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TRADE REFORMS: THE MALAYSIAN EXPERIENCE

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Trade Reforms: The Malaysian Experience

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ABSTRACT

This paper outlines the experience Malaysia had undergone in becoming a successful developing economy. It analyses the trade reforms undertaken by the government and the circumstances within which they were made. While it is difficult to determine the actual causation between the trade reforms and Malaysia's economic successes, nevertheless, the main factors commonly accepted as the reasons for Malaysia's successes are put forward. The outcomes of the Malaysian economy in general indicates that trade reforms have been a qualified success in Malaysia.

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Overview

This paper provides an overview of trade policy reforms in Malaysia focusing on the Malaysian government's initiatives to eradicate poverty and restructure society mainly by attracting foreign direct investment beginning in the late 1960s to liberalisation measures beginning in the early 1980s to the accelerated reforms at the beginning of the 1990s boom. The paper will also provide an overview of the political economic context within which these trade reforms occurred.

The first section will briefly discuss the socio-politico-economic conditions surrounding trade reforms in Malaysia. Section two will discuss the reforms. The third section will discuss the outcomes and consequences of the reforms. Section four will analyse what are the remaining challenges to be faced by Malaysia to liberalise the economy. The concluding section will outline the political economy lessons learnt from trade reform programmes, and their replicability.

1. Malaysia – an overview

Malaya gained independence from the British in 1957 with a nascent democracy framed by the Federal Constitution that provided for a constitutional Supreme Head of State, bicameral Parliament[1] and a federal government structure. On 13 September 1963, Sarawak and Sabah on the Borneo Island together with Singapore joined the Federation of Malaya to form Malaysia. Singapore was expelled from Malaysia on 9 August 1965[2].

[1] Parliament consists of an elected lower house (Dewan Rakyat) and an appointed upper house (Dewan Negara).
[2] The main reason for Singapore being expelled was Singapore's ruling Peoples Action Party's (PAP) call for a "Malaysian Malaysia" against the UMNO's pro Malay agenda leading to UMNO dominated Malaysian Parliament to vote for the expulsion of Singapore. The inclusion of Singapore had also titled the majority of citizens to non-Malays.

Malaysia is a plural society with people of different race, religion and culture with three major ethnic groups. At the time of independence, the balance between Malay and non-Malay citizens were equal (Table 1). In 2005, Bumiputeras (Malays and other indigenous people) account for 65.1 percent of the population, Chinese, 26 percent and Indians 7.7 percent. Due to Malaya's economic history, Malays were also predominantly rural. This composition, together with the "special position"[3] granted to the Bumiputeras (*sons of the soil)* by the British has had a profound impact on domestic politics, which has impacted on trade policy reforms.

Table 1: Distribution of population by strata and race, Peninsular Malaysia, 1957 and 1970

	1957				1970			
Strata	**Urban (%)**	**Rural (%)**	**Total (%)**	**Total (no.)**	**Urban %**	**Rural %**	**Total (%)**	**Total (no.)**
Malays	21.0	60.2	50	3,125,474	27.4	63.4	53	4,671,874
Chinese	62.5	28.0	37	2,333,756	58.7	26.1	35.5	3,131,320
Indians	12.8	10.5	11	696,186	12.8	9.8	10.6	936,341
Others	3.7	1.3	2	123,342	1.1	0.7	0.8	70,022
Total	100	100	100	6,278,758	100	100	100	8,809,557

Note: 1957 and 1970 Censuses unadjusted figures.
Urban means centres with population of 10,000 and above.
Source: Second Malaysia Plan

At Independence in 1957, Malaysia was a dualistic low-income economy[4] reliant on commodities, mostly tin, rubber and palm oil for its foreign exchange earnings. While palm oil earnings have remained significant, Malaysia has diversified its foreign exchange earnings into other sectors such as manufacturing and tourism. The table below illustrates the changes in the structure of the Malaysian economy since 1965.

Table 2: Composition of Gross Domestic Product (in percentage)

Sector	1965	1975	1985	1995	2005
Agriculture, livestock, forestry & fishing	29.0	29.5	20.8	13.5	8.2

[3] Article 153 of The Federal Constitution of Malaysia grants the Yang diPertuan Agong (The Supreme Head of State) responsibility for safeguarding the rights and privileges of the Malay (and other indigenous people) of Malaysia, collectively called Bumiputera.
[4] Although Malaya is a resource rich nation, the British imperialists had for 200 years (1874-1957) plundered its resources.

Sector	1965	1975	1985	1995	2005
Mining & quarrying	7.9	4.2	10.5	7.5	6.7
Manufacturing	10.5	14.3	19.7	33.1	31.6
Construction	4.7	4.6	4.8	4.5	2.7
Electricity, gas & water	1.9	2.6	1.7	2.3	4.1
Transport, storage & communication	3.7	7.2	6.4	7.4	8.8
Wholesale & retail	15.7	13.7	12.1	12.3	14.7
Finance, insurance, real estate & business services	6.0	7.3	8.9	10.8	15.4
Government services	6.9	7.8	12.2	9.5	5.5
Other services	13.6	8.1	2.3	2.1	4.8

Source: Economic Reports and Malaysia Plans (various years)

This transformation from a predominantly agriculture economy to a manufacturing and services based economy was achieved in an ad-hoc manner since 1957 but with clearer focus through three long-term development policies from 1970. The long-term development policies were the New Economic Policy (NEP–1971-1990), National Development Policy (NDP–1991-2000) and National Vision Policy (NVP–2001-2010). Within these long-term development policies, sector and target specific policies such as the Industrial Master Plans, Malaysia Inc. and Privatisation Policy, were also formulated to achieve the developmental objectives explained below.

