still affected by equity and export conditions, the Malaysian Industrial Development Authority will consider requests for the removal of these conditions on a case-by-case basis (Malaysian Industrial Development Authority, 2004).

The Malaysian Industrial Development Authority handles foreign and domestic manufacturing proposals, or manufacturing-related service proposals, on a case-by-case basis. Approval depends on factors such as investment size, export orientation, required financing, technology transfer, infrastructure requirements and the existence of a product market (United States Department of Commerce, 2004). The relevant regulatory agencies, such as Tourism Malaysia or the Ministry of Health, handle applications for investment in other sectors.

The conditions for attracting foreign investment to Malaysia are good. Malaysia ranked seventh in the world in terms of top foreign direct investment locations for investment being considered in 2004-2005 (UNCTAD, 2004a). Using a combination of survey and statistical information, another report ranked Malaysia among the world's top three contenders for offshore locations (A.T. Kearney, 2004a). The Malaysian business environment, characterised by high-quality infrastructure and strong government support for information and communication technology, was the best in the Asian region. The financial structure – that is, compensation, infrastructure, tax, and regulatory costs – also compared favourably with other competitors for foreign direct investment. The main weakness for Malaysia was in people skills and availability. Acute shortages of appropriately qualified labour occur in the sciences in particular and more generally, with the Malaysian labour market at close to full employment. There also is not the depth of experience in business process outsourcing as, for example, in India (A.T. Kearney, 2004a). A complementary report – the 2004 FDI Confidence Index – saw Malaysia jump eight places to rank 15th in the world as an attractive foreign direct investment location (A.T. Kearney, 2004b).

THE MALAYSIAN INDUSTRIAL DEVELOPMENT AUTHORITY

The Malaysian Industrial Development Authority, more commonly known as MIDA, is the Government's principal agency for the promotion and coordination of industrial development. It is the first point of contact for investors who intend to set up projects in manufacturing or related manufacturing support services sectors in Malaysia. Although MIDA is not authorised to approve investment outside manufacturing, senior Government representatives from Finance, Human Resources, Immigration, Customs, Environment, Occupational Safety and Health, Tenaga Nasional and Telekom Malaysia are stationed at MIDA's headquarters in Kuala Lumpur to advise investors on government policies and procedures.

The major functions of MIDA are to promote foreign and local investment in manufacturing and related services sectors, undertake planning for industrial development in Malaysia and recommend to the Minister of International Trade and Industry policies and strategies on industrial promotion and development. MIDA also evaluates applications for: establishing a business; tax incentives and expatriate posts for operational headquarters, regional distribution centres, international procurement centres, representative offices and regional offices; incentives for promoted manufacturing activities, tourism, R&D, training institutions and software development; manufacturing licences; expatriate posts required by manufacturing projects and tariff protection/duty exemption for raw materials, components and machinery.

To help business, MIDA facilitates new and existing companies in the implementation and operation of their projects, offers assistance through direct consultation and cooperation with the relevant authorities at both the Federal and State levels and facilitates the exchange of information and coordination among institutions engaged in, or connected with, industrial development.

The Malaysian Industrial Development Authority is headquartered in Kuala Lumpur and has offices in Johor Bahru, Kuala Terengganu, Alor Setar, Kuantan, Kota Bharu, Ipoh, Bandar Melaka, Kota Kinabalu, Pulau Pinang and Kuching. They also have international offices in Sydney, Boston, Chicago, Los Angeles, New York, San Jose, Cologne, London, Milan, Paris, Stockholm, Osaka, Seoul, Shanghai, Taipei and Tokyo.

Source: Malaysian Industrial Development Authority, www.mida.gov.my.

ENABLING VERSUS TARGETING

At various times since Independence, the Malaysian Government has targeted industries it believed would contribute to Malaysia's economic development, with varying degrees of success. Government attempts at influencing industry development and economic growth by 'picking winners' is a second-best method of ensuring efficient use of an economy's resources compared to markets. At present, there are direct and indirect tax incentives available for 262 activities ranging from the cultivation of tea, the manufacture of bicycles and the establishment of convention centres (Malaysian Industrial Development Authority, 2004). While the breadth of incentives increases the cost to government, it lowers the risk of resource misallocation because the incentives are not focussed on a single sector. Improvement in several crucial areas such as transparency, preferential treatment for *bumiputera*s and regulatory burdens facing business could enable Malaysia to attract the private investment it needs to drive the economy further.

Enabling policies

Governments have an important role to play in ensuring markets function well – that is, creating an enabling environment. The above discussion on strengthening the financial sector and improving the workforce's skill set is an important part of the Government's efforts to improve the business environment. The Government also is trying to improve the delivery of services, including reducing the processing time for new investment, investing in quality infrastructure and relaxing foreign exchange rules.

Ports, shipping and maritime-related services play an important role in Malaysia since 90 per cent of Malaysia's international trade is seaborne (United States Department of Commerce, 2004). Upgraded Malaysian ports can now compete with Singapore and both Port Klang and the Port of Tanjung Pelepas are participating in the Container Security Initiative, a US Customs program that facilitates clearance of goods destined for the United States. Both these ports have private sector involvement; Hutchinson International Terminal in the case of Port Klang and Maersk Sealand in the case of Port of Tanjung Pelepas (Economic Planning Unit, 2003).

Well-functioning telecommunications are an important requirement in doing business and Malaysia spends more on ICT as a share of GDP than any other ASEAN economy (Table 2.3). Telecommunications are better than they were, but outside the promoted areas such as the Multimedia Super Corridor or key urban centres such as Kuala Lumpur, access to broadband services are not particularly reliable, if they are available at all. In the calculation of the e-readiness ranking, Malaysia scores well in the business environment, and consumer and business adoption sub-sectors, but falls down in terms of connectivity (Economist Intelligence Unit and IBM Corporation, 2004). That said, for those that do have access to the Internet, the costs are more comparable with developed economies (Table 2.3) and the digital divide is not as pronounced as in Thailand, China, Indonesia, the Philippines or Vietnam (Economic Analytical Unit, 2002).

Table 2.3

Internet better than developing ASEAN, not quite at developed country stage

Selected Internet statistics, selected countries, latest year

	E-readiness ranking [a]	E-readiness score	Networked readiness index [b]	Monthly Internet price	ICT expenditures
		out of 10		per cent of monthly GNI per capita	per cent of GDP
	2004	2004	2002	2002	2002
Singapore	7	8.02	5.47	0.6	6.5
Hong Kong	9	7.97	5.23	0.2	4.6
Australia	12	7.88	5.22	1.1	6.4
Republic of Korea	14	7.73	4.86	1.2	6.5
Taiwan	20	7.32	5.18	-	-
Malaysia	33	5.61	3.82	2.9	7.3
Thailand	43	4.69	3.58	4.2	4.7
Philippines	49	4.35	3.27	20.1	4.2
Indonesia	59	3.39	3.24	37.6	1.5
Vietnam	60	3.35	2.42	55.4	2.4

Notes: a. E-readiness rankings are calculated by adding scores across six categories: connectivity and technology infrastructure; business environment; consumer and business adoption; social and cultural infrastructure; legal and regulatory environment; and supporting e-services.

b. The networked readiness index is a summary measure of an economy's ability to leverage their ICT networks based on network use (quality and quantity) and enabling factors (access, policy, society and economy) (Kirkman *et al.* 2002).

Sources: Economist Intelligence Unit and IBM Corporation, 2004; Kirkman *et al.* 2002; World Bank, 2004

The financial system has greater depth and strength than it did before the financial crisis, although, as discussed above, the banking sector could consolidate further, non-performing loans still are higher than before the Asian financial crisis, and foreign financial institutions have limited Malaysian investment options (Table 2.4). That said, the finance sector certainly is strong enough to support further expansion of the Malaysian economy. Chapter 4 – *A Supporting Environment* discusses the Malaysian business environment in more detail.

Table 2.4

Financial strength improves

Selected financial system indicators, 1997, 1998 and 2003

	1997	1998	2003
Number of financial institutions	86	80	44
of which: commercial banks	35	35	23
Domestic credit provided by the banking sector, per cent of GDP	165.1	159.8	154.2[a]
Risk premium on lending, percentage points[b]	3.8	1.0	3.7[a]
Ratio of bank liquid reserves to bank assets, per cent	11.3	8.7	12.5[a]
Non-performing loans as a percentage of total loans[c]	4.1	13.6	8.9

Note: a. 2002.
b. Prime lending rate minus treasury bill rate.
c. Three-month.

Sources: CEIC 2004; World Bank, 1999, 2004.

Targeting policies

Two examples of targeting are Proton – the national car producer – and more recently, the Multimedia Super Corridor. Originally, the idea of having a national car company was to kick-start the industrialisation process by creating supporting industries such as component part manufacturing, research and development, distribution networks and engineering. Proton has gone some way to achieving these aims, directly and indirectly, creating 24 franchise holders, 350 component makers, 250 vendor companies, 100 000 jobs and investing close to RM8 billion in the domestic market (*The Edge Malaysia,* "Proton under a microscope", 2 August 2004). However, this has come at a high cost. Duties ranging from 40 to 300 per cent on vehicle parts and cars protected Proton and the respective component manufacturers from competition. Only some of the component manufacturers are successfully serving international car makers and quality issues and insufficient overseas marketing have led to a systematic decline in Proton's market share and profits.

The Multimedia Super Corridor is still in its infancy and it is too soon to comment on its success. The idea of creating a clustering effect for ICT and multimedia is not new – Penang has had considerable success in creating a cluster for the electronics industry, and Silicon Valley is a textbook example of the benefits of clusters. What is different about the Multimedia Super Corridor is that it is government mandated rather than market driven. Some commentators suggest the Corridor has diverted companies that would otherwise have gone to Penang, simply based on the tax and investment incentives business can obtain by being a Multimedia Super Corridor approved company. This is business diversion rather than creation.

THE MULTIMEDIA SUPER CORRIDOR

The Multimedia Super Corridor (MSC), designed to be a global ICT and multimedia hub, encompasses the area from Kuala Lumpur City Centre through Cyberjaya, Putrajaya and out to Kuala Lumpur International Airport.

To receive the benefits of working in the Multimedia Super Corridor, businesses must first qualify for MSC status. To qualify, applicants must be a provider or heavy user of multimedia products and services; employ a substantial number of knowledge workers; provide technology transfer and/or contribute towards the development of the MSC or support Malaysia's knowledge-economy initiatives; establish a separate legal entity for the MSC-qualifying multimedia business and activities; locate in a MSC-designated cybercity (Cyberjaya, Technology Park Malaysia, UPM-MTDC, KLCC and Menara KL); and comply with environmental guidelines. Manufacturing, trading and consultancy services are not eligible for MSC status.

Active MSC-status companies include Sun Microsystems, Intel, Oracle, Siemens, HSBC, NTT and Fujitsu. Australian businesses operating in the MSC include Flaming Pear, Technology One Corporation, MYOB Asia, Learned Solutions, World Net Services, Lembaran Pegun, Cissa Communications, Optimiser Digital Management and Runge Malaysia. Australian firms also are involved with 21 other businesses in the MSC, covering everything from game development to risk analysis software.

Source: Multimedia Development Corporation, www.mdc.com.my.

Aside from inefficiencies, another problem arising from targeting is it creates an entrenched culture of rent seeking regarding investment decisions. In practically every government report, particularly ones discussing development, investment and tax incentives always are options listed to encourage investment. When the Government provides additional incentives for business to move into a particular area, investors end up chasing and expecting tax advantages, rather than basing their investment decision on market principles. Such behaviour also does not encourage an entrepreneurial spirit among domestic investors.

Shifting focus

There are encouraging signs that the Government is leaning towards a more enabling environment. The Government is changing its focus to infrastructure quality not quantity, with no new mega projects in the pipeline. In an interview in June 2004, Prime Minister Abdullah Badawi pointed out that the Malaysian Government already had many incentives and did not believe that incentives had to be monetary. Rather the environment must be conducive to doing business at a low cost. The Prime Minister also announced that Proton could not depend on government protection forever (*Far Eastern Economic Review*, "Wish List", June 3 2004, p. 20). Bank Negara's governor also has stated the public sector's role in the economy will be scaled back and will primarily focus on providing an enabling environment to strengthen the role of the private sector in the economy (*The Edge Malaysia,* "Economic Rebalancing to Intensify, says Zeti", 4 August 2004, www.theedgedaily.com).

PLANNING FOR A MARKET ECONOMY

The Vision 2020 statement envisaged the private sector driving economic growth. The Malaysian Government has a plethora of "Master Plans" to support Malaysia's economic expansion.[7] One of the issues influencing the Government's involvement in planning is its desire to ensure an equitable development process. While a certain degree of planning is a sensible addition to any policy process, the overuse of plans has the potential to stifle entrepreneurial ability by making businesses over-reliant on such guidance.

The Malaysian Government retains strong links with much of corporate Malaysia (see Chapter 1 – *The Transformation*). Petronas, the oil and gas giant and by far Malaysia's largest company, is wholly Government owned. Government controlled institutions have a majority equity stake in seven of the top ten listed companies and frequently trades in these stocks to drive the market up. The Malaysian Government also holds 'Golden Shares' in strategic national companies such as Malaysian Airlines, Telekom Malaysia and Tenaga Nasional – an electricity company – which give the Government the final decision in the corporate direction of the business. Therefore, if the Government's policy objectives differ from what might be best for shareholders, then minority shareholders suffer. The ability to influence companies for policy purposes also suggests a certain lack of transparency and potentially raises issues about corporate governance.

That said, in 2004 the Malaysian Government introduced key performance indicators and performance-linked pay for government-linked companies in an effort to improve efficiency, reduce the budget deficit and possibly prepare government-linked companies for divestment. In practical terms, the Government is unable to sell significant shareholdings all at once. The size of their equity stakes preclude rapid divestment because of the impact it would have on the stock exchange. Businesses identified by some commentators as potential privatisation options include those in property development, construction and building materials (*The Edge Malaysia,* 'Reforming the GLCs and Khazanah', July 12 2004, p. 58).

IMPLEMENTATION

Perhaps the biggest challenge facing Malaysia is implementing the various policies designed to promote growth and economic restructuring. The top levels of Government have advanced several ideas that, if implemented, will take Malaysia to the next level of development. Thirteen years ago, the Vision 2020 statement identified the need for small and medium enterprises to be dynamic, self-reliant and prepared to think long term. However, a plethora of incentives and grants still are available for domestic investors. Incentives can be restrictive on business activity and can focus entrepreneurial effort on rent-seeking behaviour. To this extent, incentives may be counterproductive and thwart the development of a vibrant and resilient business community. Domestic private investment remains low and some fear that the Government's statements on how the challenges ahead will be addressed are expressions of intent that might not be realised.

[7] Current Master Plans include, but are not limited to, the overarching Eighth Malaysia Plan, the Financial Sector Master Plan, the Capital Market Master Plan, the Second Industrial Master Plan, the Knowledge-Based Economy Master Plan and the Privatisation Master Plan.

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EDUCATION: TACKLING A CONSTRAINT TO GROWTH

KEY POINTS

- **Education is an integral part of the Malaysian Government's move towards a knowledge-based economy in both service delivery and higher value-added production.**
- **The current education system is complex, with many pathways to choose on the way to work or higher education.**
- **Gaps in the current system include quality of teaching, English language capacity and limited research capacity.**
- **The policies to improve educational attainment are broad ranging, covering policies to encourage Malaysians to stay in education longer, improving delivery of educational services, and establishing Malaysia as a regional centre of excellence for education.**
- **Australia is playing a role in Malaysia's education ambitions; Australia and Malaysia have strong educational links and Australian institutions have considerable experience in providing the type of services Malaysia is looking for.**

Both the necessity and the opportunity to move to higher value-added production activities based on knowledge – to move more from a production economy to a knowledge economy – are drivers of change for Malaysia today. Improving Malaysia's education is a key priority for the Malaysian Government and includes both increasing the number of Malaysians undertaking educational pursuit and lifting the quality of the educational service. Australia and Malaysia have a long history of educational links, which looks set to continue as Malaysia pursues its development goals.

EDUCATION'S IMPORTANCE FOR THE MALAYSIAN ECONOMY

Malaysia has experienced dramatic economic growth through moving from agriculture to industry and through expanding international trade and investment flows. It has emerged in the last twenty-five years as one of the most globally integrated trading nations and the export of manufactures has been the backbone of this process. However, competitors for markets based on low wage cost manufacturing have emerged. China, Indonesia, Thailand, Vietnam and others are jostling for market share in this field.

At the same time, globalisation, liberalisation and the technological revolution have changed the rules and nature of international trade, investment and competition. A country's competitive advantage often is dependent on its potential to generate, disseminate and utilise knowledge. Economies, industries and businesses are restructuring so they can harness the new technologies in information and communication, biology, and manufacturing materials and processes and move to new business methods in logistics, marketing, supply-chain management and the strategic use of research and development.

The role of such developments in inducing new forms of growth was recognised in Malaysia's Third Outline Perspective Plan, 2001-2020. This plan focuses on building a resilient and competitive nation while developing Malaysia increasingly into a knowledge-based economy. It acknowledges the need to re-orient human resource development to support a knowledge-based society.

This recognition represents a self-conscious pursuit of "paradigm shift" for Malaysia. Of all the East Asian economies, the contribution of total factor productivity to growth has been lowest in Malaysia for much of the post-war period.[8] Its average GDP growth of six per cent over 40 years was driven mostly by labour and capital growth, much more than most other countries in the region (Table 3.1). Total factor productivity has risen more substantially in recent years, representing about one quarter of GDP growth between 1996 and 2000, but still below the best practice countries in Table 3.1.

[8] Total factor productivity is a measure of the efficiency of the production process considering several inputs or factors. It is expressed as a ratio of outputs to a combined measure of two or more factor inputs, such as capital and labour (Noble, 1995).

Table 3.1

Total factor productivity has negative contribution to Malaysian growth

Postwar sources of growth in East Asia, per cent per year, 1950 to 1990

Country	Output growth	Capital contribution	Labour contribution	Total factor productivity	Total factor productivity share
Japan	6.8	3.7	0.8	2.3	33.8
China	5.5	2.9	2.2	0.4	7.3
Hong Kong	9.0	2.8	3.1	3.1	34.4
Korea	7.4	2.9	2.4	2.1	28.4
Taiwan	8.6	2.6	3.1	2.9	33.7
Singapore	7.7	3.9	3.0	0.8	10.4
Indonesia	6.7	2.6	2.0	2.1	31.3
Malaysia	6.0	3.6	2.9	-0.5	-7.5
Philippines	4.9	2.4	2.3	0.2	4.1
Thailand	5.8	1.7	2.4	1.7	29.3

Source: Drysdale, *et al,* 2004.

