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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

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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**

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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**

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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.