The overriding objective of these policies was to maintain **national unity** through the eradication of poverty and the restructuring of the Malaysian society so as to reduce the identification of race with economic functions and geographical locations. These core objectives were the outcome of the response of the Alliance[5] government to appease the demands of the radical faction in the United Malay National Organisation (UMNO) after the May 13, 1969[6] race riots. The radical faction in UMNO[7], who

[5] The Alliance Party is made up of the three major ethnic groups – The United Malay National Organisation (UMNO), the Malayan Chinese Association (MCA) and the Malayan Indian Congress (MIC). In the 1969 elections, the Alliance had the Sarawak United People's Party as coalition partner. After the reversals of the 1969 elections, UMNO (led by Tun Razak) in order to gain a two-thirds majority in Parliament, courted and expanded the number of political parties in the Alliance to include the Peoples Movement Party (GERAKAN), the Pan Islamic Party of Malaysia (PAS) and regional parties from the Borneo states. This new alliance was called The National Front (Barisan Nasional) and UMNO was the dominant party.

[6] The government laid the blame for May 13 race riots on the actions of the Malayan Communist Party (MCP), the Labour Party (LP), Democratic Action Party (DAP) and GERAKAN whose members were predominantly Chinese. The poverty of the Malay community was also cited as a reason for the anger of the Malay community. (The May 13 Tragedy: A Report, The National Operations Council, 1969). However, evidence points that the May 13 was organised by then Chief Minister of Selangor (whose residence was in Kampung Bahru) with Malay hoodlums and tacit approval by the authorities before it became widespread (May 13: Declassified Documents on the Malaysian Riots of 1969, Dr. Kua Kia Soong, 2007). The following news article captures the essence of the

suffered massive reversals in the 1969 electoral, noted that pre-NEP affirmative actions were insufficient, as poverty remained highest among the Malay community.

In fact, the First and Second Bumiputera Economic Congress in 1965 and 1968 had already reflected the growing demands of the Bumiputera elites. Although, the economy grew at a stable rate of 5.7 percent during the 1960-69 period, it was mostly in the modern sector, which bypassed the rural communities where the Bumiputeras were predominant. The redistributive objective was therefore to be achieved through a wide range of direct redistribution policies to assist the Bumiputera to obtain parity with the non-Bumiputera in income and wealth. However, key to the redistribution effort was that it would come from **an expanding economy** as was argued by non-Bumiputera interests represented at the policy formulation and not through appropriation[8]. The Alliance government and its reincarnation National Front (Barisan Nasional)[9] governments have since used the theme "Growth with Equity" to mobilise support for these development policies.

Table 3: Poverty Rates in Malaysia

Sector	1957/58[a]	1970[b]	2005[b]
Total	51.2	64.8	5.7
Rural	59.6	58.7	11.9
Urban	29.7	21.3	2.5
Indian	35.7	39.2	2.9
Chinese	27.4	26.0	0.6
Malays	70.5	64.8	8.3

Note: [a]- Federation of Malaya (only 11 states in Peninsular) [b] Federation of Malaysia (which includes Peninsular Malaysia, Sabah and Sarawak)
Source: Abu Bakar & Hassan (2003) and Ninth Malaysia Plan

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race riots. http://www.time.com/time/magazine/article/0,9171,900859-1,00.html and http://www.time.com/time/magazine/article/0,9171,901058-1,00.html

[7] The 1969 general election, the third in the nation's history, saw the ruling Alliance party loose its two-third majority in Parliament thereby restricting its ability to amend the Constitution at will. The Alliance could also not form a government in four states, especially in the urban West Coast of Peninsular Malaysia - Selangor, Perak and Penang, and the Malay heartland of Kelantan, in the east of Peninsular.

[8] Just Faaland, J.R Parkinson and Rais Saniman, consultants at the National Operations Council in 1969 & 1970, are often credited for the formulation of the NEP. Ghazali Shafiie's influence was also noted in formulating the NEP.

[9] Barisan Nasional has 14 component parties representing the various ethnic groups in Malaysia as at 2005. The United Malay National Organisation (UMNO) leads the Barisan Nasional.

The NEP comprised of seven strategic thrusts that were to be achieved by 1990:

- Economic growth at approximately six to seven percent annually;
- Economic restructuring to reduce economic imbalances in terms of:
  - (i) Income – mainly seen as reduction between Bumiputeras and non-Bumiputeras;
  - (ii) Achieving a wealth target of 30 percent public quoted share holdings;
  - (iii) Creation of a Bumiputera commercial and industrial class; and
  - (iv) Employment to reflect the multiracial composition of the population at all levels in firms[10] by 1990;
- Reduction of poverty irrespective of race;
- Full employment of the labour force and absorbing surplus labour particularly from the rural sector;
- An interventionist and proactive government;
- Monitoring of the implementation of the NEP; and
- Social policy for conflict avoidance.

Underpinning the development policies noted above were Malaysia's industrialisation policies, which included trade policies. Trade policies in Malaysia are therefore contingent on the objectives of Malaysia's development policies especially since 1970. While external factors have played an important role in Malaysia's trade reforms, nevertheless, appeasement of the ruling political party (UMNO) in the name of the Bumiputera community has been the crux of industrial and trade polices in Malaysia.

On the international front, Malaysia maintained a policy of neutrality by being a member of the Non-Aligned Movement (NAM) and promoting ASEAN[11] as a Zone

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[10] The actual targets are provided for in the Outline Perspective Plan 1 (OPP1). http://www.epu.jpm.my/new%20folder/development%20plan/2nd%20opp%20content/opp2/t2-1.htm

[11] ASEAN – Association of South East Asian Nations. The founding nations of ASEAN are known as the ASEAN 5. They are Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei joined in 1984, Vietnam in 1995, Lao PDR and Myanmar in 1997 and Cambodia in 1999.

of Peace, Neutrality and Freedom[12]. In 1974, Malaysia initiated diplomatic ties with the People's Republic of China, considered a very radical move then. However, western capital and interests were courted and welcomed as a buffer against perceived threats of Communism and indigenous Chinese capital. Britain, through the granting of independence to the Alliance Party and the continued support given to them after the May 13 race riots, ensured that Malaysia remained a market economy where state capitalism dominates the strategic sectors thereof.