Knowledge versus production economy

World competitiveness ratings and rankings, such as those produced by the World Economic Forum and the International Institute of Management Development (IMD), find that while Malaysia rates well in terms of a range of criteria such as openness, infrastructure, finance and government policy, in the areas of management, labour skill and technology much lower rankings are obtained, certainly well below Malaysia's average competitiveness ratings. For example, compared with an overall competitiveness country rank of 16 in the IMD World Competitiveness Yearbook 2004, in key knowledge economy areas Malaysia ranked much lower: secondary school enrolment rate, 39; tertiary education attainment rate, 36; female labour force participation rate, 51; illiteracy rate, 52; and R&D personnel in business per capita, 46. By contrast in the "Production Economy" areas of working hours, wage costs, employment growth, taxes, labour legislation and regulation, Malaysia ranks in the top 15 countries (IMD International, 2004).

The Malaysian Government saw that Malaysia's future competitiveness would depend increasingly upon knowledge rather than increases in labour and capital. The availability of knowledgeable and highly skilled personnel with thinking skills was identified as the "missing link" in allowing Malaysia to develop into a successful knowledge-based economy, and to sustain its position in the international market place against other rapidly industrialising economies (Economic Planning Unit, 2001a).

Government strategies

The Eighth Malaysia Plan, 2001-2005, highlighted the importance of creating a strong resource base to support the development of the knowledge-based economy so as to raise productivity and competitiveness. Strategies and programs were defined which were to increase the accessibility of education and training at all levels, strengthen the delivery system and improve the quality of education and training. This was seen as essential for increasing general labour force productivity, but also for helping the country to "leapfrog" towards the forefront of technology and information system use. Complementing the economy-wide vision was the Ministry of Education's Education Development Plan (2001-2010) known as the "Blueprint".[9] To achieve these goals, the Eighth Malaysia Plan set aside 20.6 per cent of the total Plan allocation for education and training and RM18.7 billion for education at pre-school through to tertiary levels, with RM9.2 billion for tertiary and teacher education. A further RM4.0 billion was allocated to vocational and skills training (Economic Planning Unit, 2003).

In line with these broad aims, particular emphasis on maths, science and technology is maintained, expressed as achievement of a target 60:40 ratio of science to arts students. Further developing English language capacity and developing teaching of other foreign languages in order to enable Malaysians to "access and contribute to global knowledge" also is part of the government's strategy. The general private sector contribution to education will be further facilitated, including university and vocational level education. A particular role is seen for the private sector in the provision of multidisciplinary education and training, and in new fields such a biotechnology and bioinformatics. Education enhancement in rural areas is receiving major support, including through distance learning.

A national curriculum for preschool education will be established. Teacher training is considered vital, with a target of 50 per cent of primary school teachers to be graduates by 2010 and 100 per cent of secondary teachers to be graduates by 2010. Information and communication technology in teaching and learning will be encouraged, including through collaboration on course design and review between the public and private sectors.

Outlays and outcomes

Expenditure on education reflects this high government priority (Table 3.2). Malaysian Government spending on education accounted for 20 per cent of all public expenditure in 2001, nearly double the OECD country average (OECD, 2004). Lesser welfare state provisions for social protection, which reduce public outlay as a share of GDP for Malaysia, do induce some overstatement, but Malaysia also is devoting a higher share of GDP to public outlay on education than, for example, other economies in the region. This partly is explained by the country's youthful demography and by small private outlays on education relative to public expenditure. Nevertheless, this should provide a solid base from which to deliver on the country's human resource development plans.

[9] The Eighth Malaysia Plan and the Education Development plan are supported by the Mid-Term Review of the Eighth Malaysia Plan, the annual Government Budgets, the Industrial Master Plan, the Knowledge Economy Master Plan and the Human Resource Development Master Plan. Early planning also is underway for these initiatives to be reflected in the Ninth Malaysia Plan, which will be announced in 2005 for the period 2006-2010.

Table 3.2

Malaysian public spending on education higher than Australia, OECD average

Public spending on education and tertiary education, selected countries, 2001

	Malaysia	Australia	OECD average
Public spending on education, share of all public spending	20.0	14.4	12.7
Public spending on education (payments to institutions only), share of GDP	7.2	4.5	5.0
Public spending on tertiary education (payments to institutions only), share of GDP	2.1	0.8	1.0
Public spending on tertiary education (subsidies to households only), share of GDP	0.6	0.4	0.3
Public spending on tertiary education (education institutions plus subsidies to households), share of GDP	2.7	1.2	1.3

Source: OECD, 2004.

Table 3.3 shows the increase in educational attainment between 1990 and 2003. At present, non-compulsory education in Malaysia is relatively less popular than in Australia (Figure 3.1). The 15 to 24-year-old age group is particularly important, as this is generally the age when individuals are attending university or undertaking vocational education and training. This could potentially affect the future supply of skilled employees and limit their ability to adapt to changing knowledge requirements as technology changes.

Table 3.3

Educational attainment increasing

Highest level of education attainment of the labour force, percentage distribution by year, 1990 to 2003

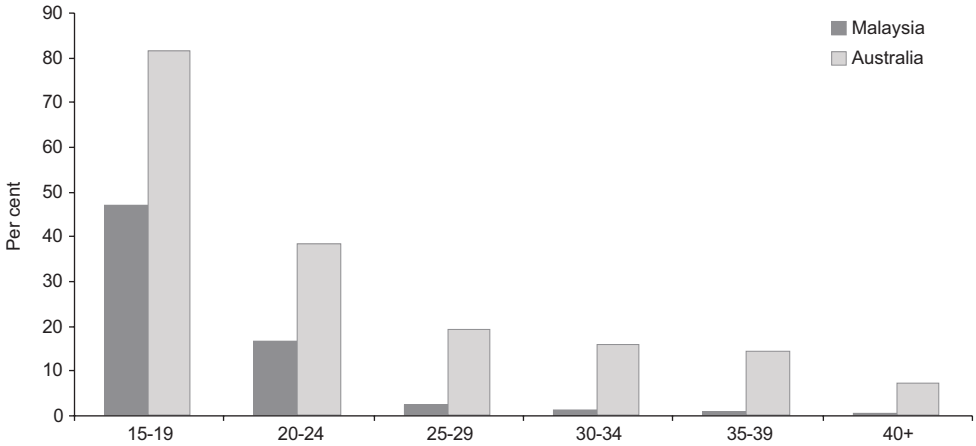
Highest Level of Attainment	1990	1995	2000	2003
None	9.6	8.6	6.1	4.9
Primary	33.8	27.6	26.1	21.8
Lower-secondary	23.5	23.3	21.9	21.4
Upper-secondary	24.3	29.4	31.9	35.6
Post-secondary	3.2	4.2	3.6	3.8
Tertiary	5.6	6.9	10.4	12.5
Workforce ('000)	6991.8	7892.6	9616.0	10 364.2

Source: Department of Statistics Malaysia, 2004.

Figure 3.1

Malaysian education participation lower than Australia

Education participation rates, Malaysia and Australia, percentage of age group, 2000



Source: OECD, 2002; Department of Statistics Malaysia, 2001.

THE MALAYSIAN EDUCATION SYSTEM

Education is the cornerstone to attaining Malaysia's development goals. In line with these ambitions, there have been concerted government efforts to achieve its goals of access, equity and quality in education.

Schooling

The emphasis of the Education Blueprint 2001-2010 is on quality primary schooling, the completion of primary school by all children and to increase pre-school availability. Malaysia has 11 years of free, basic education; six years of primary education, three years of lower secondary and two years of upper secondary. School attendance is compulsory from age seven. Between 1992 and 2002, the transition rate from primary to lower secondary study increased from 68 per cent to 83 per cent.

The education system in Malaysia is complex. There are three types of national primary schools with the medium of instruction either in Malay, Chinese or Tamil.[10] All students sit the Primary Schools Assessment Test, which is the main criterion for entrance into different types of lower secondary school, that is, regular day schools, fully residential schools and the Ministry of Entrepreneur Development Junior Science Colleges. At the end of lower secondary school, all students sit the Lower Secondary Assessment test.

[10] Students from the Chinese and Tamil medium schools proceed to a transition year before entering lower secondary school so they can build sufficient proficiency in the Malay language, the only medium of instruction in secondary schools.

At the end of the two years of upper secondary education, students sit for the Malaysian Certificate of Education (*Sijil Pelajaran Malaysia*), a national examination described as equivalent to the British GCE 'O' level and could be considered equivalent to the NSW School Certificate. The Malaysian Certificate of Education is the accepted exit examination. From here the majority of students either continue their post-secondary education or enter the labour market. In 2002, the upper secondary level of education had an enrolment of 74 per cent of the age group (Ministry of Education, 2002b).

A key educational issue is the adequacy of the preparation of students for university degree level study.[11] After the Malaysian Certificate of Education examination, a number of possibilities for further study are open to students. They can continue with Form 6, which is classified as post-secondary education, and is equivalent to year 12 in Australia and years 12 and 13 in countries such as Germany, France and the United Kingdom. Students then sit the Malaysian Higher School Certificate Examination (*Sijil Tinggi Pelajaran Malaysia* – STPM) which is described as equivalent to the British 'A' level examination and could be considered equivalent to the NSW Higher School Certificate. Alternatively, students can study a one-year Matriculation examination, the international baccalaureate or an overseas equivalent of the Malaysian Higher School Certificate Examination such as the British A-levels or the Australian Higher School Certificate examinations offered by the various states. The Matriculation examination meets the requirements of local universities, while the Malaysian Higher School Certificate Examination and overseas equivalents meet the requirements of local and international universities. In place of Form 6 post-secondary study, students also can move into technical and vocational courses and awards offered by a variety of institutions.

Higher education

The Malaysian Government established the Ministry of Higher Education to manage its strategy of encouraging more Malaysians to undertake tertiary studies and to establish Malaysia as an education hub. University-level study has grown considerably since the mid 1990s and is targeted to grow further as school retention and participation at senior secondary levels grow. In 2002, there were 11 public universities, six university colleges and the Tunku Abdul Rahman College. In 2002, a total of 283 206 students, of whom 59 per cent were female, were enrolled in public universities (Ministry of Education, 2001).

Within Malaysian public universities a variety of courses and awards are provided and around 60 per cent of students are undertaking their first degree. More than one quarter of students are in pre-degree courses – that is, matriculation, pre-diploma, certificate, diploma and integration, and diploma. Therefore a sizeable effort of teaching within the universities essentially is at pre-university level. The proportion undertaking study at this level will decrease over time as more students qualify for direct undergraduate degree entry through longer school participation and completion of the Malaysian Higher School Certificate Examination, and possibly through growth in the private higher education area. This will take time to pass through the system and, in the meantime, large absolute numbers of students at pre-degree study will continue during the plan period.

[11] Up to the end of upper secondary school, the Ministry of Education is solely responsible for the quality and direction of education. After this, at least five different ministries play a role in offering educational programs and awards, although the Ministry of Education and the Ministry of Higher Education still are the major ministries.

Private universities have been established following the Private Higher Education Institutions Act, 1996, to meet with the projected local student growth and to develop Malaysia as a regional education centre. This Act provided for the establishment of private universities and foreign university offshore campuses at ministerial invitation (Ministry of Education, 2001). There are a number of different collaborative programs available:

- Twinning programs (2+1) where students register with the college and foreign institution, undertaking the first two years of study in Malaysia and completing the final year in the foreign university.
- Twinning programs (3+0) where students register with the provider to obtain a foreign degree but undertake all three years of their study with the private provider in Malaysia.
- Credit transfer programs where students accumulate credit for their local study and then use these to apply to a foreign institution.
- Advanced standing programs where the course is set by the local college usually leading to the award of a diploma which is recognised in part or full by a foreign university for admission.
- External degree programs where students are directly registered with a local or foreign university and the private college serves as a tuition centre.
- Joint programs which lead to postgraduate degrees where the foreign university and local college jointly design the curriculum.

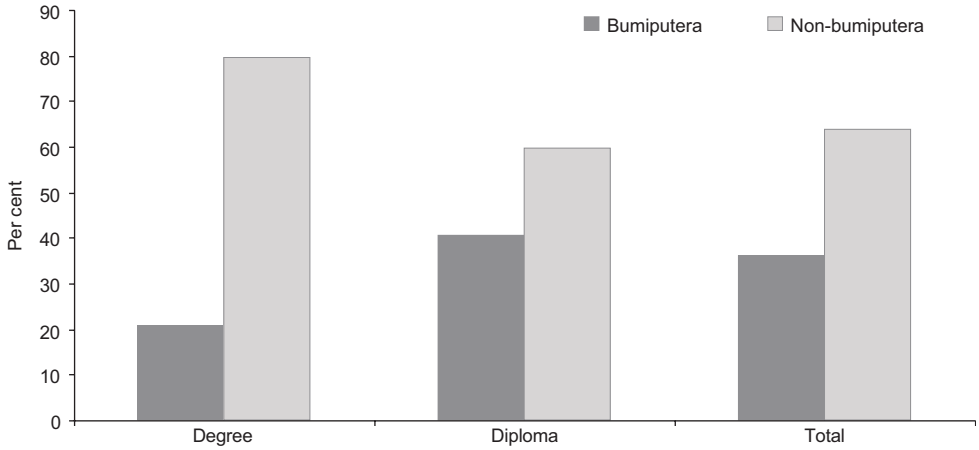
Between 1996 and 2004, there was rapid growth in private Malaysian universities as well as the establishment of foreign branch campuses from Australia and the United Kingdom. There currently are 11 private universities, five private university colleges and five foreign branch campuses. Of the 11 private universities, six are Malaysian, three are Australian (Monash University Malaysia, Curtin University of Technology and Swinburne University of Technology) and two British (University of Nottingham and De Montfort University). The Malaysian Government requires both public and private institutions to increase access to local students especially to *bumiputera* (Economic Planning Unit, 2001a). Figure 3.2 shows the enrolment of local students in 1999.

The predominant emphasis in higher education provision among the private providers is at pre-degree and undergraduate levels, which assists in meeting the growing participation of local students at pre-degree and undergraduate degree levels. There is only limited postgraduate and research involvement at this stage. The main research capacity rests with public universities with the development of research intensive universities and centres of research excellence planned. Among the targeted areas are biotechnology, pharmaceuticals, information and communication technology, microelectronics, advanced materials and aerospace technology (Economic Planning Unit, 2001a).

Figure 3.2

Bumiputera enrolments lower than non-_bumiputera_ in private institutions

Enrolment in private institutions of higher learning, per cent of total enrolments, 1999



Source: Economic Planning Unit, 2001a.

MONASH UNIVERSITY MALAYSIA

Monash University Malaysia was established in February 1998 in Bandar Sunway at the invitation of the Malaysian Government and in 2004 had 2300 enrolled students. Its establishment is a joint-venture between Monash University and the Sunway Group.

Monash University Malaysia offers nine undergraduate degrees: Bachelor of Business and Commerce, Bachelor of Engineering (Mechanical), Bachelor of Engineering (Mechatronics), Bachelor of Engineering (Electrical and Computer Systems), Bachelor of Computer Science, Bachelor of Information Technology, Bachelor of Science (Biotechnology), Bachelor of Science (Medical Bioscience) and Bachelor of Communication and a double degree in Bachelor of Science (Biotechnology)/Bachelor of Science (Medical Bioscience). The Malaysian campus also offers three postgraduate degrees: Master of Information Technology (Minor Thesis), Master of Science (Research) and Master of Engineering Science (Research). In 2005, Monash Malaysia will offer a Bachelor of Medicine/ Bachelor of Surgery degree, although enrolled students will initially spend their first two years studying in Australia while the Malaysian facilities are being built.

Monash University Malaysia has established the Biotechnology Resource Centre and is the only private university in Malaysia to build and operate a physical containment laboratory for experimentation into genetic manipulation of DNA. The School of Business established three research units in 2002: the Banking and Finance Unit, the Malaysian Business Unit and the Economic and Business Modelling Unit. In 2002, the School of Information Technology established the Information and Communication Technology Enterprise Unit.

Source: Monash University Malaysia, www.monash.edu.my.

Technical and vocational education

Technical and vocational education is a diverse area covered by a variety of different institutions across an array of ministries. The Ministry of Agriculture and the Ministry of Health, for example, have their own institutions to provide non-graduate training in the professions and occupations in their domain.

Vocational education and training education is nationally run, although State governments also operate Skill Development Centres. The major ministries involved in vocational education and training are the Ministry of Education (at secondary school level), the Ministry of Higher Education, the Ministry of Human Resources, the Ministry of Entrepreneur Development and the Ministry of Youth and Sport. Between them they offer vocational education and training courses at certificate and diploma levels and at the different skill levels defined through the National Vocational Training Council. The National Occupational Skill Standards provide the skill competencies at each of five skill levels (SKM 1-5) and allow for progression to different levels. These skill levels are not used by the Ministry of Higher Education in its institutions, staying with its own qualifications of certificates and diplomas. The entry qualification into public vocational education and training institutions is the Malaysian Certificate of Education. The diversity of the vocational education and training options makes it difficult to determine an appropriate vocational career path and introduces coordination issues, not least because of limited data availability for planning and monitoring progress.

In addition to public sector vocational education and training, there is substantial involvement of private providers in the vocational education and training field. The National Vocational Training Council currently accredits around 1500 private training centres. At the beginning of 2003, private providers accounted for 4726 courses delivered through 1488 accredited centres (for more information, see the National Vocational Training Council summary at www.trainingmalaysia.com).

EDUCATIONAL GAPS AND ISSUES

In comparing the present Malaysian education system and the goals and directions outlined in the various government plans a number of potential gaps are evident. These include the extent of secondary school retention and participation in higher education; the quality of education in relation to curriculum, teacher quality, and standards; English language capacity; developing widespread use of information and communication technology at all educational levels; expanding research capacity; implementing the 60:40 principle in relation to science and technology; and making lifelong learning and flexible education systems a reality. Each of these is discussed briefly below.

School retention and expansion of participation in higher education

Low retention rates in secondary school have been a key government concern. Although 11 years of education are provided, 90 per cent of the Malaysian population undertakes at least nine years of education versus an average of 12 years for 90 per cent of the population in the OECD countries

(OECD, 2003). The Ministry of Education Blueprint targets an increase in tertiary participation rates to 30 per cent of the 17 to 23-year-old age group by 2005 and 40 per cent of the 16 to 22-year-old age group by 2010. Thus, substantial growth will need to be met in terms of course provision, qualified teachers and types of institution. The private sector is seen as a partner in achieving these national participation goals.