2. Industrial Policy and Trade Reforms

Industrial policies are measures taken to develop or enhance the industrial capacity or capability of a nation. Trade policies are often part and parcel of industrial policies. In Malaysia, trade, industrial and development policies are all entwined, with "National Unity" being the end objective. Trade policy broadly defined encompasses all measures governing international trade such as tariffs, quotas, import and export restrictions, non-trade barriers and ownership restriction for foreign investment and takeovers. In the era of multilateral and preferential trade agreements, trade policy also extends to all the 'trade-related' regulatory issues, especially in the context of trade negotiations.

2.1 Industrial Policies

There have been four phases of industrial policies in Malaysia's industrial development:

- Phase I: Import substitution industrialisation (1957 to 1968);
- Phase II: Export oriented industrialisation (1968 - 1986);
- Phase III: Heavy industries import substitution (1981 to 1985); and
- Phase IV: High technology export oriented industrialisation (1986 to present).

[12] ZOPFAN – Zone of Peace, Freedom and Neutrality is a declaration signed by the Foreign Ministers of the ASEAN member states on 27 November 1971 with the purpose of keeping Southeast Asia "free from any form or manner of interference by outside powers" and "broaden areas of cooperation."

2.1.1 Phase I – Import substitution industrialisation (ISI-1)

Manufacturing was not a significant component of the newly independent Malaya's economy, as reflected in Table 3. Post-colonial Malaya however actively promoted industrialisation. Industrialisation began with a low-key phase of import substitution (IS) in the 1960s. *The Pioneer Industries Ordinance, 1958* signalled the beginning of IS as it offered tax relief on profits for pioneer firms which were mainly in the IS industries. The government also provided infrastructure, credit facilities and tariff protection to these firms.

In the early stages, the new industries concentrated mainly on the manufacture of consumer goods for which there was a home market. The growth of manufacturing output was rapid in the initial years, mainly caused by low base values. It began to slow down soon after as the small and low average income domestic market saturated.

During this phase, the contribution of the manufacturing sector to the country's GDP increased meagrely from 11 percent in 1957 to 13 percent in 1968 and manufacturing's share of total employment increased marginally from 6 percent to 9 percent. Alarmingly unemployment increased from 6 percent in 1962 to 6.6 percent in 1967 due mostly to slump in the rubber prices, leading to reduction of acreage and production of rubber. It was clear that import substitution could not effectively solve the unemployment problem. The generous investment incentives had clearly favoured capital-intensive operations by subsidising the price of capital, resulting in low labour absorption.

2.1.2 Phase II – Export oriented industrialisation (EOI-I)

Malaysia then began to shift towards export orientation from 1968 with the introduction of the *Investment Incentives Act 1968*. Several factors were responsible for this policy shift. The most critical factor was the failure of import substitution to generate growth of manufacturing output and employment, as noted above. Mounting domestic political tensions caused by unemployment forced the government to look for immediate employment creation industries. Other factors that influenced the shift were the spectacular success of export-led industrialisation of the Asian NICs[13] and the change in the intellectual climate in Malaysia towards greater emphasis on exports with growing evidence associating exports with efficiency and import substitution with inefficiency[14].

Export orientation did not lead to the abandonment of import substitution. EOI-1 and ISI-1 were pursued in together with stronger emphasis was given to EOI. Investment incentives were restructured so as to offer a variety of export incentives including export allowances and accelerated depreciation of capital equipment (e.g. plant and machinery) and building, in addition to tax holidays and investment tax credit and other fiscal incentives, which were aimed at Export Oriented Industries (EOI). Pre-shipment and post-shipment export credit re-financing facilities at concessionary rates of interest were also introduced.

The establishment of free trade zones (Free Trade Zones Act 1971) represents another aggressive measure taken by the government to promote manufactured exports from 1971 onwards. These FTZs operates as "foreign enclaves" with duty-free access to imported inputs and machinery, while at the same time enjoying a wide range of investment and export incentives and weaker labour laws[15]. The labour laws did not allow for the formation of trade unions as opposed to the Industrial Relations Act, which governs labour in Malaysia. By focusing on labour-intensive industries, the FTZs absorbed surplus labour especially from the Malay community that were

[13] Asian Newly Industrialising Countries (NIC): Republic of Korea, Taiwan, Hong Kong and Singapore.

[14] Mohamed Ariff and Muthi Semudram (1987). Trade and Financing Strategies: A Case Study of Malaysia. Working Paper No. 21. Overseas Development Institute. London.

[15] Dr. V. Anantaraman noted that historically, the industrial relations legislations were deliberately developed to weaken the labour movement. (V. Anantaraman). Until1988, workers in the electronic and electrical industries were not allowed to form trade unions under the Free Trade Zones Act 1971 in violation of the already weak Industrial Relations Act 1967 which governs industrial relations in Malaysia. After the recession of 1985-87, where many workers in the electronic & electrical sector suffered (retrenched), the government allowed for in-house trade unions.

unemployed. Equity consideration were also liberal as MNC were allowed to be 100 percent foreign owned.