In terms of tertiary education, Malaysians undertake an average of 1.3 years compared with 2.6 years in the average OECD country and 3.1 in Australia (Table 3.4). Currently the Malaysian Certificate of Education examination is the expected exit exam and the accepted entry to vocational education and training study and study for occupations in health and agriculture. Only 14 per cent of the age group qualifies for direct university entrance compared with the OECD average of 55 per cent (OECD, 2002), partly because of Malaysia's complex and differentiated route to university study.

Table 3.4

Malaysians spend less time at school than Australians, OECD average

School expectancy, expected years of schooling under current conditions, excluding education for children under the age of five, 2001

Countries	Primary and lower secondary education	Upper secondary education	Post-secondary non-tertiary education	Tertiary education	All levels of education
Australia	11.9	4.3	0.6	3.1	15.5
OECD country mean	9.4	3.6	0.2	2.6	15.7
Malaysia	8.6	1.8	0.2	1.3	12.4

Source: OECD, 2003.

A further consideration is the funding and scholarship support to students to continue their education. Much of the education budget actually is spent on students in the form of full subsidies to students and their families such as scholarships, net public loan payments and funded living allowances. No significant fees are charged for public education. As part of the government's democratisation of education, there are many generous government schemes to support rural students, vocational education and training students, university students, teachers in remote areas and teacher professional development in upgrading to degree status. In targeting growth in participation at the upper secondary and post-secondary levels the government is considering further strategies to support students through support services, scholarships and loans.

The private sector is seen as a source of funds to support educational growth through financing programs and funding institutions. The ability to finance and encourage post-secondary participation without placing a high debt burden on students and their families may require alternative approaches to those currently used.

Quality

Quality is a major theme in Malaysia's array of plans. It extends across the areas of curriculum, teacher quality and institutions, including private providers of post-secondary education.

Curriculum

The curriculum at all levels of education has come under review in recent years. The aim has been to broaden and diversify the curriculum and to emphasise critical thinking, creativity and innovation. The development of technical schools, the introduction of technical and vocational streams in academic schools and the major review of the school vocational curriculum being phased in during 2002-2005 are important developments. The intention is to provide a pathway from school to semi-skilled workforce, community colleges, polytechnics, and technical universities. The philosophical shift in curriculum has been to move from teacher-centred to student-centred teaching and to encourage active involvement in learning. At the vocational education and training level the National Occupational Skill Standards have been reviewed, developed and extended, though the emphasis is strongly on the hard skill competencies with a need to broaden their applicability to an ever-changing workplace. This entails the incorporation of soft and generic competencies to broaden and add flexibility to workforce skills. The extensive curriculum developments bring with them demands in relation to support programs such as early learning intervention support and monitoring, work experience programs, specialist support for information and communication technology and school libraries, and special education.

Teacher skills

The quality of teacher skills needs to be addressed given the increased numbers required with increasing school retention and participation in upper secondary and Form 6 levels. The target 50 per cent of primary school teachers and 100 per cent of secondary school teachers to be university graduates by 2010 will require an expansion of university level teacher education. Table 3.5 shows primary and secondary teacher levels of training in 2001. Teacher training takes place in either the (public) universities or in one of the 27 Ministry of Education teacher training colleges. With the goal for all secondary teachers to be graduates by 2010, the teacher training colleges now train only primary school teachers.

Teacher quality in terms of content knowledge, practical work experience and training also needs to be addressed in the vocational education and training areas. Currently only the Centre for Instructor and Advanced Skill Training (CIAST) provides training for vocational education and training teachers in the public institutions and can also train instructors from the private sector. There also are a handful of private providers able to provide instructor training. The CIAST Handbook shows an instructor course at diploma level with a duration of around 16 weeks. To 'professionalise' vocational education and training teachers, the Malaysian Government is increasing the number of qualified instructors and reviewing their remuneration (Economic Planning Unit, 2001b). There will be pressure on the existing capacity to meet the professional needs.

Table 3.5

Some secondary school teachers still untrained

Teachers by level of training in government primary and secondary schools, per cent of all teachers, June 2001

Types of schools	University trained	College trained	Untrained
Primary schools			
National	-	99.6	0.4
National type C	-	90.0	10.0
National type T	-	88.1	11.9
Special	-	100.0	-
Secondary schools			
Regular	64.5	32.7	2.8
Fully residential	88.4	11.6	-
Religious	77.9	20.3	1.8
Special	66.7	33.3	-
Vocational	82.4	17.6	-
Technical	63.2	34.8	1.9

Source: Ministry of Education, 2002b.

Private institutions

A third area of quality is that of assuring the quality of education provided through private institutions. The quality of private providers is crucial to Malaysia's ambitions to be a regional centre of educational excellence. Currently the National Vocational Training Council (MLVK) and the National Accreditation Board (Lembaga Akreditasi Negara) provide quality assurance in the vocational education and training and higher education areas. This regulatory framework aims to ensure that the development of individual institutions and the private sector as a whole is consistent with national needs. A considerable capacity in course accreditation has developed in a short period and there has been concern to introduce and maintain quality standards.

The National Accreditation Board, a statutory body, has responsibility for the standard and quality of higher education courses provided by the private higher education institutions and the certificates, diplomas and degrees awarded. The National Accreditation Board sets, monitors and reviews the standard and quality of courses. The Department of Private Education in the Ministry of Education has responsibility for the accreditation of the private institutions but not their courses. Foreign institutions, once approved, must have each course accredited on a course-by-course basis, a costly and time consuming process.

Between them the National Vocational Training Council and the National Accreditation Board currently accredit 1800 centres. The National Vocational Training Council accredits skill level courses and National Accreditation Board higher education courses from diploma level.

English language capacity

English language competency varies considerably throughout Malaysia. Performance in public examinations in English is not as strong as in other subjects and there are marked differences between urban and rural performance. To ensure greater capacity, English is now a compulsory subject from primary school and, from 2001, all maths and science has been taught in English. At post-secondary levels of higher education and vocational education and training, the teaching in private institutions generally is in English. This is not necessarily the case in the public universities and public vocational education and training institutions. Given the increase in information and communication technology in education much of the available curriculum software is in English. The Ministry of Education Blueprint target is to increase the number of foreign students in public universities by 2010 to have five per cent at undergraduate level and 25 per cent at postgraduate level. For this, English delivery is essential.

Development of information and communication technology capacity and capability

Expanding the use of information and communication technology at all levels of education has been part of the national information technology agenda since the Seventh Malaysia Plan and is a key component of becoming a knowledge-based society. Information and communication technology is the strategic means to increasing productivity and competitiveness and involves developing human resource capacity, providing infrastructure and developing information and communication technology applications. The Malaysian Government aims to accelerate the implementation of information and communication technology-related programs and projects and expand the diffusion and use of information and communication technology (Economic Planning Unit, 2001b). The Multimedia Super Corridor is a visible initiative to attract and foster a critical mass of knowledge workers similar to the Silicon Valley environment. The Smart School program in schools is a flagship program to increase information technology literacy and through information technology to deliver education better. It incorporates teaching, learning, administration and management and staff development. Through distance learning, it is hoped that access to education can be increased and lifelong learning promoted.

The agenda is thus a large one. In terms of capability and capacity, Malaysian infrastructure to enable information and communication technology use is stronger than for many of its Asian neighbours. However, there were only 320 internet users per 1000 population compared with 482 in Australia in 2002. The number of personal computers per 1000 population, at 147, was well behind Singapore at 622 and Australia at 565 (International Telecommunications Union, 2004). In 2002, Malaysia had 241 392 computers in education, compared with 672 471 in Australia (World Bank, 2004).

There is thus a reasonable foundation to achieve the educational goals set. The Malaysian Government plans to cater for 54 000 distance learning students in 2005 and the private sector will be encouraged

to increase their distance learning programs. Within public institutions, the key issue besides infrastructure is the willingness among teachers to make a cultural shift in their teaching and above all the support, especially in terms of time, to re-orient teaching.

Expansion of research capacity

Enrolments at PhD level are currently low with only 244 doctoral graduates in 2002. By comparison, Australia had 3628 local PhD graduates in 2002, and a further group of Australian doctoral graduates are trained internationally. Many PhD's in Malaysia have been gained via coursework and therefore there is often an even smaller base for both research and the supervision of research.

A strong research base and capacity to generate new knowledge and products is fundamental to a strong, globalised knowledge economy. It stands as perhaps the most crucial element for realisation of ambitions of a knowledge-based economy and international standing in education at advanced levels. There is therefore a goal of increasing the number of R&D experts and research ("smart") partnerships between public and private universities and industry, and efforts to attract foreign scientists and technologists, as well as Malaysians abroad, to Malaysia on a short- or long-term basis. The Ministry of Education Blueprint adds to this the aim of establishing existing premier public universities as research universities and increasing the number of research centres of international standing.

In recent years R&D funding overall has operated at 0.5 per cent of Malaysia's GDP. R&D funding via universities as a proportion of GDP is well below levels in Australia and the OECD averages and the Malaysian Government is seeking to increase the amount to at least 1.5 per cent by 2010 (Economic Planning Unit, 2001a). The Eighth Malaysia Plan allocated RM1.6 billion to R&D and commercialisation and RM100 million to basic research in universities. There also are targeted areas, known as Intensification of Research in Priority Areas, designed to align with national goals. In terms of research output, data on publication in the sciences and social sciences show that in 1995 Malaysians published only 587 scientific papers in total compared with 18 088 in Australia, 5393 in Korea and 1914 in Singapore (UNESCO and World Bank Taskforce on Higher Education and Society, 2000).

The 60:40 principle

Malaysia's 60:40 principle between science and arts is designed to assist research development, innovation and entrepreneurship by ensuring "the creation of a critical mass of S&T personnel to meet the demand of a knowledge-based economy" (Economic Planning Unit, 2001b). The aim is to have 60 per cent of student enrolment in science and technology courses in secondary and post-secondary education. The Form 5 upper secondary enrolment in science in 2001 was 28 per cent, compared with 60 per cent in arts. However, when technology and vocational enrolments are taken into account the figure increases to 40 per cent. Based on 1998-99 data, the Ministry of Education reported enrolments in first degree programs in public universities as 46 per cent science and 54 per cent arts (Ministry of Education, 2001).

Given the 60:40 targets, most new public universities and university colleges have a strong science and technology focus as well as an emphasis on application. The Kolej Universiti Kejuruteraan dan Teknologi Malaysia focuses on areas related to chemical, petrochemical, natural resources, manufacturing and process industry. The Kolej Universiti Kejuruteraan Utara Malaysia aims to produce highly skilled engineers while catering for students "inclined towards practical learning in view of its applied and skill-integrated approach" (Ministry of Education, 2002a). All private Malaysian universities contribute to the ambitions in science, technology and information and communication technology and often are backed by large corporations. Private higher education providers that can assist in the expansion of science and technology and also are able to boost research development will be highly sought. The challenge for the Malaysian Government is to ensure industry take-up of these skills if the target is achieved.

Making lifelong learning and flexible education systems a reality

Malaysian education is heavily focused on young people – the demographics themselves require this. However, government planning documents realise that the direction of change is towards ongoing, lifelong learning. The two sets of strategies are: first – to achieve high education participation and attainment for the young, and second – to put in place systems providing flexibility in education as the workforce re-trains and upgrades to meet new knowledge requirements and to allow for professional development needs to be met.

To meet the second strategy, provision will need to be made for more part-time study and re-entry into education at different life stages. The fragmentation of post-secondary education among the many ministries can present barriers to learning. In principle there are learning pathways from school to post-secondary education and to the workforce. In practice the system is difficult to navigate. The different awards and curricula make it hard to judge equivalence, in particular for the purposes of recognition of prior learning and awarding of advanced standing. There have been strong moves towards the development and acceptance of a Malaysian Qualifications Framework, along the lines of the Australian Qualifications Framework. Adoption of such a Framework would greatly assist in producing a more flexible education system and for international exchanges.

Further, the present education system is centralised and characterised by strong top-down policy formulation and implementation by each of the ministries. There is very little institutional flexibility or autonomy, including for financial management and revenue raising. The restrictions this presents have been recognised by the government and the Ministry of Education Blueprint discusses moving towards 'decentralisation' and 'responsibility centres'. The development of greater scope in decision making at the institutional level will increase the need for management development of senior staff. Key areas include financial management, human resource management, communication, marketing and the management of change.

THE AUSTRALIA-MALAYSIA EDUCATION RELATIONSHIP

The dominant feature of Australia-Malaysia education relations has been the long-standing presence of Malaysian students as a major source of enrolments in Australian institutions. This relationship dates back to the 1950s, when Malaysian students came to study in Australia under the auspices of the Colombo Plan.[12] In 2003, nearly half of overseas Malaysian students came to Australia to study. Anecdotal evidence indicates that ongoing networks play a strong role and that some of these networks are long-standing.

In more recent years, developments such as a strong presence of Australian institutions in Malaysia itself has complemented these linkages, both through campuses and "twinning" programs. Enrolments in Australia continue to be the major element in the arrangements and Malaysians comprise almost eight per cent of overseas students in Australia.[13]

CURTIN UNIVERSITY OF TECHNOLOGY

The Curtin Sarawak Campus is a branch campus of Curtin University of Technology that started operation in Malaysia in 1999 and in 2004 had 1 700 enrolled students. Curtin offers an English language program, pre-university studies, undergraduate degrees and postgraduate degrees.

Pre-university studies include Foundation Commerce and Arts, which prepares students for undergraduate study in Commerce, Arts and Social Sciences, and Foundation Engineering and Science, which prepares students for undergraduate study in Engineering, Science, Health Science, Computing and Information Technology. Undergraduate degrees include Bachelor of Engineering, Bachelor of Science, Bachelor of Technology, Bachelor of Business Administration, Bachelor of Commerce and Bachelor of Arts. It is anticipated that a Bachelor of Science (Life Science) will be offered in 2006, subject to Government approval. Postgraduate degrees include Master of Business Administration, Master of Engineering and Doctor of Philosophy.

In August 2003, Curtin Sarawak became the first international university in Malaysia entitled to access the Intensification for Research in Priority Areas grants of the Malaysian Ministry of Science, Technology and the Environment. The main fields of research at Curtin Sarawak currently include the Soft Soil Centre, the Centre for Sustainable Energy and Communication, parallel computing and GIS applications, palm oil research, geopolymer concrete research, systems approach to aviation safety, entrepreneurship in Sarawak, cultural approaches to teaching and learning, and media studies.

Source: Curtin University of Technology, www.curtin.edu.my.

[12] The Colombo Plan, which came into effect in 1951, was a plan for cooperative economic development of South and South-East Asia (Sauer, 2001).

[13] With data in this area care is needed in comparing stocks and flows, averages over time versus fixed point calculations, inclusion/exclusion of offshore, distance education etc. The following data are all taken from Commonwealth Education or Immigration Department estimates plus some data from IDP Education Australia and Australian Vice Chancellors Committee sources based upon the official figures.

Malaysia has especially strong representation in higher education enrolments compared with other countries, where Malaysian students represent 11 per cent of students (Table 3.6). In all other sectors, the Malaysian presence is proportionately smaller, in the four to eight per cent range.

Table 3.6

Malaysia well-represented in Australian higher education

Malaysian enrolments in Australia by sector, August 2004

Source	Schools	Vocational education and training	Higher education coursework	Higher education research	Foundation/ non-award	Total
Malaysia	750	1261	13 031	347	605	16 093
All countries	23 343	33 169	121 225	5490	11 574	207 262
Malaysia, per cent of total	3.2	3.8	11.0	6.3	5.2	7.8

Notes: Higher education research includes Masters Research and Doctor of Philosophy.

Source: Australian Education International, 2004.

Management and Commerce, Information Technologies and Engineering and Related Technologies are the largest fields of enrolment, respectively, absorbing more than 76 per cent of the total. Compared with the average pattern for other countries Malaysians are enrolled much more in engineering and related technologies and in architecture and building. They are less well represented in studies for agriculture and the environment, health, and society and culture.

Offshore education

Malaysian planning for future growth of education has allowed for a major offshore component and to encourage overseas providers to assist with on-shore provision. It also is important to point out that the Malaysian Government has deliberately begun a process of attracting overseas students to its own education system with the aim of becoming a regional centre for education servicing the Chinese, Indian, Indonesian and Middle Eastern markets (Economic Planning Unit, 2001a).

The Malaysian Government will encourage 'centres of excellence' in both public and private universities to benefit this process. This includes priority enhancement of the quality of staff and provision of well-equipped facilities. There is to be encouragement of team research as well as individual researcher specialisations and an expansion of postgraduate programs to bring about an overall strengthening of R&D capability. Procedures for appointing academic staff will be simplified. Public universities with 'centres of excellence' will be expected to act as catalysts for innovation and "the development of indigenous technology". Public universities with such centres will receive greater autonomy and flexibility and be encouraged to market aggressively to "attract a continuous inflow of foreign students". Private institutions will be encouraged to develop niche areas to attract foreign students. There will

be incentives to attract good quality foreign universities to establish branch campuses in Malaysia, in particular with a focus on teaching science and technology and for undertaking R&D. For all tertiary institutions a rating system to rank institutions will be developed in line with overseas practice with the aim of indicating the international standing of all Malaysian tertiary institutions (Economic Planning Unit, 2001a).

TAKING ADVANTAGE OF AUSTRALIAN KNOW-HOW

The following list summarises areas where Australian practice is relevant to Malaysia's education expansion and reform plans. These are listed by education sector, but across all sectors Australian know-how is available in relation to English language programs, teaching and reading; management development and performance management systems; financing and funding mechanisms, fees and loans; and family friendly work practices. In addition to these considerations, Australia has the following strengths:

In **secondary/senior secondary education**, Australia has strengths in school-based assessment and the monitoring of learning; developing programs to meet individual learning needs; work experience programs – school-to-work programs; examinations and building 'real' pathways; and teacher professional development, leadership and performance management.

In **vocational and technical education**, Australia has strengths in teacher training and professionalisation of teacher status; competencies to include soft skills and assessment; information and communication technology and teaching, assessment and administration; refining quality assurance especially in rationalising the number of private providers; and working with stakeholders.

In **tertiary education**, Australia has strengths in building research capacity through further study, research collaborations and exchanges; postgraduate research study – Masters and PhD; postdoctoral programs and fellowships; teacher training – primary, secondary, and special purpose (for example, teacher-librarians or special needs); course and program review with international peer review; information and communication technology in teaching, online programs and administration; and English language programs.

Malaysia's ethnic composition means it can reasonably seek to appeal to Middle Eastern, Indonesian, Chinese and Indian markets though concern is expressed by some providers over the regulatory and bureaucratic hurdles that may still surround this process in Malaysia. The ability to increase English language competence in educational delivery will also be an important requirement, as discussed above, to achieve plans such as five per cent overseas students at undergraduate level and 25 per cent at postgraduate level in public universities by 2010.