To meet the equity objectives of the NEP, the government introduced the *Industrial Coordination Act (ICA) 1975*[16], which stipulated that all new manufacturing projects above a predetermined threshold have at least 30 percent Bumiputera equity[17]. This unfortunately had a crippling effect of small and medium scale enterprises (SMEs) in Malaysia. Nevertheless, through the creation of FTZs, manufacturing value-added of total GDP increased from 10.4 percent in 1970 to 19.6 percent in 1980, while employment increased from 270,000 to 755,000. Unemployment during this period fell from 7.8 percent in 1970 to 5.3 in 1980.

2.1.3 Phase III – Heavy Industries Import Substitution Industrialisation (ISI-II)

The incorporation of the Heavy Industries Corporation of Malaysia (HICOM) introduced Malaysia to heavy industrialisation. However, this policy introduced expensive investments and burdensome protectionist measures. Through HICOM, investments were made into the national car project, motorcycle engines, cement plants, petrochemical and gas projects and steel plants with active participation from Japanese and South Korean firms. The government invested in these projects, as the private sector was reluctant to take the lead role.

Dr. Mahathir, the third Prime Minister, promoted heavy industrialisation to deepen the industrial capacity and capabilities of Malaysian firms and develop a more balanced, integrated national economy, as the EOI was dominated by MNCs with little linkage to the rest of the economy[18]. Furthermore, the impressive gains made by

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[16] The main purpose of the ICA 1975 was to restructure equity ownership according to the 30:30:40 formula (30-Bumiputera, 30-foreign, 40-Chinese/non-bumiputera Malaysians). Gomez and Jomo 1999.
[17] The initial threshold was RM250, 000 and 25 employees. This forced many Chinese SMEs to stop expanding their business to avoid giving away 30 percent of equity. After realising the negative impact it created and to attract foreign investment, the government revised the threshold upwards to RM2.5 million and 75 employees.
[18] Jomo K.S., Malaysian Economy in the 90s. pg. 118

the Republic of Korea and Japan through heavy industrialisation prompted Dr. Mahathir to introduce "The Look East Policy", which promoted "Picking the Winners" through close collaboration between selected corporations in Malaysia, South Korea and Japan in heavy industries.

2.1.4 Phase IV – High Technology Export Oriented Industrialisation

ISI-II was a failure on most counts. With the nation facing severe debt crisis due to heavy industrialisation projects that were not profitable and falling foreign direct investment due to a global recession, the government reemphasised EOI quietly suspending of selected NEP privileges. Critical among those were the liberalisation of foreign equity ownership with the introduction of the *Promotions of Investment Act (PIA)* in 1986, which granted additional tax incentives and pioneer status for periods of five years for export oriented manufacturing, agriculture and tourism. Amendments were also made to the *Industrial Coordination Act (ICA) 1975* to allow industrialists to invest in new projects or to expand and diversify existing investments, and to reduce the requirements including equity considerations (e.g. number of employees, paid-up capital).

The timing for this liberalisation was perfect. It coincided with structural changes in Japan, South Korea, Taiwan and Hong Kong, caused mainly by exchange rate appreciation due to the Plaza Accord, the loss of Generalized System of Preferences (GSP) benefits, and the rising wages. These forced many of their manufacturers to seek lower cost production sites offshore. The Industrial Master Plan 1 (IMP1) launched in 1986, which identified 12 industrial sub-sectors that were to be promoted, also gave further impetus to these manufacturers.

2.2 Flanking Policies

Two crucial flanking policies that were introduced were the entrepreneurial role of the state and the privatisation policy, which transformed the entrepreneurial role of the state.

2.2.1 The Entrepreneurial Role of the State

With the implementation of the New Economic Policy (and the subsequent development policies), the role of the state has increased tremendously. The state comprised the public sector and public enterprises. The nature of government intervention had also changed from a trusteeship approach and direct intervention in the 1970s to a business-like approach since the mid 1980s.

Government allocation for development expenditure increased from RM4.6 billion in the First Malaysia Plan (1966-1970) to RM11.5 billion in the Second Malaysia Plan (1971-1975) – the first after the race riots. The amount tripled to RM36.7 billion in the Third Malaysia Plan (1976-1980), and the Fourth Malaysia Plan (1981-1985) was allocated RM42.8 billion. This was the period when "direct" government intervention was highest.

The federal government intervened through four methods:

- The enlargement of the public sector (e.g. setting up of new government departments and expanding existing ones)
- The setting up of statutory bodies (e.g. Malaysian Industrial Development Authority (MIDA), Malaysian External Trade Development Corporation (MATRADE), etc);
- The setting up of public enterprises (HICOM Bhd, Perusahaan Otomobil Nasional-PROTON), etc; and
- The setting-up of 'Trust Agencies'[19] (Perbadanan Nasional Bhd (Pernas), Permodalan Nasional Berhad (PNB), etc).

The state governments were also involved in setting-up their own public enterprises under the auspices of the State Economic Development Corporation (SEDC). Table 4

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[19] Trust Agencies was set-up by the government as an instrument to hold equity for Bumiputeras as in the 1970s, Bumiputeras did not have the financial capacity to purchase and/or own equity of listed firms.

and 5 below illustrate the depth and breadth of government intervention in the economy before the privatisation programme.

Table 4: Malaysia: State Owned Enterprise by Paid-Up Capital, 1988.

Level	Number of companies	Total capital (RM million)	Govt Equity (RM million)	Govt. Equity as % of Total Capital	Average Capital (RM million)
Federal	556	18,521	12,738	68.78	33.3
State	553	5,048	3,829	75.85	9.1
Regional	49	241	170	70.54	4.9
Total	1,158	23,810	16,737	70.29	20.6

Source: Jomo K.S. and Tan Wooi Syn

Table 5: Malaysia: State Owned Enterprise by Sector, 1988.