OUTLOOK

Strengthening education is an important part of the Malaysian Government's development goals. The generally high quality and depth of Malaysia's educational system is one of the reasons for Malaysia's economic success. However, education also is one of the biggest challenges as Malaysia develops from a production to a knowledge-based economy. The openness of Malaysia's economy means education is a crucial part of the enabling economic environment, providing business with the skills they need to compete successfully on the world stage. For this reason, expanding research and development, improving teachers' skills and encouraging Malaysians to embark on further study after secondary school are important goals.

Given the extent and richness of the Australia-Malaysia education experience and the imperatives for ongoing development and priority for Malaysian education within the country, there is much that Australian education might reasonably offer to assist Malaysia with the increasing human resource development emphasis in its national planning. The basic structures of education, the extensive use of English, the historical linkages and the geographical proximity all support this direction.

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A SUPPORTIVE ENVIRONMENT

KEY POINTS

- **Malaysia is competitive relative to other economies in the region in terms of business start-up costs, infrastructure quality and skilled labour.**
- **Australian business will find many common features, including a common law legal system, wide use of the English language, similar accounting standards and similar commercial laws.**
- **Issues to be aware of include restrictions on foreign investment, aspects of positive discrimination for the *bumiputera* community, price controls, intellectual property protection and opaque procedures regarding privatisation.**
- **These issues could potentially affect Malaysia's ability to move into higher value-added areas such as advanced manufacturing and services.**

In general, doing business in Malaysia is not difficult for Australian businesses. English is widely used, the legal system is the common law system and a wide range of investment incentives exist. Malaysia is competitive relative to other economies in the region, has a skilled work force and has a well-developed infrastructure and banking system. Some barriers remain, including positive discrimination for *bumiputera*s, copyright protection and transparency in the privatisation process.

OVERALL COMPETITIVENESS

The World Economic Forum Business Competitiveness Index ranked Malaysia 23 out of 103 economies in 2004 (Table 4.1). Areas of particular strength included overall infrastructure quality and few regulatory burdens.

Table 4.1

Malaysia competitive

Business and Growth Competitiveness Index rank, selected countries, 2004

	Business competitiveness index	Growth competitiveness index[a]
	Rank out of 103	Rank out of 104
Singapore	10	7
Australia	13	14
Malaysia	23	31
India	30	55
Thailand	37	34
Indonesia	44	69
China	47	46
Philippines	70	76
Vietnam	79	77

Note: a. The Growth Competitiveness Index measures the capacity of the national economy to achieve sustained economic growth over the medium term, controlling for the current level of development.

Source: World Economic Forum, 2004.

The costs of starting a business in Malaysia compare favourably with other regional economies (Table 4.2). There generally are no minimum capital investment requirements although the costs to register a business are more than most other economies in the region. Historically, the Malaysian Government has promoted investment in export-oriented manufacturing and capital-intensive and high-technology industries, including electrical equipment and electronics, oil and gas, biotechnology and chemicals. In keeping with its economic development goals, the Government infrequently issues approvals for labour-intensive manufacturing ventures (Economist Intelligence Unit, 2004a).

Table 4.2

Relatively easy to start a business in Malaysia

Selected indicators for starting a business and enforcing contracts, selected countries, January 2004

	Number of start-up procedures	Time to start a business	Cost to register a business	Minimum capital requirement	Procedures to enforce a contract	Cost to enforce a contract
	number	days	per cent of GNI per capita	per cent of GNI per capita	number	per cent of GNI per capita
Malaysia	9	30	25	0	22	19
China	12	41	15	1237	20	32
India	11	89	50	428	22	95
Indonesia	12	151	131	138	29	269
Philippines	11	50	20	2	28	104
Singapore	7	8	1	0	23	14
Thailand	8	33	7	0	19	30
Australia	2	2	2	0	11	8

Source: World Bank and International Finance Corporation, 2004.

SETTING UP SHOP IN MALAYSIA

Companies doing business in Malaysia must register with the Companies Commission of Malaysia. Reservation of the company name, which is held for three months, costs RM30 (US$8). Company registration fees vary according to the size of the nominal share capital. These fees range from RM1000 (US$263) for projects with share capital of less than RM100 000 (US$26 316) to RM70 000 (US$18 421) for projects with share capital exceeding RM100 million (US$26.3 million).

Initial applications should be made to the Ministry of International Trade and Industry (MITI), including detailed information on a project's employment, environmental effects, estimates of projected profits, the amount of raw materials and components to be used, capital investment per forecast employee (projects where the ratio is less than RM55 000 are categorised as labour-intensive and discouraged), the extent to which output will replace imports and the contribution to Malaysia's exports. Projects involving technology transfer receive the best reception. Approval typically takes six to eight weeks.

Investors must choose one of four types of business organisation in Malaysia (limited company, local branch of a foreign company, partnership or sole proprietorship) and submit an application for a company licence.

Manufacturers with shareholder funds of RM2.5 million or more, or at least 75 full-time paid employees, must obtain a manufacturing licence from MITI.

Technology transfers, including joint ventures, technical assistance and licensing, must be approved by MITI.

Companies seeking incentives must apply to the Malaysian Industrial Development Authority (MIDA), which also considers applications for the creation of expatriate posts in manufacturing, tourism, hotel and agricultural projects.

Investors may need approval from Bank Negara Malaysia for some foreign exchange transactions.

The Department of Environment requires environmental impact assessments for selected investment projects. These are generally handled by private contractors and approved in two to four months.

Additional permits such as those related to environment effects and building are needed from relevant state or local authorities. Approval may require two to six months. Building permits may be applied for only after securing basic investment approvals. A wait of around three months is normal.

Individual written contracts stating terms and conditions should be used when hiring workers.

Makers of CDs, VCDs, DVDs, DVD-RWs and any other optical discs must obtain licences from MITI.

Licensing requirements in general may involve greater disclosure and mandatory race ratios for *bumiputera*s, other Malaysians and foreigners in regards to management, labour and the board of directors.

Source: Companies Commission of Malaysia, 2004; Economist Intelligence Unit, 2004a; Malaysian Industrial Development Authority, 2004a.

Factor costs

Table 4.3 provides a brief summary of basic costs of doing business in Malaysia. Although labour costs are higher than, for example, China and India, total factor costs tend to be lower in Malaysia once items such as labour skills and infrastructure costs are taken into account. Most employees have received a minimum of nine years of schooling, with 58 per cent having lower and middle secondary education and 14 per cent having tertiary education (Austrade, 2004).

Costs can differ depending on location. For example, basic costs such as rent and electricity can be higher in the states of Sabah and Sarawak than in Peninsular Malaysia, although they can be offset by incentives to invest in this relatively underdeveloped area of Malaysia. Telecommunication costs are lower for businesses with Multimedia Super Corridor status.

Table 4.3

Factor costs not onerous

Selected factor costs, Malaysia

Electricity	
Commercial tariffs, per kWh	RM0.10 (US$0.03) – RM0.40 (US$0.10)
Industrial tariffs, per kWh	RM0.10 (US$0.03) – RM0.40 (US$0.10)
Minimum charge per month	RM10.00 (US$2.63) – RM1000.00 (US$263.16)
Water	
Per cubic metre	RM0.52 (US$0.14) – RM2.96 (US$0.78)
Minimum charge	RM0.00 (US$0.00) – RM30.00 (US$7.89)
Sewerage, per month	
Domestic	RM2.00 (US$0.53) – RM8.00 (US$2.10)
Industrial, per head	RM2.00 (US$0.53) – RM2.50 (US$0.66)
Commercial	RM8.00 (US$2.11) – RM9975.00 (US$2625.00)
Telecommunications	
Rental charges, per month	RM13.00 (US$3.42) – RM45.00 (US$11.84)
Domestic call charges per minute	RM0.04 (US$0.01) – RM0.90 (US$0.24)
International call charges per minute	RM0.90 (US$0.24) – RM2.40 (US$0.63)
Internet service fees	
Dial-up call charge per minute	RM0.03 (US$0.01)
Broadband per month	RM44.00 (US$11.58) – RM1188.00(US$312.63)
Digital leased line – normal, annual charge	RM10 800 (US$2842) – RM636 000 (US$167 368)
Digital leased line – Multimedia Super Corridor, annual charge	RM9600 (US$2526) – RM548 400 (US$144 316)
Rent, per month	
Prime office space, per m^2	RM12.95 (US$3.41) – RM67.20 (US$17.68)
Factory space, per $foot^2$	RM0.35 (US$0.09) – RM2.00 (US$0.53)
Industrial land, selling price $foot^2$	RM0.46 (US$0.12) – RM22.00 (US$5.26)
Freight	
Road, 20 foot container, per metric ton per km laden	RM0.06 (US$0.02) – RM0.20 (US$0.05)
Air, per kg	RM4.45 (US$1.17) – RM23.87 (US$6.28)
Sea, per 20 foot container	RM380 (US$100) – RM24 966 (US$6 570)
Allowances on qualifying capital expenditure	Initial allowances (allowances given only once) range from 10 per cent for industrial buildings to 40 per cent for environmental control equipment. Annual allowances (allowances given every year) range from 3 per cent for industrial buildings to 40 per cent for computer and information technology equipment.

Source: Malaysian Industrial Development Authority, 2004a.

Wages and conditions

There is no legislated minimum wage in Malaysia. Basic wage rates vary according to location and industrial sector and companies can provide additional benefits such as free medical treatment or bonuses. In 2003, the Malaysian Employers Federation conducted surveys of salary and fringe benefits for executives and non-executives in the manufacturing sector. For executives, monthly wages typically range from a minimum of RM1779 (US$468) for a chemist, to a maximum of RM16 787 (US$4418) for a general manager. For non-executives, monthly wages range from a minimum of RM481 (US$127) for an unskilled production operator to a maximum of RM3004 (US$791) for a production or technical supervisor (Malaysian Industrial Development Authority, 2004a).

Contributions by both employers and employees to the Employees Provident Fund are compulsory for all employed Malaysians. In contrast, only employees earning no more than RM2000 (US$526) per month contribute to the two schemes run by the Social Security Organisation (for more detail, see Table 4.4). Foreign workers and their employers voluntarily contribute to the Employees Provident Fund. Employers also are subject to levies on expatriate employees, ranging from RM200 (US$53) per year if they occupy a management, professional or technical post to RM1200 (US$316) per year for low-skilled positions (Malaysian Industrial Development Authority, 2004a).

Infrastructure

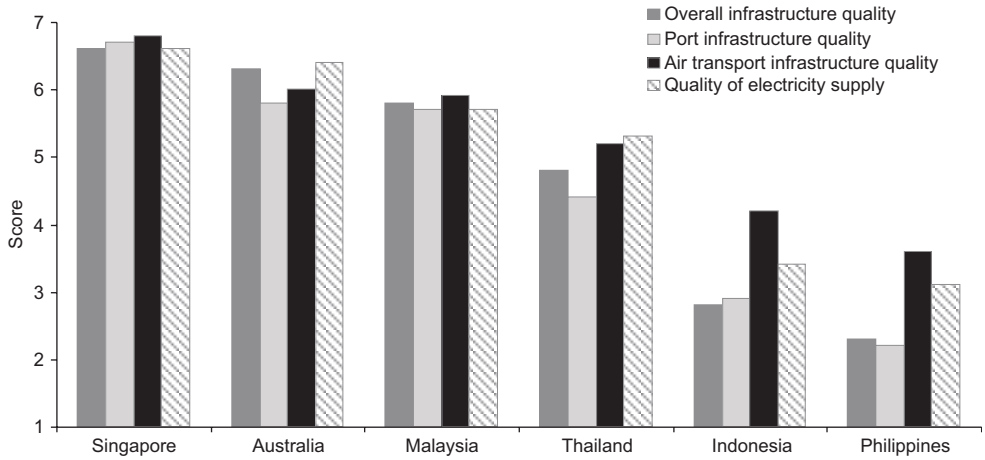
Malaysia has well-developed infrastructure, albeit underutilised in parts, partly paid for by large petroleum revenues (Figure 4.1). Port facilities have improved to the extent that container traffic has grown, on average, by 21 per cent per year over the three years to 2003 and tonnage has grown 11 per cent per year over the same period. Expansion of port capacity was timely; in 2003, the volume of cargo exceeded the 2000 available port capacity (Economic Planning Unit, 2003). Malaysian ports are the eighth busiest in the world – measured by twenty-foot equivalent unit container traffic – behind China (including Hong Kong), the United States, Singapore, Japan, Korea, Germany and Italy (World Bank, 2004).

Peninsular Malaysia has over 65 000 kilometres of national roads – 75.8 per cent of which are paved – and over 1200 kilometres of privatised highways (Austrade, 2004; World Bank, 2004). PLUS Expressways, which operates a large share of Malaysia's toll roads, currently ranks sixth among global toll highway operators in terms of market capitalisation (*New Straits Times,* 'PLUS plans to venture overseas', 30 August 2004). Of the Eighth Malaysia Plan allocation for infrastructure development, transport was a priority with RM5.1 billion to be used for the development of new roads to increase accessibility to rural areas. An additional RM8.9 billion was budgeted to upgrade existing roads (Economic Planning Unit, 2001). Total expenditure on roads was increased in the Mid-term Review of the Eighth Malaysia Plan to RM18.6 billion (Economic Planning Unit, 2003).

Figure 4.1

Malaysian infrastructure of a high standard

Quality of infrastructure – overall, port, air transport and electricity supply, average score out of seven, selected countries, 2002



Notes: Overall infrastructure quality – general infrastructure in your country (1 = poorly developed and inefficient, 7 = among the best in the world). Port infrastructure quality – port facilities and inland waterways in your country are (1 = underdeveloped, 7 = as developed as the world's best). Air transport infrastructure quality – air transport in your country is (1 = infrequent and inefficient, 7 = as extensive and efficient as the world's best). Quality of electricity supply – the quality of electricity supply in your country in terms of lack of interruptions and lack of voltage fluctuations is (1 = worse than most other countries, 7 = equal to the highest in the world).

Source: World Economic Forum, 2003.

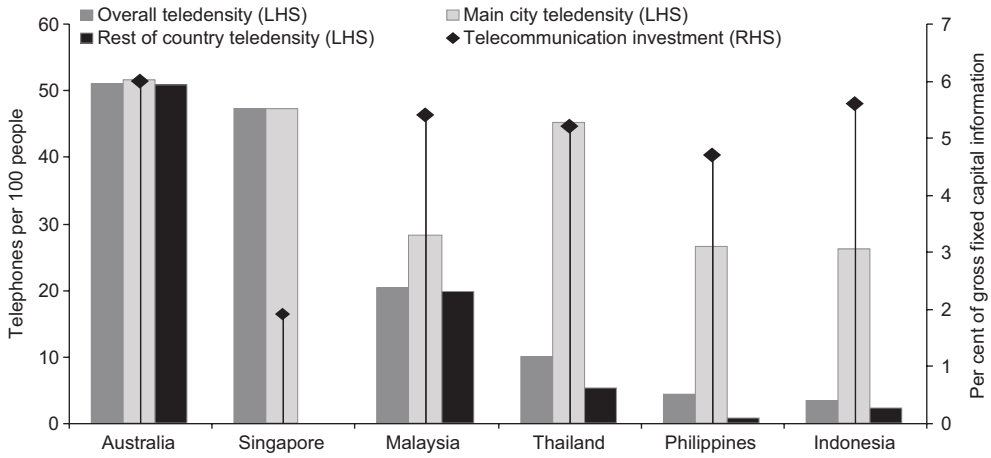
The principal airport for the country is Kuala Lumpur International Airport, opened in 1998 and located approximately 75 km south of Kuala Lumpur city centre. An example of government investment in showcase infrastructure, the airport's capacity is significantly greater than demand. Kuala Lumpur International Airport has not become a hub for international carriers in the way Singapore and Bangkok have. Non-commercial considerations determined its design and size and consequently the rate of return is lower than what could have been achieved.

Malaysian telecommunications infrastructure is much better than other developing economies in East Asia, but still lags Singapore, Korea, Taiwan, Japan and Hong Kong (Economic Analytical Unit, 2002b). Communications and information technology infrastructure is a key element in Malaysia's plans for development and investment in telecommunications is 5.4 per cent of gross fixed capital expenditure (Figure 4.2). Overall telecommunications access also is better than other South-East Asian nations. The Government has identified several key areas to develop further the information and communications technology (ICT) sector throughout 2001 to 2005 and the Mid-term Review of the Eighth Malaysia Plan allocated around RM7.7 billion to the ICT sector, of which RM1.5 billion was allocated to Multimedia Super Corridor flagship applications (Economic Planning Unit, 2003).

Figure 4.2

Telecommunications investment and access higher than other developing ASEAN economies

Teledensity and telecommunications investment, per 100 people and per cent of gross fixed capital formation, 2001



Note: 2000 data for Australia and Malaysia.

Source: International Telecommunications Union, 2002, 2003.

Water supply is a looming issue for Malaysia. Each state is responsible for developing and maintaining its own water supplies, with varying degrees of success. Although coverage is quite good, the delivery system is getting old and, in some cases, as much as 60 per cent of water supplied is lost from the system because of leaks and theft. The Government hopes to meet demand, in part, by privatising water and sewage management. The process of water privatisation currently is under review.

LEGAL AND REGULATORY ENVIRONMENT

Regulations and legislation covering companies, capital markets and accounting are straightforward and similar to those in Australia. Taxes are comparable to other economies in the region, import duties are low on average and industrial relations are typically non-confrontational. However, there are limits to foreign ownership in sectors outside manufacturing, the Government exercises price controls on certain goods and some foreign exchange controls remain in place.

Legal system

Many rules and regulations governing business in Malaysia are similar in nature to Australian legislation and regulation (Table 4.4). Examples include tax, company and securities laws; listing rules on Bursa Malaysia and the Australian Stock Exchange; and financial reporting frameworks for companies. Like Australia, Malaysia uses the Torrens land title system and Common Law. In Malaysia, traditional Islamic law is applied to Muslims only in respect of personal matters.