Sector	Federal	State	Regional	Total
Agriculture	5	19	3	27
Construction	8	26	1	35
Extractive	6	27	1	34
Finance	100	33	1	134
Manufacturing	153	155	14	322
Plantation	22	61	12	95
Property	44	53	1	98
Services	162	135	16	313
Logging	0	25	0	25
Transport	56	12	0	68
Others	0	7	0	7
Total	556	553	49	1158

Source: Jomo K.S. and Tan Wooi Syn

Under the NEP, the entrepreneurial role of the state was dominant. The state took upon itself the task of holding in trust the Bumiputera share of the equity, as the Bumiputera private sector was not in a position to mobilise resources for capital acquisition. It was reasoned that the state should fill the vacuum and hold the Bumiputera shares until the Bumiputera community is ready to take over.

Public sector expenditure rose sharply under the NEP. The ratio of public sector expenditure to GNP rose from 29.2 percent in 1970 to a peak of 58.4 percent in 1981. At the time of independence in 1957, there were only 23 public enterprises engaged mainly in the provision of public utilities, transportation, telecommunication, agricultural development and finance. However, during the period 1975 – 1989, 901 public enterprises were created, representing nearly 80 percent of all public enterprises in the country.[20] They state also took over foreign interests or developed partnerships with existing foreign corporations in Malaysia.[21]

At the same time, however, certain institutions have been crucial in developing the nation's external economy. The Malaysian Industrial Development Authority (MIDA) and the Malaysian External Trade Development Corporation were instrumental in attracting FDI and promoting Malaysia as a location for foreign investors.

Although privatisation has been implemented since the early 1980s, the government continues to play a leading role in the Malaysian economy through Government-Linked Companies (GLCs[22]) and Government-Linked Investment Companies (GLICs). There are 57 GLCs and seven GLICs. GLCs and GLICs are different from non-financial public enterprises such as PETRONAS. There are 50 listed GLCs, which represent 50 percent of total listed companies. They have a collective market capitalisation of RM295 billion, representing 36 percent of the Bursa Malaysia and 41 percent of the market capitalisation of the benchmark KLCI.[23]

2.2.2 Privatisation and Deregulation

The early eighties saw privatisation becoming a buzzword, thanks to Margaret Thatcher and Ronald Reagan. Secondly, the failure of state-owned enterprises (SOE) had affected negatively on Malaysia's fiscal position.[24] The dismal performance of SOE, reflected in the table below, where on average, more than 50% performed either satisfactory or less than satisfactory and almost 40% were loss making (measured by the utilisation of shareholders funds) also prompted a reconsideration.

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[20] Ariff, Mohamed, "*Structural Change, Economic Development and the Role of the State: The Malaysian Experience*," in Anh, Vu Tuan (Ed), The Role of The State in Economic Development: Experience of the Asian Countries." (1994). Social Science Publishing House. Hanoi, Vietnam.

[21] The "Dawn Raid" or backdoor nationalisation as termed by the British, is often quoted as an example where state capitalism or Malay ethnic nationalism used market mechanisms to take control of foreign private sector interests in Malaysia. The Petroleum Development Act 1974 also

[22] GLCs are defined as companies that have a primary commercial objective and in which the Malaysian Government has direct controlling stake. GLICs are defined as Federal Government linked investment companies that allocate some or all of their funds to GLC investment. http://www.pcg.gov.my

[23] KLCI- Kuala Lumpur Composite Index.

[24] Jomo K.S. and Tan Wooi Syn, "Privatisation and Re-nationalisation in Malaysia: A Survey."

Table 6: Malaysia: Relative Performance of State Owned Enterprise, 1980 – 1988 (%)

Year	Sick[a]	Weak[b]	Satisfactory[c]	Good[d]
1980	12.53	26.24	10.88	50.35
1981	13.19	26.74	9.63	50.44
1982	15.25	29.15	9.86	45.74
1983	12.12	30.12	10.04	47.72
1984	14.02	26.98	11.80	47.20
1985	16.79	30.20	11.09	41.92
1986	18.95	29.54	13.31	38.20
1987	19.23	27.43	13.87	39.47
1988	16.67	24.15	14.42	44.76

Notes: [a]-Companies with negative shareholders' funds.
[b-]-loss making companies with shareholders' funds < 200% of paid-up capital.
[c]-Shareholders' funds < 100% but currently profitable.
[d-]Shareholders' funds > 100% and profitable.

However, what most crucial, was Mahathir's commitment to develop Bumiputera entrepreneurs through privatisation. Mahathir introduced privatisation beginning in 1983[25] as part of his strategy for Bumiputera capital accumulation and growth to fulfil NEP objectives.

Although this policy was a reversal of earlier government policies of promoting public enterprises, the end goal was still the redistribution of resources to the Malay community through the restructuring of employment and ownership of share capital in the corporate sector, aimed at creating a Bumiputera Commercial and Industrial Community (BCIC)[26]. The privatisation policy was a corollary to Mahathir's "Malaysia Inc."[27]

[25] The Privatisation Policy was launched in 1983. However, the Guidelines on Privatisation was only released in 1985 while the Privatisation Masterplan and the Privatisation Action Plan was issued in 1991.
[26] Tan, Wooi Syn, Privatisation and Capital Accumulation in Malaysia, 2002.
[27] Malaysia Incorporated

2.3 Trade Regime

Malaysia's trade regime had been created to support Malaysia's industrialisation policies while responding to regional and global pressures. However, at all times the government has insulated sensitive and strategic sectors of the Malaysian economy to achieve the development and NEP objective but never excessively[28]. The essence of Malaysia's trade regime are captured below[29]:

- Phase I (1957 – 1968): Tariffs were mostly for protecting infant industries producing consumer goods. Moderate tariff protection was the key instrument used to encourage new investments in manufacturing. However, the protection was mild. The average bound tariff rate in 1965 was estimated at only 13 percent. Very few quantitative restrictions were used to limit imports.

- Phase II (1968 – 1980): Free Trade Zones were established and tariffs were gradually reduced. Incentives were granted to encourage manufactured exports, partly linked to export performance.

- Phase III (1981 – 1985): High protection in comparison to other tariffs in Malaysia was given to the selected industries (automobile, petrochemical, iron and steel and cement industries) in the form of high import duties or import restrictions for competing goods. Tariffs on a wide range of manufactured goods were substantially increased as part of the heavy industrialisation strategy. The average effective rate of protection in the manufacturing sector increased from approximately 25 percent in the early 1960s to 70 percent in the early 1980s.

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[28] Dr. Rokiah Alavi (1995) noted in her paper, "The Performance of Highly Protected Industries in Malaysia," that ERP have been high for import competing industries. ERP increased from 25% in 1962 to 50% in 1972. ERP in these industries started to fall from 61% in 1974 to 42% in 1980 to 28% in 1987. The ERP for consumer goods in 1969 were 72% and intermediate goods were 33%. In 1987, consumer goods fell to 9% but intermediate goods rose to 65%. Although Malaysia had high ERPs, its average bound tariff rate was generally low throughout.

[29] UNDP Malaysia 2006, pg. 25

- Phase IV (1985 onwards): The economic crisis of 1985-87 caused by the global recession and deficit spending for heavy industries led to the introduction of a voluntary structural adjustment reform package including significant tariff reduction and the removal of quantitative restrictions. The average effective rate of manufacturing protection declined to below 30 percent by the late 1980s. From the late 1980s, further tariff reductions were introduced as part of the Common Effective Preferential Tariff (CEPT) of the ASEAN Free Trade Agreement (AFTA). With the slow progress of the Doha trade talks at the WTO, Malaysia has pursued bilateral and regional trade agreements, which has brought about further trade liberalisation.

2.3.1 The Role of the External Sector

Trade reforms have made Malaysia's one of the most open economies among developing countries. Exports of goods and services grew at 14 percent per annum during the period 1971-90, and at a higher rate of 17 percent per annum between 1991 and 2000. As a percentage of GDP, exports of goods and services rose from 46 percent in 1970 to 123 percent in 2005 while imports rose from 41.3 percent of GDP in 1970 to 100 percent of GDP in 2005. In total, trade accounted for 87 percent of GDP in 1970 and grew to an astounding 223 percent of GDP in 2005.

It is clear that the external demand for Malaysian products dictates the pace at which the economy moves. The external sector is all the more critical to Malaysia's "growth with equity" policy, as Malaysia has a small economy. This is a double-edge sword as the vulnerability, due to the openness of the Malaysian economy to external influence is exacerbated by the high degree of concentration in terms of product mix and export destination.

Table 7: Exports of Goods and Services

Variable	1970	1980	1990	2000	2005
Exports of goods and services (RM million)	5,389	30,676	88,675	427,004	611,082
Imports of goods and services (RM million)	4,888	29,342	86,241	358,530	494,529
Trade Balance	501	1334	2434	68474	116,553
GDP at purchasers' value (RM million)	11,829	53,308	119,081	343,215	495,239
Exports of goods and services (% of GDP)	45.6	57.5	74.5	124.4	123.4
Imports of goods and services (% of GDP)	41.3	55.0	72.4	104.5	99.9

Total (% of GDP)	86.9	112.6	146.9	228.9	223.2

Source: Adapted from UNDP Malaysia (2006)

Due to Malaysia's trade policies, both the pattern of exports and the direction of trade have shown significant changes over the years. Most striking is the composition of exports. In the 1970s, rubber, palm oil and forestry products were the main export earners contributing 55 percent of exports. However, from mid 1980s, manufactured goods have been the main contributor of exports. The share of the manufacturing sector of total exports continued to rise, reaching 81 percent in 2005. Within the manufacturing sector, the electrical and electronics (E&E) sub-sector is the most important. Since 1998, the manufacturing sector has been fully exposed to foreign equity. This sector is dominated by foreign MNCs. Local interest is predominantly indigenous Chinese capital. The changes in exports have also impacted the composition of imports with intermediate goods growing in importance compared with consumption goods.

Table 8: Share of exports (percentage), Malaysia, 1970-2005

	1970	1980	1990	2000	2005
Agriculture	52.1	35.5	18.7	6.1	7.7
Minerals	22.8	34.5	17.7	7.2	13.2
Manufacturing	15.8	25.2	58.8	85.2	77.4
Others	9.3	4.8	4.8	1.5	1.7

Source: Malaysia Plans (various years) and MITI Annual Report 2006

Trade policies have also had a significant effect on direction of trade. In line with Malaysia's commitment to 'open regionalism', Malaysia continues to participate actively in ASEAN and the Asia-Pacific Economic Cooperation (APEC), and the Asia-Europe Meeting (ASEM). Malaysia is also active at the sub-regional level within ASEAN that contributes to increased trade, notably the Indonesia-Malaysia-Thailand Growth Triangle and the Brunei-Indonesia-Malaysia-Philippines-East Asian Growth Area.

As the importance of manufacturing sector has grown, the USA has become critically important destination for Malaysia's exports accounting for almost 20 percent of Malaysia's exports. Exports to China have also increased dramatically from 1.3 percent in 1970 to 11.5 percent in 2005, indicating China's growing importance as a trading partner. However, export shares to the European Union (E.U.) and Japan are declining. Exports to E.U. were 19.2 percent in 1970 and dropped to 11.7 percent in 2005. Conversely, the E.U. and Japan were the main sources of imports in 1970. This trend has been reversed where ASEAN is now the largest source of imports.