Table 4.4

Selected Malaysian business regulations and conditions

Corporate income tax	28 per cent. Businesses operating in the petroleum industry pay 38 per cent.
Capital gains tax	None on portfolio investment. 5 to 30 per cent on property.
Withholding tax	10 per cent on special classes of income; 15 per cent on interest; 10 per cent on royalties; 10 per cent for a contract payment on an account of contractor; 3 per cent for a contract payment on an account of employee.
Personal income tax	1 to 28 per cent for resident individuals on taxable income of RM30 000 (US$7895) and above per annum. 28 per cent for non-resident individuals.
General sales tax	5 per cent on fruits, certain foods, building materials and selected services. 20 per cent on alcohol. 25 per cent on cigarettes. 10 per cent on all other types of goods. A goods and services tax will be introduced on 1 January 2007.
Import duties	Tariff exemptions are available on raw materials, components, machinery and equipment not produced locally. For exemption on spares and consumables, businesses must also export 80 per cent of production and the tariff must exceed 5 per cent. Duty drawback is available for exported goods.
Excise duties	10 to 100 per cent levied on selected manufactured goods. Piece rates on alcohol and cigarettes.
Social security/payroll tax	No unemployment benefits. Employee Provident Fund, currently 20 per cent of employee salaries, provides retirement benefits. 11 per cent paid by the employer, 9 per cent paid by the employee. Compulsory.
Foreign exchange controls	Limits on ringgit payments and currency held by travellers; payments for imports must be made in foreign currency; investment abroad typically limited to 10 per cent of funds invested by resident clients; ringgit lending to non-residents limited to RM10 million.
Labour supply	Foreign workers are an important source of cheap, low-skilled labour.
Staff overtime/bonuses	8-hour day, 48-hour week. Overtime pay is one-and-a-half times the hourly rate of pay on normal working days, twice the hourly rate of pay on rest days and three times the hourly rate of pay on public holidays.
Staff leave	60 days maternity leave, up to 16 days annual leave per year and up to 22 days sick leave per year, depending on length of service. Up to 60 days paid sick leave where hospitalisation is necessary.
Staff dismissal	Malaysian workers typically cushioned from dismissal because foreign workers are easier to dismiss.

Employee health cover	Available for workers earning wages not exceeding RM2000 (US$526) per month. Employers contribute 1.25 per cent of employees' wages to the Employment Injury Insurance Scheme. Employers and employees each contribute 0.5 per cent of employees' wages to the Invalidity Pension Scheme. Maximum contribution is based on wages of RM2000 (US$526) per month.
Labour issues	Shortage of scientists and teachers.
Skills development	A key priority of the Malaysian Government. Manufacturers contribute to the Human Resources Development Fund which qualifies them for a training grant. Levies vary according to firm size.
Accounting principles	International accounting standards.
Foreign land ownership	Ownership of agricultural land allowed under certain conditions.
Banking services	Well-developed banking sector, with some commentators suggesting Malaysia is "over-banked". Strong Islamic banking sector.
Stock/financial markets	20th largest stock exchange in the world.

Sources: Economist Intelligence Unit, 2004a; Malaysian Industrial Development Authority, 2004a, 2004b; United States Department of Commerce, 2004.

Accounting standards in both Australia and Malaysia are based on International Accounting Standards. Malaysia has an independent board, the Malaysian Accounting Standards Board, whose standards are accorded legal status. Practitioners must be a member of the Malaysian Institute of Accountants to practise or work as an accountant. CPA Australia is a Scheduled Body of the Malaysian Institute of Accountants, which automatically entitles members to practise in Malaysia. Of the 20 000 accountants in Malaysia, 8000 are CPA Australia members. Of these 8000, 90 per cent are Australian-trained.

Securities law in Malaysia is very similar to the Australian regime. A Memorandum of Understanding between the Securities Commission and the Australian Securities and Investments Commission establishes a framework for assistance and mutual cooperation between the two regulators. Both parties facilitate the exchange of information to enforce and ensure compliance with the securities and futures laws of their respective countries. Mutual cooperation between the two countries also is evident in terms of enforcement and surveillance of capital market laws.

Bursa Malaysia and the Australian Stock Exchange consult closely, including in several developmental areas. Under the listing rules of both exchanges, companies are required to disclose their extent of compliance with codes on corporate governance and best practice.

Malaysia does not have a national competition policy and only energy and the communications and multimedia sector have made legal provisions for competition policy. In other sectors, competition regulation mostly is undertaken through control over prices and entry conditions, for example, permits and licences. These controls aim to achieve socioeconomic objectives, such as encouraging *bumiputera* entrepreneurship, rather than to promote market competitiveness. The absence of formal competition policies potentially can make it difficult for regulators to deal with problems such as collusion (Lee, 2004).

Foreign ownership

Few industries are completely off-limits to foreign investors. Foreigners can hold 100 per cent equity in any new manufacturing project and manufacturing expansion or diversification investment by existing companies, regardless of whether the product is destined for export or the domestic market. Foreigners also can hold 100 per cent equity in any new venture involving extracting, mining or processing mineral ores. The 2005 Budget Speech announced 100 per cent foreign ownership would be allowed in futures broking companies and venture capital companies.

Foreign ownership in other industries is less generous. For example, it is limited to 30 per cent in commercial banks, merchant banks, leasing companies, telecommunication companies, and any companies whose activities involve national interests such as water and energy supply, broadcasting, defence and security (Economist Intelligence Unit, 2004a; Foreign Investment Committee, 2004a). Australian law firms and lawyers are excluded from operating in Malaysia.

Foreign Investment Committee approval is required for any acquisition involving 15 per cent or more of the voting power by one foreign interest or 30 per cent or more of the voting power by multiple foreign interests. The Foreign Investment Committee guidelines contain more detail on foreign ownership regulations regarding businesses and property (Foreign Investment Committee, 2004a, 2004b; Ministry of Finance, 2004).

Bumiputera participation

The Malaysian Government has a policy of positive discrimination for *bumiputera*s and is working towards establishing a sustainable *bumiputera* commercial and industrial community.[14] This takes many forms. Government contracts often are awarded to *bumiputera* companies; new listings on Bursa Malaysia require an initial 30 per cent *bumiputera* equity ownership; concessionaires in any privatisation must allocate at least 30 per cent of contractual works to *bumiputera* contractors; companies involved in privatisation are required to offer employment opportunities to *bumiputera* individuals; a minimum of 60 per cent of government procurement, contract work and other related projects are to be awarded to *bumiputera* entrepreneurs; and 18 funds are available for the exclusive use of *bumiputera* to obtain finance (Economic Planning Unit, 2003; Economist Intelligence Unit, 2004a). Acquisitions of domestic companies by local or foreign interests require at least 30 per cent *bumiputera* equity participation. Companies with *bumiputera* equity shareholding of 30 per cent or more, but less than 51 per cent, are required to maintain at least 30 per cent *bumiputera* equity at all times. Companies which already have *bumiputera* equity shareholding of 51 per cent or more are required to maintain at least 51 per cent *bumiputera* equity at all times. The Foreign Investment Committee guidelines contain more detail on *bumiputera* participation (Foreign Investment Committee, 2004a, 2004b; Ministry of Finance, 2004). Such policy can be restrictive on business activity and can focus entrepreneurial effort on rent-seeking behaviour. To this extent, the policy may be counterproductive and thwart the development of a vibrant and resilient *bumiputera* business community.

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[14] This policy was introduced as part of the National Economic Policy in response to the 1969 riots. It has been credited with significantly improving the quality of life for Malays and reducing the potential for ethnic tension.

This policy is changing gradually. In 2003, acceptance to public Malaysian universities was based solely on merit and foreign companies with new investments in manufacturing no longer have to have 30 per cent *bumiputera* ownership.

DIFFERENT BUSINESS APPROACHES: BUILDING AND CONSTRUCTION

Australian experience illustrates the different approaches to engaging local business in Malaysia.

Leighton – structured relationships

Leighton Contractors (Malaysia) Sdn Bhd, established in 1982, is a 100 per cent foreign-owned entity. Leighton work on Malaysian Government contracts via structured relationships with Malaysian entrepreneurs. These entrepreneurs secure the contract and then work with Leighton to undertake the project. Current projects include Rawang to Ipoh Rail Double Tracking Project; Kuala Lumpur to Putrajaya Highway; Maxis Base Transceiver Stations; Maxis National Optical Fibre Network Phase 2; Lekir Bulk Terminal Jetty; Manjung Power Station, Cooling Water Intake and Civil Works Package; Teachers' Housing Phase I, Stages I, II and III; Cabot Offshore Terminal and Pipeline; Lahad Datu Flour Mill; and Penang Water Supply.

Bluescope Steel – a joint venture company

BlueScope Steel (Malaysia) Sdn Bhd is a joint venture company between BlueScope Steel Limited (60 per cent holding) and PNB Equity Resource Corporation Sdn Bhd (40 per cent holding). They are a manufacturing and building supplier, producing Clean Colourbond® and Zincalume® products in their manufacturing plant in Kapar, Selangor. These products are designed specifically for tropical climates and available to the domestic market and for export to Singapore, Brunei, Sri Lanka and China.

Multiplex – 100 per cent locally owned

Multiplex Constructions Sdn Bhd is 100 per cent locally owned and undertakes civil engineering and building work. Multiplex Australia provides technical support.

Sources: www.leighton.com.my, www.bluescopesteel.com.my, Economic Analytical Unit interviews.

Price controls

The Malaysian Government has price controls on refined sugar, wheat flour, chicken, sweetened condensed milk, cooking oil (pure palm oil and mixed palm oil), white bread, unleaded petrol, diesel, LPG, Portland cement, steel and round steel bars. Prices for sugar, flour, condensed milk and cooking oil are higher in Sabah and Sarawak than in Peninsular Malaysia. Portland cement prices differ by town, varying between RM9.70 per 50kg bag in Kangar and Ipoh to RM14.10 in Limbang, Sri Aman and Kapit. According to the Ministry of Domestic Trade and Consumer Affairs the prices of these 'essential items' are controlled to achieve price stability. Any increase in the price of controlled items must be approved by the Ministry of Domestic Trade And Consumer Affairs (see www.kpdnhq.gov.my/

english/index_eng.html). There also are tariff ceilings for fixed and mobile phone services. Businesses can set their rates at par or below these ceilings (Malaysian Industrial Development Authority, 2004a). In 2004, the Government reduced the petrol subsidy and increased petrol prices by five sen per litre.

Taxation

Malaysia has double taxation treaties with Australia and 46 other countries. Domestic and foreign companies are essentially treated the same for taxation purposes. The corporate tax rate is 28 per cent, with the exception of companies with petroleum operations, where the rate is 38 per cent. The tax burden on business is lessened by the available incentives and deductions. Non-residents are subject to withholding tax ranging from 3 to 15 per cent. Certain goods attract sales tax of between 5 and 25 per cent; services attract a sales tax of 5 per cent (Malaysian Industrial Development Authority, 2004a).

In 2002, tax revenue represented 18.5 per cent of GDP, one of the higher ratios in ASEAN, although individual and corporate tax rates compared favourably with other regional economies (Table 4.5).

Table 4.5

Marginal tax rates comparable with the region

Tax revenue, per cent of GDP, and highest marginal tax rate, per cent, selected countries, 2002

	Tax revenue	Highest marginal tax rate		
		Individual		Corporate
	per cent of GDP	per cent	on income over $US	per cent
Australia	29.6	47	35 149	30
OECD	26.2	-	-	-
Malaysia	18.5	28	65 789	28
Thailand	15.8	37	92 379	30
China	15.4	45	12 048	33
Singapore	13.5	22	184 438	22
Indonesia	13.2	35	22 371	30
Philippines	12.5	32	9320	32
India	8.6	30	3139	37

Source: Economist Intelligence Unit, 2004b; International Monetary Fund, 2003; CEIC, 2004.

The main tax revenue sources for the Malaysian Government are corporate, petroleum, personnel and sales tax (Table 4.6). The oil industry in particular has nearly doubled its contribution to government revenue through a combination of industry growth, higher oil prices, and higher tax levies relative to other taxes. Petronas – the oil and gas giant and by far Malaysia's largest company – is wholly government owned. In 2003, petroleum mining and processing accounted for 8.9 per cent of total Malaysian output, and petroleum taxes and royalties accounted for 11.4 per cent of government revenue.

Malaysian trade policy liberalisation has contributed to a fall in the importance of taxes such as excise, import and export duties. In order to broaden the tax base, the Government plans to introduce a broad-based goods and services tax by 1 January 2007 to replace the sales tax, which is levied on goods at the point of import or at the manufacturers' level, and the services tax, which is levied on selected services. According to the Budget Speech delivered in September 2004, the Malaysian Government expects the introduction of a goods and services tax will give it the opportunity to reduce corporate and individual income tax rates. This will allow Malaysia to remain competitive with other regional economies.

Table 4.6

More taxes from the oil industry, less from imports

Direct and indirect taxes, share of tax revenue, per cent, 1997 and 2003

	1997	2003
Direct taxes		
Corporate	31.1	37.0
Petroleum	7.2	13.0
Personnel	12.0	12.3
Stamp duties	5.1	3.1
Other	1.4	0.9
Indirect taxes		
Sales	11.5	12.3
Excise duties	11.3	7.8
Import duties	12.2	6.0
Service tax	2.8	3.1
Export duties	2.0	1.8
Other	3.6	2.7

Source: CEIC, 2004.

LABOUR MARKET

The Malaysian labour market is lightly regulated compared to most other economies in the region and has established procedures to deal with industrial disputes. Basic (manual) labour in Malaysia usually is carried out by foreigners; legal foreign workers make up nearly 10 per cent of the Malaysian workforce.[15] That said, labour market conditions are tight. In 2003, the Malaysian unemployment rate was only 3.6 per cent and the labour force participation rate was 66.9 per cent, despite an increase in the workforce of 3.6 per cent, to 10.2 million workers, between 2002 and 2003. In comparison, in October 2004 the Australian unemployment rate was 5.3 per cent and participation was 63.7 per cent. Greater female participation would boost the workforce as, at present, female participation is around 10 percentage points lower than Australia.

Most employees have received a minimum of nine years of schooling. More than half have lower- and middle-secondary education and 14 per cent have tertiary education. However, to help move the Malaysian economy up the value-added chain, the Malaysian Government has programs to improve the skills of the Malaysian workforce.

Industrial relations

Labour and management relations generally are good, with established procedures to resolve disputes and minimise disruptive industrial action (Austrade, 2004). Strikes and lockouts are prohibited once a trade dispute has been referred to the Industrial Court (Malaysian Industrial Development Authority, 2004b). However, once the dispute is in the Industrial Court, the process can drag on for some time (United States Department of Commerce, 2004). According to the Ministry of Human Resources, only two strikes and 23 pickets occurred in 2003 (Ministry of Human Resources, 2004a).

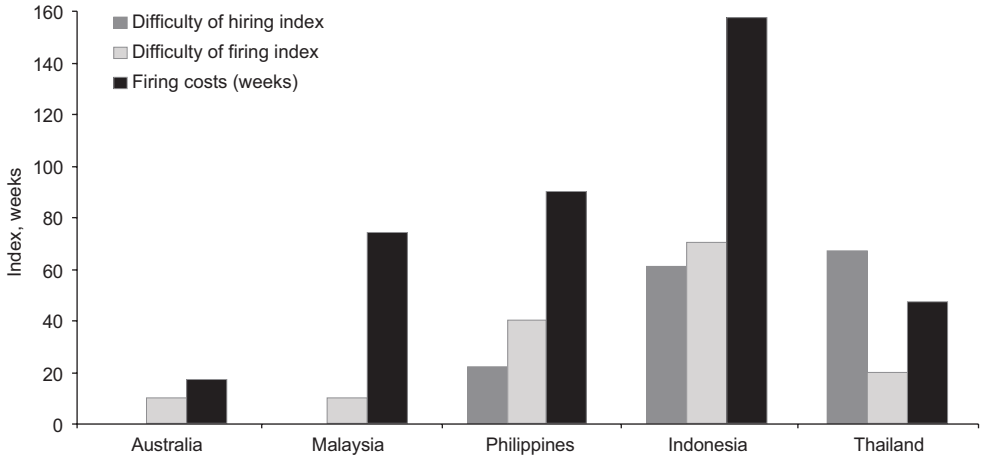
The Malaysian labour market is lightly regulated relative to other economies in the region (Figure 4.3). Few regulations exist regarding hiring or firing employees, although it costs the equivalent of 74 weeks of wages to retrench a worker in Malaysia. Employees are entitled to four weeks notice if they have worked for less than two years, six weeks if they have been employed for between two and five years and eight weeks if they have been employed for more than five years. If insufficient notice is given, the employee is entitled to wages in lieu of notice. Retrenchment benefits are 10 days wages for each year of service if the worker has been employed for less than two years, 15 days wages for each year of service if the worker has been employed between two and five years and 20 days wages for each year of service if the worker has been employed for five years or more (Ministry of Human Resources, 2004b).

[15] There also is a sizeable number of illegal foreign workers in Malaysia, although estimates vary as to the exact number.

Figure 4.3

Malaysian labour market generally lightly regulated

Difficulty of hiring, difficulty of firing and firing costs, selected countries, 2004[a]



Note: a. Difficulty of Hiring Index is zero for Australia and Malaysia.
The Difficulty of Hiring index measures (i) whether term contracts can only be used for temporary tasks; (ii) the maximum duration of term contracts; and (iii) the ratio of the mandated minimum wage (or apprentice wage, if available) to the average value-added per working population. The Difficulty of Firing index has eight components: (i) whether redundancy is not grounds for dismissal; (ii) whether the employer needs to notify the labour union or the labour ministry for firing one redundant worker; (iii) whether the employer needs to notify the labour union or the labour ministry for group dismissals; (iv) whether the employer needs approval from the labour union or the labour ministry for firing one redundant worker; (v) whether the employer needs approval from the labour union or the labour ministry for group dismissals; (vi) whether the law mandates training or replacement prior to dismissal; (vii) whether priority rules apply for dismissals; and (viii) whether priority rules apply for re-employment. Each index takes values between 0 and 100, with higher values implying more regulation. The Cost of Firing indicator measures the cost of advance notice requirements, and severance payments and penalties due when firing a worker, expressed in terms of weekly wages.

Source: Botero *et al,* 2004; World Bank and International Finance Corporation, 2004.

Expatriate workers

Foreign workers go some way to alleviating the Malaysian labour shortage. Basic labour in Malaysia usually is carried out by foreign workers. The Foreign Workers Division of the Immigration Department is the approving authority for the employment of foreign workers belonging to the skilled, semi-skilled and unskilled categories (Austrade, 2004). Foreign workers with work permits account for 9.5 per cent of the Malaysian labour force, predominantly working in manufacturing (31.5 per cent), plantations (29.3 per cent), services (6.7 per cent) and as domestic maids (18.9 per cent). Of these foreign workers, nearly 10 per cent are skilled expatriates working as managers, software consultants, lecturers, engineers and trainers (Economic Planning Unit, 2003). Semi-skilled and unskilled foreign workers are limited to the nationals of Cambodia, India, Indonesia, Kazakhstan, Laos, Burma, Nepal, the Philippines, Sri Lanka, Thailand, Turkmenistan, Uzbekistan and Vietnam. Nationals from India and Sri Lanka are not permitted to work in manufacturing (Malaysian Industrial Development Authority, 2004b).