Table 9: Direction of Malaysia's External Trade (in percentage)

Country	1970		1980		1990		2000		2005	
	X	M	X	M	X	M	X	M	X	M
USA	13.0	8.5	16.4	15.0	16.9	16.7	20.5	16.6	19.7	12.9
ASEAN	24.7	15.6	22.4	16.4	28.9	18.9	26.5	24.1	25.8	24.5
Singapore	21.5	7.2	19.1	11.7	22.7	14.9	18.4	14.4	15.6	11.7
E.U.	19.2	23.0	16.9	15.4	14.9	14.6	13.7	10.8	11.7	11.6
Japan	18.2	17.7	22.8	22.9	15.8	24.0	13.1	21.0	9.4	14.5
China	1.3	5.2	1.7	2.4	2.1	1.9	3.1	4.0	6.6	11.5
India	0.4	1.5	2.2	0.9	1.6	0.7	2.0	0.9	2.8	1.0
Total (RM million)	5,163	4,289	28,172	23,451	79,646	79,119	373,459	311,459	533,790	434,030

Note: X – Exports from Malaysia to country noted and M - Imports by Malaysia from country noted
Source: Adapted from UNDP Malaysia 2006

2.3.4 Microeconomic Reforms

Trade reforms have impacted differently at the microeconomic level. The guiding principles are that the state must maintain control of strategic and sensitive sectors of the economy and that Bumiputera interest must be safeguarded.

- *Controls on inward and outward investment.*

In 1974, the government set up a Foreign Investment Committee (FIC), which is guided by the *"Guidelines for the Regulation of Acquisition of Assets, Mergers and Take-Overs"* of companies and businesses with interests in Malaysia. The FIC has far-ranging powers and formulates policies to promote the achievement of NEP objectives in the corporate sector. The FIC regulates investments into Malaysia for the non-manufacturing sector while MITI/MIDA regulates investment in the manufacturing sector and the Ministry of Domestic Trade and Consumer Affairs for wholesale and retail trade except in sectors that have been liberalised [30]. On the other hand, there are no restrictions on outward investment except for a blanket ban on trade and investment with Israel, who Malaysia does not recognise.

- *Competition policies.*

To date Malaysia does not have competition policy or law although the need for it has been mentioned in the Eighth Malaysia Plan. Competition regulation however exists in the telecommunication sector. However, competition policy and law is becoming increasingly important as a means to regulate the economy. The lack of competition policy and law was glaring in Malaysia, following the government's ambitious privatisation programme. This need was further heightened, as competition policy became a key issue in the WTO and in the bilateral and regional preferential trade agreements especially between Malaysia and developed economies such as the U.S. At the ASEAN level, it has been agreed that there will be a competition policy.

The main challenge for implementing competition policy is the belief that it would undermine the NEP and further the position of non-Malays and foreign interest. Currently there are many sectors that are protected for Bumiputera interests. An illustrative example is government procurement. The government procurement market is estimated to be worth RM92.7 billion or 20.6 percent of GDP in 2004. Government procurement is used to support national objectives such as encourage greater participation of Bumiputeras in the economy, transfer technology to local industries, reducing the outflow of foreign exchange and creating opportunities for local service-oriented companies.

- *Labour laws*

[30] Except for the manufacturing sector which is fully liberalised, all other sectors are still regulated by government policies especially in achieving NEP objectives.

Labour has suffered the most because of the government's labour policies in the face of Malaysia's rapid development[31]. Rapid growth was achieved mainly through the weakening of labour rights. In 2005, only 9 percent of labour force was represented by 617 trade unions[32]. Labour laws were amended in the later part of 1969, after the declaration of a state of emergency as a result of the May 13, 1969. Trade unions, before 1969 were a dominant force in local politics mainly through the Labour Party. These amendments served a twofold purpose – one to curtail labour movements links with politics and second, to more effectively use and control labour in the new, mainly labour-intensive EOIs by strengthening the Registrar of Trade Union's power to prevent electronic factory workers from forming a union, by allowing shift work for women, by restricting the right to strike and by limiting trade union activities and rights. Furthermore, as a concession to MNCs in the E&E sector, no national level union are allowed in the free trade zones. There are only eight in-house unions in this sector of 150,000 workers.

The Malaysian government adopts a low wage policy through flexible labour market policy with interventionist measures for Bumiputeras. It was believed that the economic expansion would absorb surplus labour caused by population growth. The *Pioneer Industries Scheme in 1957* required companies to fulfil a quota of employment for Bumiputeras to receive Pioneer Industry status.[33] However, since the 1990s, Malaysia has had a tight labour market. The government continued to promote Malaysia as a low cost manufacturing destination as its comparative advantage. Liberal labour policies to allow migrant workers in free trade zones and later the manufacturing sector, plantation sector, construction, selected services such hotels,

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[31] Wages have been kept artificially low through the policy of allowing migrant labour into labour intensive sectors both at the unskilled and the semi-skilled level. A case in point would be the plantation and banking sectors. Banks are registering record profits on the back of outsourcing and the shifting from permanent to contract staffing. Plantation companies in Malaysia refuse to allow for minimum wages but have instead relied on market forces assisted by the government, which allows for migrant labour in this sector. Therefore, the tight labour market in Malaysia has not resulted in upward movement in wages.

[32] Country Report on Human Rights Practises, 2006, by the U.S. State Department provides an excellent write-up on labour issues in Malaysia. http://www.state.gov/g/drl/rls/hrrpt/2006/78780.htm

[33] Yi, Il Cheong (2003). "The National Patterns of Unemployment Policies in Two Asian Countries: Malaysia and South Korea," Working Paper 15, Stein Rokkan Centre for Social Studies, Bergen University Research Foundation.

restaurants, healthcare and information technology (Multimedia Super Corridor status companies), complimented with weak labour laws are driven by a philosophy of a low wage policy to spur growth. The trade unions demand for a minimum wage law has constantly been denied by the government utilising the argument that Malaysia will not attract FDI should there be minimum wage laws. Favourable policies for Bumiputera workers were maintained through Foreign Investment Committee requirements for approval of investment by foreign firms investing in Malaysia.