The flexibility to dismiss foreign workers shielded the domestic labour force from the full impact of the Asian financial crisis and the Malaysian Government still periodically tightens immigration laws to act as an unemployment buffer (Economist Intelligence Unit, 2004a; Khatri, 2001). An annual RM1200 levy

on expatriate workers, representing 40 per cent of the maximum monthly salary for a non-executive manufacturing employee, helps ensure foreign labour only is employed when necessary. The Government also requires foreign investors, to the best of their ability, recruit and train Malaysians so as to reflect the country's population composition at all levels of employment (Foreign Investment Committee, 2004a). That said, expatriate workers are likely to remain an important source of labour in certain industries for a number of years.

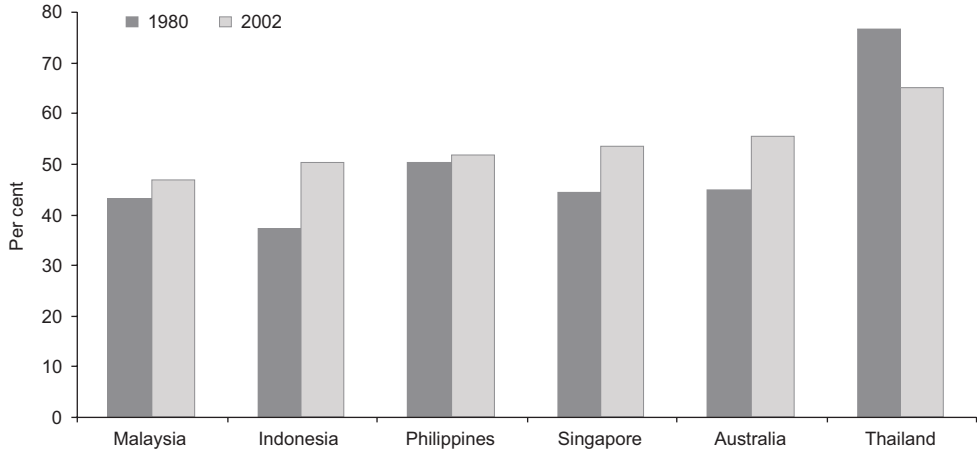
Female participation

One reason labour market conditions are tight is because of a substantial difference between male and female labour participation rates – 87.1 per cent for the former and 45.7 per cent for the latter (Economic Planning Unit, 2003). Female participation is lower than most developed countries and other regional economies (Figure 4.4). To persuade women to enter the labour force, private business is being encouraged to introduce facilities such as child care centres, housing and transportation for female employees, and increased training opportunities. The Government also plans to amend the Employment Act to include new and flexible working arrangements such as teleworking, part-time work and job sharing (Economic Planning Unit, 2003). Nevertheless, the participation rate has not grown much over the past 21 years, suggesting social norms may be influencing decisions by women about entering the paid workforce.

Figure 4.4

Less than half of Malaysian women in workforce

Female labour market participation rates, per cent of working age women, selected countries, 1980 and 2002



Source: Asian Development Bank, 2004b.

Human resource development

The Malaysian Government has identified education and training as key development priorities (see Chapter 3 – *Education: Tackling a Constraint to Growth*). The Human Resources Development Fund, a fund for manufacturing companies, operates on the basis of a levy/grant system. Manufacturing employers who pay the levy qualify for training grants from the fund to defray or subsidise training costs for their Malaysian employees. Manufacturing companies that either employ 50 or more Malaysian workers, or employ between 10 and 50 employees and have paid-up capital equal to or above RM2.5 million (US$658 000) contribute one per cent of employees' monthly wages. Manufacturing companies that employ between 10 and 50 employees and have paid-up capital less than RM2.5 million (US$658 000) have the option of registering with the Fund and paying a levy of 0.5 per cent of employees' monthly wages. These companies also are eligible for a matching subsidy on training expenditure (Malaysian Industrial Development Authority, 2004a). Non-manufacturing companies that enrol their employees in approved training institutions can claim double deductions on costs (Economist Intelligence Unit, 2004a).

PROPERTY RIGHTS

Property rights generally are well protected in Malaysia, although there is some international concern with the enforcement of intellectual property despite recent strengthening of legislation. Both foreign and domestic investors are entitled to fair compensation in the event the Government appropriates investors' assets (Malaysian Industrial Development Authority, 2004b). Foreign ownership of agricultural land is permitted, but only to carry out agricultural activities on a commercial scale using modern or high technology; to carry out agro-tourism projects; or to carry out agricultural or agro-based industrial activities for the production of goods for export. This land must be valued at more than RM250 000 or at least five acres in area, whichever is higher (Foreign Investment Committee, 2004b). Traditional land ownership systems still cover Sabah and Sarawak, and companies wishing to acquire property in these states should consult local authorities on their rights and obligations.

Malaysia has signed investment guarantee agreements with 69 individual countries (Australia does not have an investment promotion and protection agreement with Malaysia), ASEAN and the Organisation of Islamic Countries. These agreements protect against nationalism and expropriation and ensure prompt and adequate compensation in the event of nationalisation or expropriation (Malaysia Industrial Development Authority, 2004b). Even without a treaty level agreement, expropriation is highly unlikely; the 1998 Agreement between the Government of Australia and the Government of Malaysia on Trade and Economic Cooperation states that both countries should actively facilitate and promote investment between their economies. The Malaysian Government ratified the provisions of the Convention on the Settlement of Investment Disputes in 1966, which provides international conciliation and arbitration through the International Centre for Settlement of Investment Disputes. Foreign companies doing business in Malaysia often stipulate in their contracts that any potential litigation must take place in foreign courts (Economist Intelligence Unit, 2004a).

Arbitration also is available through the Kuala Lumpur Regional Centre for Arbitration, which aims to provide a system to settle disputes between parties engaged in trade, commerce and investments with and within the region (Malaysia Industrial Development Authority, 2004b).

Intellectual property

Malaysia is a member of the World Intellectual Property Organization and a signatory to the WTO Agreement on Trade Related Aspects of Intellectual Property Rights. Patents are available for products or processes for 20 years, trade marks registration is extendible indefinitely and literary, musical or artistic works are protected for the life of the author plus 50 years. To encourage development in the Multimedia Super Corridor and higher value-added manufacturing and services, the Malaysian Government has strengthened intellectual property protection. Legislation passed in 2000 included the Trade Marks (Amendment) Act, Layout – Designs of Integrated Circuits Act, Optical Disc Act and Geographical Indications Act. In July 2003, the Malaysian Parliament passed the Patents (Amendment) Act and the Copyright (Amendment) Act. Regulations and penalties are strong and it is the only ASEAN member with an official enforcement squad to investigate counterfeiting complaints from private business. The Optical Disc Act makes the unauthorised reproduction of CDs, VCDs, DVDs and all other optical discs explicitly illegal. Optical disc makers must apply for a manufacturing licence, allowing authorities to monitor production. The Copyright (Amendment) Act 2003 doubled the fines for copyright infringements, lengthened the term of imprisonment and gave greater powers to enforcement officers (Economist Intelligence Unit, 2004a).

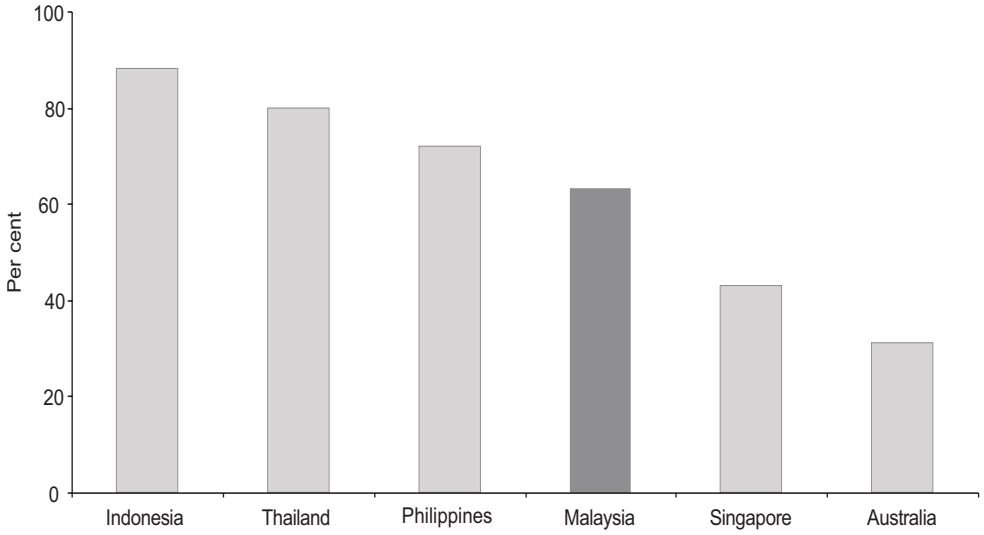
Despite these improvements, Malaysia remains on the intellectual property "Watch List" – along with 34 other economies – of the Office of the United States Trade Representative. The "Priority Watch List", which is one level above, has 15 economies listed.[16] Pirated software accounts for 63 per cent of software in use in Malaysia, less than countries such as China, Vietnam, Indonesia, the Philippines and Thailand, but still much higher than Singapore, Australia or Korea (Figure 4.5). The Office of the United States Trade Representative claims that Malaysia is the world's largest exporter of pirate entertainment software; trademark infringement is apparently a serious problem; court cases are slow and there are few prosecutions. In its Watch List statement, the Office of the United States Trade Representative expressed concern about the continued high rate of production and export of pirated optical disc media, counterfeiting, lack of effective patent and data protection for pharmaceutical products, and lax enforcement (United States Trade Representatve, 2004). The legal foundation exists for intellectual property rights, but it would seem there could be greater enforcement of these rights (Asian Development Bank, 2004a).

[16] The Office of the United States Trade Representative has a 'Special 301' annual review that examines in detail the adequacy and effectiveness of intellectual property protection in approximately 85 countries. The Special 301 provisions of the Trade Act of 1974 require the USTR to identify foreign countries that have inadequate and ineffective protection of intellectual property rights. There are four 'lists' in the 2004 review, Priority Foreign Country (Ukraine), Section 306 (China and Paraguay), the Priority Watch List and the Watch List.

Figure 4.5

Soft on software piracy

Software piracy as a share of software use, selected countries, 2003



Source: Business Software Alliance, 2004.

GOVERNANCE AND TRANSPARENCY

In an economy where the government is heavily involved both through substantial infrastructure development and corporate holdings, it is particularly important that good principles of governance and transparency are applied in decision making.

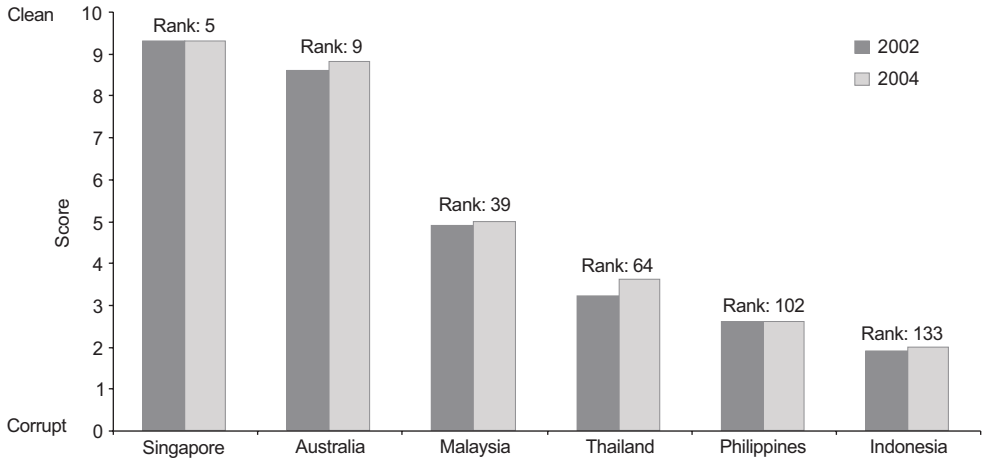
Transparency International ranked Malaysia 39 out of 146 economies in its 2004 Corruption Perceptions Index, better than Italy, the Republic of Korea and Greece with a score of 5 out of 10 (Figure 4.6). This is an improvement on 2002, but still lags behind a number of regional economies (Transparency International, 2004).

The Malaysian Government unveiled the National Integrity Plan in April 2004. Three of the five stated aims are: effectively reduce corruption and abuse of power, enhance efficiency in the public service delivery system and overcome bureaucracy and enhance corporate governance. Measurable outcomes of the plan include moving Malaysia's standing in Transparency International's Corruption Perception Index to 30th position by 2008, reduce the number of corporate fraud cases and increase the number of contracts awarded through open tender (Abdullah, 2004). The Government has established the Malaysian Institute of Integrity to monitor the Plan's implementation.

Figure 4.6

Malaysia improving

Corruption Perceptions Index, score out of 10, selected countries, 2002 and 2004



Source: Transparency International, 2004.

Strengthening the corporate sector

Several programs have been introduced to address corporate governance issues. The Mandatory Accreditation Program requires directors of listed companies to undergo training programs to raise the standards of governance (Economic Planning Unit, 2003). Bursa Malaysia's listing requirements have been refined to ensure listed companies prepare their annual audited accounts in line with standards approved by the Malaysian Accounting Standards Board. Bursa Malaysia also requires disclosure of compliance with the Corporate Governance Code through its listing requirements. All listed companies must report on corporate governance in their annual reports and company directors must report separately on internal controls (Economic Analytical Unit, 2002a). Bank Negara Malaysia has issued new regulations to improve governance in the banking sector, including guidelines governing the functioning and composition of banks' boards of directors (Asian Development Bank, 2004a).

The Malaysian Code on Takeovers and Mergers, introduced in 1998, was designed to improve corporate governance and makes it a criminal offence to disseminate false or misleading information (Economist Intelligence Unit, 2004a). Minority shareholders also have greater protection through lowering the class action requirement and strengthening the disclosure requirement of listed companies (East Asia Analytical Unit, 1999).

Improving privatisation transparency

A privatisation program that is transparent, competitive and efficient will go some way to strengthening Malaysia's investment climate. A more open privatisation process also provides domestic firms with greater exposure to market forces and competition. Commentators point out that "in the past, privatisation awards were made in an opaque manner, without public debate or competitive bidding, often with decades-long concessions going to politically influential companies or individuals lacking viable business plans" (*Far Eastern Economic Review,* 'Water for sale', 10 June 2004, p. 16). In response, the Malaysian Government has placed several privatisations on hold while policies and processes are reviewed. It also has said it plans to make the bidding process for contracts more transparent, although details remain sketchy (Economist Intelligence Unit, 2004a).

A GOOD PLACE TO DO BUSINESS

On all measures, Malaysia's business environment is attractive. It is relatively easy to establish a business in Malaysia and there is high-quality supporting infrastructure such as roads, telecommunications, ports, air transport and electricity supply. The legal and regulatory environment is similar to Australia's and few industries are completely off limits to foreigners. Marginal tax rates are comparable with those elsewhere in the region.

The trading relationship between Australia and Malaysia is strong – foreign direct investment is less so – and conditions are favourable to expanding this association. The following chapter looks at the strengths of the current commercial relationship and examines where the two countries might usefully ease restrictions to promote further growth.

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THE AUSTRALIA-MALAYSIA COMMERCIAL RELATIONSHIP

KEY POINTS

- **In 2003-04, Malaysia was Australia's 10th largest trading partner. In 2003, Australia was Malaysia's 14th largest trading partner.**
- **Since the Asian financial crisis, the balance of merchandise trade has shifted in favour of Malaysia. Information technology and petroleum products dominate Australian imports from Malaysia, whereas commodities dominate Australian merchandise exports to Malaysia.**
- **Australia enjoys a trade surplus with Malaysia in services, dominated by education-related travel.**
- **Malaysian investment in Australia is much larger than Australian investment in Malaysia.**
- **Malaysia's liberal trade and investment policies, growing disposable income and policies encouraging higher value-added production create an excellent market for Australian producers, service providers and investors.**

Malaysia's rapid economic development, location, active participation in our immediate region, and its long-standing relationship with Australia in many spheres make Malaysia an important bilateral partner.

The bilateral relationship is diverse, with active and cooperative relations across a broad range of sectors. These include trade and investment, defence, education, tourism, sports cooperation, science and technology, people-smuggling and narcotics control, aviation and newly emerging areas such as electronic commerce.

In 2003-04, Malaysia was Australia's tenth largest trading partner. In 2003 (the most recent data available), Australia was Malaysia's 14th largest trading partner. Australian investment in Malaysia has declined since the Asian financial crisis but Australian companies continue to pursue opportunities in Malaysia. Malaysia presents good prospects for robust trade and investment growth in the medium to long term.

AUSTRALIAN-MALAYSIAN TRADE FLOWS

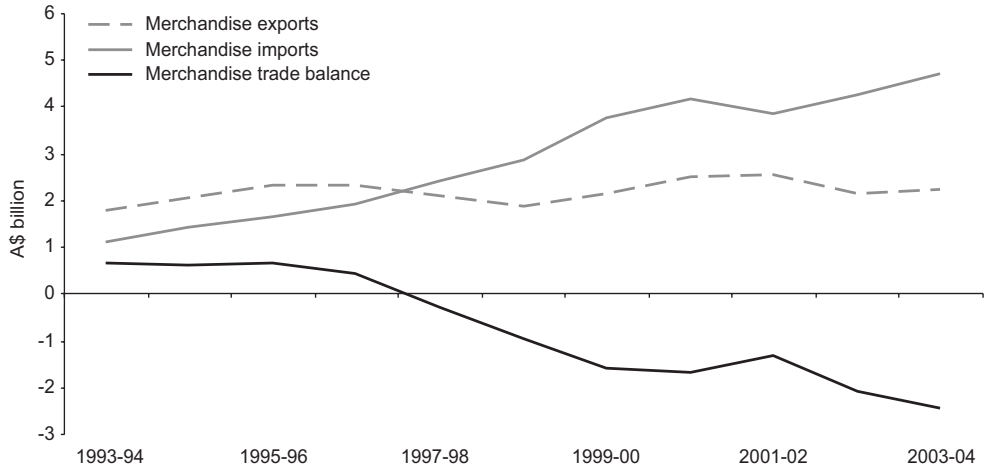
Australia and Malaysia enjoy a strong trading relationship reflecting the complementary nature of the two economies. Bilateral merchandise trade reached A$6.9 billion in 2003-04, accounting for 2.9 per cent of all Australian trade and ranking Malaysia as Australia's tenth largest goods trading partner. Before the Asian financial crisis, the balance of merchandise trade was in Australia's favour with rapid growth and a strong ringgit fuelling Malaysia's import demand (Figure 5.1). However, the crisis shifted the trade balance in favour of Malaysia as domestic demand contracted sharply causing Australian exports to Malaysia to fall significantly during that period. While Australian exports have recovered from the crisis lows, the trade balance remains strongly in favour of Malaysia, largely reflecting its increased exports of information technology-related and petroleum products to Australia and strong growth in the Australian economy.

Australia's service exports have grown steadily over the past decade or so, notwithstanding a slight downturn in the wake of the Asian financial crisis. Bilateral service trade reached A$1.6 billion in 2003. The service trade balance has shifted back in favour of Australia as Australia's service exports recovered and continued to grow while service imports from Malaysia fell in recent years (Figure 5.2).

Figure 5.1

Trading places – trade surplus now favours Malaysia

Australia's merchandise trade with Malaysia, A$ billion, 1993-94 to 2003-04

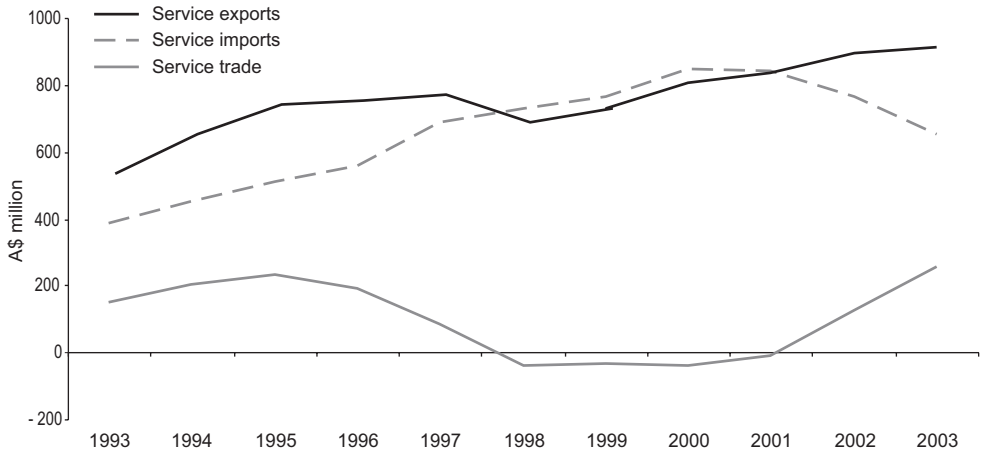


Source: Department of Foreign Affairs and Trade, 2004a.

Figure 5.2

Australia – a net service exporter to Malaysia

Australia's services trade with Malaysia, A$ million, 1993 to 2003



Source: Department of Foreign Affairs and Trade, 2004a.

AUSTRALIAN EXPORTS TO MALAYSIA

Australia's exports to Malaysia are predominantly agricultural products, simply transformed mineral-based manufactures and education-related travel services. There are 3750 Australian exporters with Malaysia as an export destination, making Malaysia number seven as a destination for Australian exporters and second among the ASEAN economies behind Singapore (Austrade, 2004).

Merchandise exports

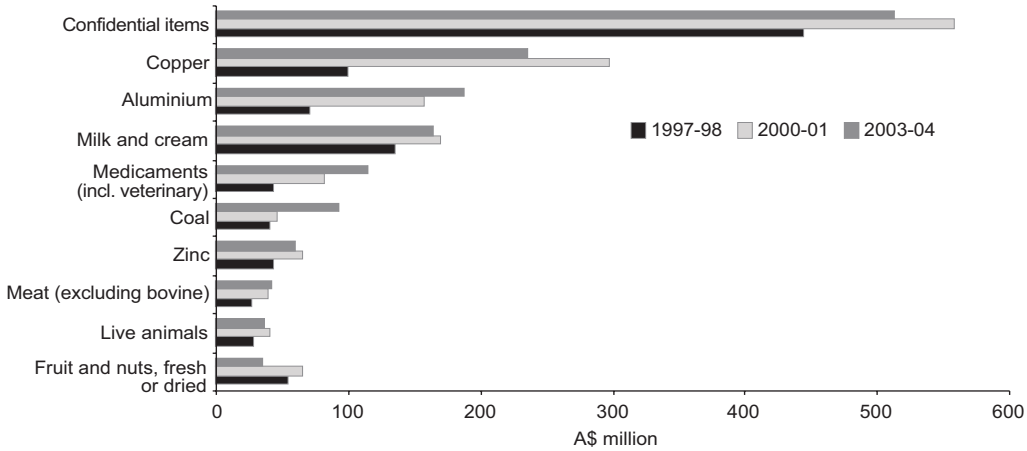
Commodities and simply transformed manufactures make up nine of the top ten Australian merchandise exports to Malaysia. In 2003-04, Australia's merchandise exports to Malaysia, valued at A$2.2 billion (RM6.0 billion), included sugar and wheat, refined copper, unwrought aluminium, unwrought zinc, coal, milk and cream, medicaments, meat, live animals and fruit (Figure 5.3).

Commodities are an important component of Australia's exports to Malaysia. However, commodities – with the exception of oil – are not part of Malaysia's top ten imports. Australian exports to Malaysia actually fell in two of Malaysia's top ten categories in the five years to 2003-04 (Table 5.1). Other exports were better able to take advantage of Malaysian demand, such as electrical machinery, transistors and valves, refined petroleum and measuring and controlling instruments, which increased 25.0 per cent, 22.4 per cent, 22.3 per cent and 17.9 per cent on average between 1998-99 and 2003-04, albeit off a low base.

Figure 5.3

Commodities dominate merchandise exports

Top 10 Australian exports to Malaysia, A$ million, 1997-98 to 2003-04



Notes: Confidential items include raw cane sugar and wheat.

Source: Department of Foreign Affairs and Trade, 2004a.

Table 5.1

Australia not part of Malaysia's top 10 imports

Top 10 Malaysian imports, share of total imports, per cent, 2003

SITC classification	Description	Per cent of total imports	Australian exports to Malaysia
			Average annual 5-year growth[a]
776	Transistors, valves, etc.	30.0	22.4
759	Parts and accessories for office machines	5.4	-8.9
772	Electrical switcher relays, circuits, n.e.s.	3.8	1.9
764	Telecommunication equipment, parts, accessories	3.7	1.8
778	Electrical machinery and apparatus n.e.s.	3.1	25.0
334	Petroleum products, refined	2.7	22.3
752	Automatic data processing equipment	2.2	1.8
333	Crude petroleum	2.0	-
874	Measuring and controlling instruments	1.6	17.9
728	Other machinery for special industries	1.5	-15.9
	Total top 10 imports	**56.1**	**1.4**

Note: a. 2003-04 data.

Source: MATRADE, 2004; Department of Foreign Affairs and Trade, 2004a.

The Asian financial crisis has had a lingering effect on Malaysian automotive imports. Australia's motor vehicle and parts exports to Malaysia fell sharply from over A$81.4 million in 1996-97 to A$16.2 million in 2003-04 (Table 5.2). This trend is not limited to Australia; total Malaysian passenger motor vehicle imports peaked at US$1.7 billion in 1996, shrank to US$0.4 billion in 1998, and recovered to around US$1.1 billion in 2003. While Australian exports to Malaysia of passenger motor vehicles and motor vehicles for transporting goods recovered in 2002-03, exports of passenger motor vehicles amounted to only A$4.3 million in 2003-04.

Table 5.2

Australian motor vehicle and parts exports to Malaysia have fallen sharply since 1996-97

Australian exports of motor vehicles and parts to Malaysia, A$ thousands, 1996-97 to 2003-04

	1996-97	1997-98	2002-03	2003-04
Passenger motor vehicles	20 766	6 723	12 770	4 337
Motor vehicles for transporting goods	9 651	4 302	1 435	2 748
Other road motor vehicles	3 358	2 145	25	0
Motor vehicle parts	24 248	6 365	9 814	6 188
Motorcycles	162	64	46	39
Trailers and semi-trailers	632	489	2 427	1 330
Railway vehicles	22 593	43 705	1 400	1 513
Total	**81 410**	**63 793**	**27 917**	**16 155**

Source: Department of Foreign Affairs and Trade, 2004a.

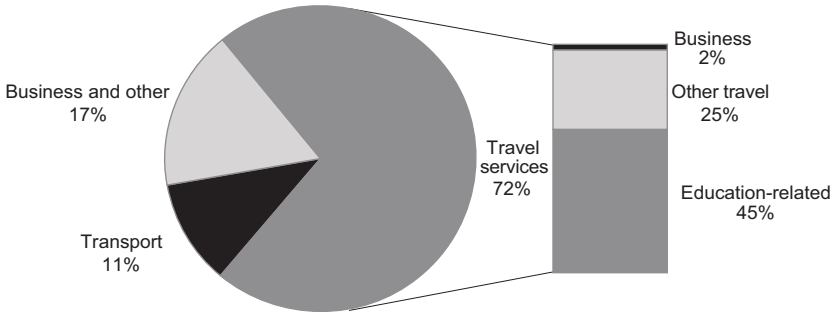
Service exports

Australia's service exports to Malaysia were valued at almost A$911 million in 2003. Around 70 per cent are 'travel services', of which nearly two thirds is education-related (Figure 5.4). After falling by seven per cent in the wake of the Asian financial crisis, exports of education-related travel services have grown on average close to ten per cent each year since 1998-99 (see also Chapter 3 – *Education: Tackling a Constraint to Growth*). Tourist flows also are strengthening; in 2003, there were over 155 000 short term visitor arrivals from Malaysia, making it the second largest source of visitors from South East Asia.

Figure 5.4

Education-related travel dominates service exports

Composition of Australian service exports to Malaysia, 2002-03



Source: Department of Foreign Affairs and Trade, 2004a.

AUSTRALIAN IMPORTS FROM MALAYSIA

Malaysia's pattern of exports to Australia reflects its comparative advantage in assembled and elaborately transformed manufactures (office machines, computers and stereos), petroleum, gas, crude oil and furniture.

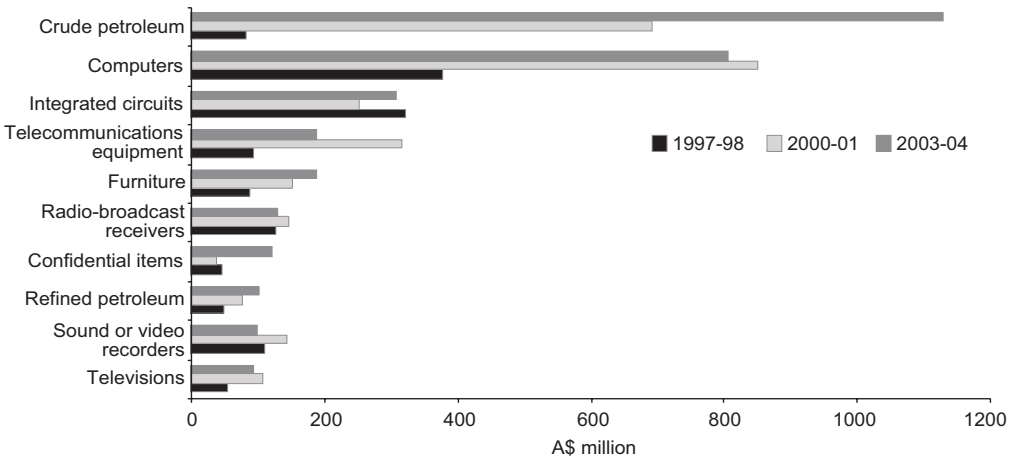
Merchandise imports

Australia is Malaysia's tenth-largest export destination with information and communication technology making up the bulk of the top ten exports (Figure 5.5). Australian merchandise imports from Malaysia, valued at A$4.7 billion in 2003-04, included crude oil, computers, electronic integrated circuits, radios, office machine parts and telephone equipment, and refined petroleum. Crude petroleum imports have shown exceptional growth in recent years as Australia has diversified its energy import base. Australian imports from Malaysia have tapered off since 2000, partly in response to curtailed business spending on information and communication technology following the electronics downturn. By grouping – although not necessarily by size – there is almost a perfect overlap of Malaysia's top 10 exports to the world and Australia's top 10 imports from Malaysia, with crude petroleum, computers, integrated circuits, telecommunications equipment and sound recorders featuring in both sets of statistics (Table 5.3).

Figure 5.5

Information and communication technology dominates Australian merchandise imports

Top 10 Australian imports from Malaysia, A$ million, 1997-98 to 2003-04



Notes: Confidential items include non-crude oil, for example, oil from petrol and bituminous mineral.

Source: Department of Foreign Affairs and Trade, 2004a.

Table 5.3

Electronic and electrical equipment dominate Malaysia's exports to the world

Top 10 exports, share of total merchandise exports, per cent, 2003

SITC Classification	Description	Export share
776	Transistors, valves, etc.	21.4
752	Automatic data processing equipment	10.2
759	Parts and accessories for office machines	5.8
764	Telecommunication equipment, parts, accessories	5.0
422	Fixed vegetable fats, oils, crude, refined, not soft	4.8
333	Petroleum oils, crude	4.0
343	Natural gas	3.3
772	Electrical switcher relays, circuits, n.e.s.	3.0
334	Petroleum products	2.1
763	Sound recorders, phonographs	1.8
	Total top 10 exports	**61.3**

Source: MATRADE, 2004.

Service imports

Australia's service imports from Malaysia were around A$654 million in 2003. This trade mainly took the form of transportation services (52 per cent) and travel services (41 per cent). Malaysia has declined as a tourist destination for Australian travellers. Around 180 000 Australians visited Malaysia in 2003-04, compared with over 230 000 in 2000-01.

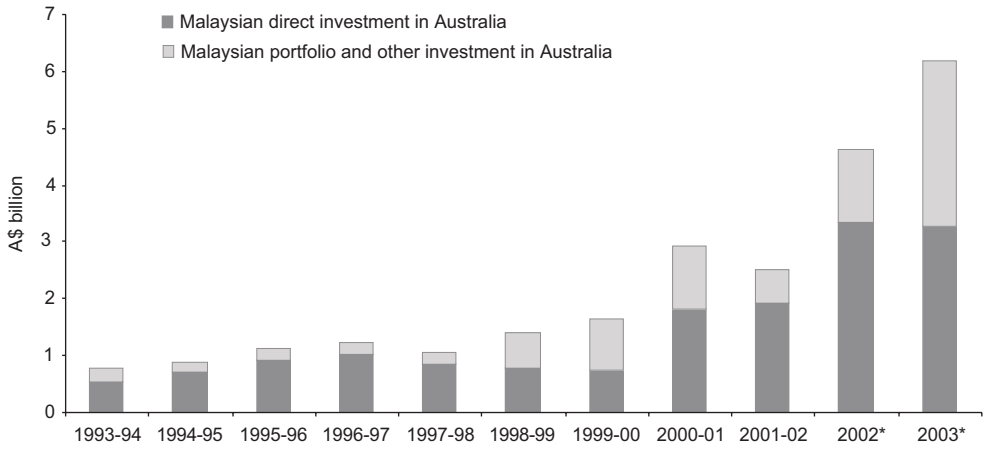
TRENDS IN BILATERAL INVESTMENT

Malaysian investment in Australia has grown steadily over the past decade. In December 2003, Malaysian investment in Australia was valued at over A$6.2 billion representing 0.6 per cent of total foreign investment in Australia. While Malaysia's share of total investment in Australia is small, it has been rising steadily over the past decade and has risen sharply in recent years (Figure 5.6). In contrast, Australian investment in Malaysia has been declining since 1997 (Figure 5.7). In December 2003, the level of Australian investment in Malaysia was valued at A$485 million, representing under 0.1 per cent of Australia's total investment abroad. Malaysia's continued economic development should encourage Australian investors to seize emerging opportunities, particularly in service-based investments such as health, education and infrastructure development. Direct investment forms the bulk of investment between the two countries.

Figure 5.6

Malaysian investment in Australia increasing

Malaysian investment in Australia, stocks, A$ billion, 1993-94 to 2003



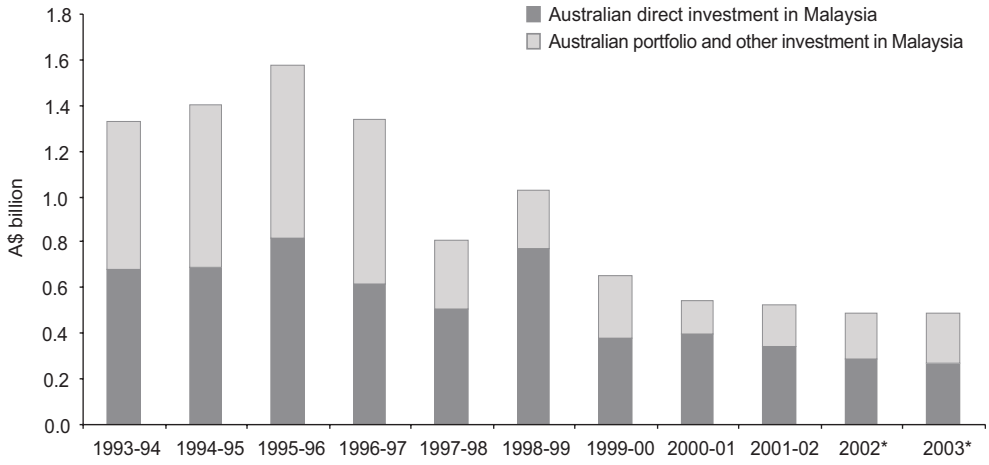
Note: *Calendar year as at 31 December.

Source: Australian Bureau of Statistics, 2004.

Figure 5.7

Australian investment in Malaysia has fallen sharply since the Asian financial crisis

Australian investment in Malaysia, stocks, A$ billion, 1993-94 to 2003



Note: *Calendar year as at 31 December.

Source: Australian Bureau of Statistics, 2004.

Australian direct investment in Malaysia

Australian direct investment in Malaysia fell to A$263 million in December 2003, less than a third of the level reached in June 1996 in Australian dollar terms. There are, however, a number of prominent Australian companies with an ongoing commitment to operations in Malaysia. These companies include Leighton, Bluescope Steel, Amcor, Ansell International, Boral, CSR and Monash University Malaysia. All have contributed importantly to Malaysia's industrial and infrastructure development. For instance, Leighton has won high-profile construction contracts for road building, teachers' accommodation and power infrastructure projects. Monash University Malaysia is a prominent private university in Malaysia and a leader in research into Islamic banking.

A stronger Malaysian domestic sector, the move up the value chain for exporters, and progressive freeing up of restrictions, could well lead to a revival of foreign direct investment. Australian investors are becoming increasingly interested in offshore manufacturing plants and the establishment of some regional offices. Infrastructure costs and resources in Malaysia are quite competitive relative to Singapore and Hong Kong (see also Chapter 4 – *An Enabling Environment*).

Malaysian direct investment in Australia

Total Malaysian foreign direct investment in Australia was A$3.2 billion in December 2003, more than four times what it was in June 1999 and equivalent to 1.3 per cent of total foreign direct investment stocks in Australia.

A lack of data means it is not possible to provide a precise sectoral breakdown of Malaysian investment in Australia. According to the Malaysia Australia Business Council, there are major Malaysian investments in energy, agribusiness, manufacturing, real estate, restaurants, travel agents and the gaming industry. Petronas is a significant investor in Australia. It has interests in East Australia Pipeline Ltd, which owns and operates the Moomba-Sydney gas pipeline, the Australian portion of the proposed PNG-Queensland gas pipeline, and the Australian Pipeline Trust, which has a 25 per cent share of the natural gas pipeline market in Australia.

Figures provided by the Australian Foreign Investment Review Board on proposed investments show that Malaysian investors have been focusing on the real estate sector in recent years. In 2001-02, 92 per cent of the value of proposed Malaysian investment in Australia was in real estate. Real estate accounted for 72 per cent of proposed investment in 1997-98 and 55 per cent in 1996-97. In 2002-03 there were unusually large investment proposals in the manufacturing sector, valued at A$6.4 billion.[17]

[17] Around A$4 billion of this amount is thought to relate to a joint bid by two Malaysian companies, Genting and Sime Darby, for a stake in Victoria's Loy Yang power station. This bid was subsequently withdrawn.

TRADE ENVIRONMENT

Malaysia has a very high trade orientation, quite low average tariffs, modest inter-industry tariff dispersion, and limited incidence of non-tariff barriers. Malaysia is a member of the Cairns Group, and is an active member of the World Trade Organisation (WTO) and of regional economic arrangements, including the ASEAN Free Trade Area (AFTA) and the Asia-Pacific Economic Cooperation.[18] Malaysia currently is pursuing bilateral free trade agreement (FTA) negotiations with Japan, and is part of the ASEAN-wide negotiations for ASEAN-China, ASEAN-India, ASEAN-Japan and the ASEAN-Australia-New Zealand FTAs.[19] Malaysia also is conducting separate parallel scoping studies with Australia and New Zealand on a possible bilateral FTA (see the section *Implications*, below, for more information on the Australia-Malaysia Scoping Study). Malaysia also is considering possible FTAs with Middle Eastern countries.

In the AFTA context, Malaysia places a high priority on the early implementation of the common effective preferential tariff scheme which provides for concessional tariffs on intra-ASEAN trade. However, Malaysia continues to offer significant protection for its automotive industry. Malaysian market access for foreign service providers remains limited in the financial and professional services sectors.

Malaysian average tariffs low but some significant tariff peaks remain

The Malaysian economy is relatively open to both trade in goods and foreign investment, although rice and automotive products are notable exceptions (World Trade Organization, 2001). More than half of all tariff lines are duty free and less than one per cent attract non-*ad valorem* rates (Table 5.4).

Malaysia's longstanding commitment to maintaining a relatively open trade and investment regime has largely been maintained, although various measures were introduced after the Asian financial crisis. There was an increase in the degree of dispersion of tariff rates because of high tariff peaks relating to a few product lines, increased reliance on non-automatic licensing to regulate some imports that directly compete with domestic production by public sector enterprises, and delays in meeting commitments under the General Agreement on Trade in Services (GATS) (Athukorala, 2002). Malaysia's average applied most-favoured nation tariff increased from 8.1 per cent in 1997 to 9.2 per cent in 2001, but is still well below the 15.2 per cent rate in 1993 (Table 5.4).

[18] The Cairns group is a coalition of 17 agricultural exporting countries lobbying for agricultural trade liberalisation. Current members are Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand and Uruguay.

[19] On 1 December 2004, leaders from ASEAN, Australia and New Zealand agreed to launch FTA negotiations during their Summit in Vientiane, Laos. Negotiations will begin in early 2005 and conclude in two years.

Table 5.4

Malaysian tariffs falling

Tariff Structure of Malaysia, per cent, 1988-2001

	1988	1993	1997	2001
Number of tariff lines	12 183	11 875	10 372	10 368
Bound tariff lines[a]	0.8	0.8	63.7	63.5
Duty-free tariff lines[a]	10.3	13.4	58.6	58.3
Specific and mixed tariffs[a,b]	22.2	12	4.5	0.7
Tariffs with no *ad valorem* equivalent[a]	7.4	5.9	4.5	0.7
Simple average applied rate	17.5	15.2	8.1	9.2
Agriculture (HS01-24)	7.7	7.3	4.8	3.5
Industrial products (HS 25-93)	14.8	14.7	8.5	9.9
Tariff range	0-207.7	0-140	0-200	0-300
Domestic tariff peaks[c]	0.8	2.2	15.8	9.6
International tariff peaks[d]	51.3	49.1	25.9	23.8
Coefficient of variation	91	86	170	210
Simple average tariff by stage of processing				
Raw materials	14.6	14.3	1.0	0.9
Agricultural products	16.9	16.5	0.6	0.5
Mining products	3.6	3.8	1.0	1.0
Manufactured products	5.9	5.8	3.2	3.0
Semi-processed products	18.3	15.3	7.0	7.7
Fully processed products	18.1	15.4	11.9	13.6

Notes: a. Percentage of total tariff lines. A bound tariff is a legal obligation not to raise tariffs on particular products above the specified rate agreed in World Trade Organization negotiations and incorporated on a country's schedule of concessions. Bound rates are ceilings on tariffs; they are often higher than the applied tariff rates.

b. Specific tariffs are tariffs that are expressed as a monetary amount per unit quantity of the goods, for example, $15 per tonne. A mixed tariff is either an ad valorem or specific rate with the rate payable being whichever returns the higher or lower level of duty, for example, $2.00 per kg or 5 per cent, whichever is higher/lower.

c. Domestic tariff peaks are defined as those exceeding three times the overall simple average MFN rate.

d. International tariff peaks are defined as those exceeding 15 per cent.

Source: Athukorala, 2002.

In 2001, around one fifth of Malaysian tariffs were classified as an international tariff peak, defined as a tariff that is 15 per cent or higher (Table 5.4). Most of these peaks were in the non-agricultural sector (Table 5.5). The car industry, in particular, attracts substantial tariffs, ranging from five to 200 per cent (the top rate was recently lowered from 300 per cent), which may have hampered a recovery in the Malaysian imported car market. The domestic automotive sector has been effectively sheltered from foreign competition by high tariffs and various incentives. According to the World Trade Organization (2001) while the sector has been successful in winning a large share of the domestic market, its exports are modest – contrary to stated objectives – suggesting a lack of external competitiveness.

Table 5.5

Non-agricultural items dominate tariff peaks

Malaysia's international tariff peaks, selected 4-digit HS codes, 2001[a]

HS Code	Description	Tariff peak per cent
8703	Passenger motor vehicles	300[b]
8708	Motor vehicles parts and accessories	70
8711	Motorcycles	60
7003	Cast glass and rolled glass	60
6908	Glazed ceramic flags and paving, hearth or wall tiles	60
9613	Cigarette lighters	50
8704	Motor vehicles for the transport of goods	50
8705	Special purpose motor vehicles	50
3604	Fireworks, signalling flares, rain rockets, fog signals and other pyrotechnic articles	50
3606	Ferro-cerium and other pyrophoric alloys in all forms	50
4011	New pneumatic tyres, of rubber	40
4412	Plywood, veneered panels and similar laminated wood	40
9106	Time of day recording apparatus	35
8528	Reception apparatus for television	35
8414	Air or vacuum pumps, air or other gas compressors and fans	35
9701	Paintings, drawings and pastels	30
9614	Smoking pipes	30
9609	Pencils	30
9607	Slide fasteners and parts thereof	30
9606	Buttons, press-fasteners, snap-fasteners and press-studs	30
9508	Roundabouts, swings, shooting galleries and other fairground amusements	30

Notes: a. The tariff peak refers to the highest applied rate for items within the HS4-digit code.

b. This rate was recently lowered to 200 per cent.

Source: Department of Foreign Affairs and Trade, 2004b.

In January 2004, the Malaysian Government reduced tariffs on cars sourced within the ASEAN region as part of their requirements under the ASEAN free trade agreement. However, the Government then increased the excise tax on all cars – both domestic and international – but gave a 50 per cent rebate to domestically produced vehicles (*Far Eastern Economic Review,* 'Proton on a slippery slope', July 15 2004, p. 54).[20] In effect, higher excise duties replaced the reduced import tariffs to maintain protection of domestic manufacturers, reducing the incentive for Proton and other local car makers to improve efficiency. The excise tax rates are effective for one year. The Government also announced it would delay further a complete harmonisation of tariffs for the automotive sector from 2005 to 2008.

Malaysia has a wide range of non-tariff measures across many different products and sectors, although they differ in terms of trade restrictiveness. Import licences cover 60 different products ranging from poultry, billets of iron or steel and magnetic tape webs for video and sound recording (Ministry of International Trade and Industry, 2004a). Some import licences are restricted to a few importers with specific quotas, such as in sugar and rice. Other licences are easily obtainable, such as those for meat. The 50 per cent rebate on domestically produced motor vehicles also is a substantial non-tariff measure.

Barriers to services in the Malaysian market vary. Restrictions on commercial presence are a general impediment which applies to a number of areas. For example, Malaysia is the only market in South East Asia that totally excludes Australian law firms and lawyers. Foreign education institutions must have each course individually approved, rather than having an institution-based accreditation. Australian architecture and engineering firms have difficulty exporting their services to Malaysia.

Malaysia's GATS Schedule tends to leave commercial presence unbound and notes that foreign acquisition of a Malaysian corporation requires approval (see Chapter 4 – *A Supportive Environment*). There also are restrictions on the movement of services providers into Malaysia. Malaysia has generally left this mode of delivery unbound in the GATS, although companies are allowed to bring in senior managers and two professionals, with additional experts subject to a market test and training Malaysians.

Barriers which are of particular interest to Australia are reflected in the changes Australia has sought in Malaysia's services trade regime, both through the current GATS negotiations occurring under the Doha Round and bilaterally. They include barriers applying to education services, legal services, architectural services, accounting services, engineering services, telecommunications, and insurance and banking services.

[20] For example, import duty for ASEAN completely knocked-down passenger vehicles was reduced to 25 per cent while import duty for completely built-up passenger vehicles were reduced to rates ranging from 70-200 per cent based on engine capacity. However, excise duties were imposed on both completely knocked-down and completely built-up from ASEAN and non-ASEAN at rates ranging from 60-100 per cent based on engine capacity. Overall, excise duties on completely knocked-down vehicles were increased from 55 per cent to 60-100 per cent and on completely built-up vehicles from 0 per cent to 60-100 per cent.

Australian tariff barriers applying to Malaysia

Most Australian tariff lines are zero or five per cent, with the simple average applied tariff of only 4.3 per cent. The average applied tariff applicable to Malaysia is a little lower at 3.9 per cent because Australia offers developing countries, including Malaysia, tariff preferences on certain tariff lines.[21] Exceptions include applied tariffs on passenger motor vehicles and parts, which will remain at 10 per cent after further liberalisation occurs in 2005.

Australia's non-tariff barriers are not a major factor in merchandise trade. There are virtually no tariff quotas and few core non-tariff barriers of any kind. Anti-dumping has not been a major issue with Malaysia.

Australia has a relatively open and transparent services regime. It made substantial commitments covering a broad range of services sectors during the negotiation of the GATS, including for business and professional services; telecommunications; construction and engineering; distribution; education; financial; recreational, cultural and sporting; tourism and transport. Australia has since made further GATS commitments in the financial and telecommunications sectors.

INVESTMENT ENVIRONMENT

Foreign direct investment is important to Malaysia. It is sought as a source of capital and foreign exchange and as a means of securing industrial technology, managerial expertise, marketing know-how, and business networks to achieve higher levels of growth, employment, productivity and export performance. Foreign direct investment has contributed significantly to Malaysia's economic development and has made possible the transformation of the country from a producer of primary commodities to a modern industrialising economy.

The Malaysian Government encourages growth in higher-value activities and sees the economy moving to high technology and knowledge-based industries. Industries currently being promoted include manufacturing services covering higher value activities such as research and development, engineering and prototyping, integrated logistics, marketing and distribution, operational headquarters, international procurement centres/regional distribution centres, and regional and representative offices. Although 'targeting' remains entrenched in Malaysian policymaking there are encouraging signs that the focus is shifting towards creating an enabling environment for private sector business to drive investment and economic growth.

In 2003, the Government unveiled new measures to improve further the investment climate and lure back foreign investment (discussed in Chapter 2 – *The Challenges Ahead*) but a number of constraints remain, in particular a shortage of skilled labour. Malaysia's strategy towards high-technology sectors also requires stricter enforcement of intellectual property rights. Although the legal foundation exists for these rights, court enforcement of laws has been inadequate. Malaysia's progress in structural

[21] The Developing Country DCS rate of duty applies to Malaysia and 107 other countries. These tariff preferences are not as generous as those Australia provides to Forum Island Countries or Least Developed Countries, but are less than the most-favoured nation rate.

reforms has important implications for foreign investment. A privatisation review recently initiated by the Government – under which sales of controlling stakes in state enterprises are being postponed while independent consultants review the procedures and plans for future sales – could be a positive step if it results in a more transparent, competitive process (Asian Development Bank, 2004).

Restrictions on foreign equity participation remain for activities such as extraction and harvesting of timber, capture fisheries, oil and gas and many of the services sectors (Asia-Pacific Economic Cooperation, 2003).

AUSTRALIAN BUSINESS LINKS WITH MALAYSIA

The highest bilateral body which oversees Australia-Malaysia trade is the Joint Trade Committee. The first meeting of the Joint Trade Committee was held in 1986 and has met 11 times since then, the most recent being in July 2004. These talks provide an opportunity for both sides to discuss bilateral, regional and global trade issues of mutual interest. For example, in recent years, the focus of the Joint Trade Committee has been on developing cooperative activities that will enhance trade opportunities between Australia and Malaysia, such as the *Halal Food Product and Marketing Initiative* which seeks to combine Australian quality product with Malaysian halal branding for export to third markets. At the Joint Trade Committee meeting in 2004, there was direct participation by construction industry representatives as part of an industry sector dialogue and it is expected that this industry sector participation will continue at future Joint Trade Committee meetings.

The Malaysia-Australia Business Council and the Australia-Malaysia Business Council conduct regular dialogue with both Governments, including through participation in the Joint Trade Committee meetings. Each council has approximately 300 members. Among other roles, the councils assist with business delegations accompanying Ministerial visits and coordinate commercial events to coincide with such visits. They provide information and advice for businesses active in Australia and Malaysia and play an important role in promoting strong networks in the respective private sectors.

According to the Australian Trade Commission (Austrade), there already are around 250 Australian businesses in Malaysia working in accountancy, agribusiness, architecture, banking and finance, building and construction, education, engineering, entertainment, government, import and distribution, information technology, management services, manufacturing, mining and quarrying, telecommunications and transport.[22] As the economy develops, Malaysia has a growing need for infrastructure and utilities, higher level of social services and greater variety of consumer goods, including food. Australia's relatively more developed health services, sophisticated communication systems and advanced technology solutions, and mainstream areas of education, mineral products, and food and beverage industries are well placed to develop greater inroads into the Malaysian market.

[22] For a full listing, see the Australian High Commission (Kuala Lumpur) website for the Austrade Directory of Australian businesses in Malaysia – www.australia.org.my.

IMPLICATIONS

Australia's complementarity with Malaysia's economy suggests significant potential for developing further the already healthy commercial relationship. Malaysia is a very important economic partner for Australia; it ranks as our tenth-largest trading partner and our ninth-largest import source. Two-way trade in goods and services currently stands at eight billion Australian dollars. The relationship is underpinned by strong education links.

Although both countries have liberal trade and investment regimes, there are opportunities for improvement in the services sector and in business and investment flows. At the Joint Trade Committee meeting in July 2004, Australia's Trade Minister, the Hon. Mark Vaile MP, and his Malaysian counterpart, the Minister for International Trade and Industry, Dato' Seri Rafidah Aziz, agreed that the two countries would conduct parallel scoping studies of a free trade agreement between Australia and Malaysia. The studies are to be completed in the first quarter of 2005 and will provide a basis for the Australian and Malaysian Governments to decide whether to negotiate a free trade agreement. This builds on the already strong and broad-ranging relations with Malaysia, including in education, security, defence, law enforcement and tourism.

MALAYSIA'S APPROACH TO FREE TRADE AGREEMENTS

Malaysia sees free trade agreements as complementing their main approach to pursuing trade liberalisation which is through an equitable, rule-based multilateral trading system. It pursues bilateral and regional trading arrangements in order to maximise every opportunity available to enhance its economic growth and complement its pursuit of market access in the World Trade Organization. Malaysia's specific objectives in concluding free trade agreements are to ensure its exporters are not disadvantaged through the proliferation of free trade agreements and other preferential trading arrangements; to seek better access by addressing tariffs and non-tariff measures; to facilitate and promote trade, investment and industrial development; and to build capacity in specific targeted areas through technical cooperation and collaboration.

Free trade agreements and Economic Partnership Agreements currently being pursued by Malaysia are not confined to liberalisation and market opening. They also include trade and investment facilitation and cooperation in various areas including: education, transport, science and technology, information and communication technology, and agriculture. In negotiating free trade agreements, Malaysia seeks arrangements that provide balanced and equivalent benefits among signatories; are consistent with World Trade Organization rules; and allow sufficient flexibility to address specific concerns and sensitive areas.

Source: Ministry of Trade and Industry, 2004b.

AUSTRALIA'S APPROACH TO FREE TRADE AGREEMENTS

The Australian Government pursues a combined multilateral, regional and bilateral approach to trade policy. As part of this policy, Australia is open to concluding regional or bilateral agreements that deliver substantial gains to Australia and which cannot be achieved in a similar timeframe elsewhere.

Free Trade Agreements (FTAs) that are comprehensive in scope and coverage can complement and provide momentum to our wider multilateral trade objectives. Australia expects that any progress in regional trade liberalisation should be multilateralised in due course through WTO negotiations.

Given the renewed interest in free trade agreements in our region, Australia believes it is important that such agreements contribute to the multilateral system. One of the best ways of ensuring this occurs is for agreements to meet the criteria in the WTO agreements.

Source: Department of Foreign Affairs and Trade, 2004c.

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