- *Sectoral Reforms*

Key sectoral reforms have occurred mainly in the financial and certain professional services sector (e.g. legal and accounting), which until the early 2000, were protected. Although Malaysia still protects its services sector, its membership in the WTO and ASEAN's concentrated effort to become an Economic Community has had impacts on promoting reforms in the services sector. The financial crisis provided the political impetus for the reforms especially in the financial sector.

In the agriculture sector, there are limitations on foreign ownership including ownership of rural land. The government provides direct support to the rice and tobacco sectors mainly due to the constituency. In the year 2004 alone, the government expended almost RM813 million to support approximately 350,000 rice farmers. In the mineral sector, except for petroleum, the Government allows for 100 percent foreign ownership for projects involving extraction or mining and processing. However, mergers and acquisitions are subject to FIC approval. The Petroleum Development Act 1974 allows the upstream oil and gas industry to be controlled by the government through Petroliam Nasional Berhad (PETRONAS – the national oil company).

The 1997/98 financial crises changed the profile of the financial sector in Malaysia. The government used the crisis to force the restructuring and consolidation of the financial system. Before the financial crisis, there were 37 locally incorporated banks of which 23 were domestic and 12 were foreign owned. In total, there were 71 financial institutions – domestic and foreign[34]. It was agreed that Malaysia was 'over-banked' and in the light of consolidation globally in the financial sector, there was a need for similar consolidation locally.

However, once again, the interest of the ruling party and Bumiputera elites linked to the ruling party triumphed. Financial institutions controlled by ethnic Malaysian Chinese were forced to merge or sell out to government owned or backed Bumiputera financial institutions, despite the ethnic Malaysian Chinese financial institutions being better managed. The outcomes of the consolidation of these 'mega-banks' are provided in the table below.

Acquirers	Banking Institutions or groups		Current Status
	Subsidiaries	Targets	
Alliance Bank Malaysia Berhad		Sabah Bank Berhad International Bank Malaysia Sabah Finance Bhd Bumiputera Merchant Bankers Bhd Amanah Merchant Bank Berhad	Owned by the investment arm of the MCA
AmBank (M) Bhd	Arab-Malaysian Finance Bhd	MbF Finance	Private Bumiputera
Bumiputera-Commerce Bank Berhad	Bumiputera Commerce Finance Bhd	Commerce International Merchant bankers Bhd Bank Bumiputera	Bought over by CIMB Bank, Government linked)
EON Bank Berhad	EON Finance Bhd	Oriental Bank Berhad Perkasa Finance Bhd Malaysian International Merchant Bankers Bhd	Government linked
Hong Leong Bank Bhd	Hong Leong Finance Bhd	Wah Tat Bank Bhd Credit Corporation (M) Bhd	Private ethnic Chinese
Malayan Banking Group	Mayban Finance Bhd Aseambankers Malaysia Bhd	PhileoAllied Bank Bhd The Pacific Bank Bhd Sime Finance Bhd Kewangan Bersatu Bhd	Government linked
Perwira Affin Bank Bhd	Affin Finance Bhd Perwira Affin Merchant Bank Bhd	BSN Commercial Bank Bhd BSN Finance Bhd	Government linked

[34] Guan Hua Lim et. al (2004)

		Asia Commercial Finance Bhd BSN Merchant Bank Bhd	
Public Bank Bhd	Public Finance Berhad	Hock Hua Bank Bhd Advance Finance Bhd Sime Merchant Bankers Bhd	Private ethnic Chinese
RHB Bank Bhd	RHB Sakura Merchant Bankers Bhd	Bank Utama (M) Bhd Delta Finance Bhd Interfinance Berhad	Government linked
Southern Bank Bhd	Southern Finance Company Bhd/ Southern Investment Bank Bhd	Ban Hin Lee Bank Bhd Cempaka Finance Bhd Perdana Finance Bhd United Merchant Finance Bhd Perdana Merchant Bankers Bhd	Bought over by CIMB Bank, a government linked company.

Source: Bankers Journal 2007

2.3.5 Steady Liberaliser

Malaysia has indeed been a steady liberaliser with stable policy coordination and coherence maintained. Although industrial policies have changed in response to global situations, since the mid 1980s, the Malaysian government has held course on progressive liberalisation. Although it is has missed some of its own set deadlines for liberalisation, in general, it has kept to its targets. Malaysia misses it deadlines mostly due to pressure from its Bumiputera constituency – both the business and the public. For example, the sectors that are protected such as the national car project (Proton), government procurement, services and the rice sector are essentially due to its political influence masked as Malaysia's development policy and national objective.

The key institution involved in trade reforms is the Ministry of International Trade and Industry. It is a powerful Ministry that oversees all international trade issues and is led by senior politicians[35]. Together with the Economic Planning Unit[36] and the

[35] Dr. Mahathir Mohamed and Tengku Razaleigh Hamzah – all heavyweights in UMNO preceded Minister Rafidah Aziz. Minister Rafidah Aziz is currently the longest serving Minister of International Trade and Industry (MITI), having come into this position in 1986. She is also head of UMNO Women's wing (Wanita UMNO). In 2006, none other than her mentor and former Prime Minister, Dr. Mahathir Mohamad accused her of corruption.

[36] The Economic Planning Unit (EPU) is the most powerful central agency. It is in the Prime Minister's Department and reports directly to the Prime Minister. It has wide ranging powers and coordinates all economic decisions from developing long term plans (OPP1, 2 & 3) as well as the five-year plans. It also coordinates and approves key policies such as the Privatisation Masterplan.

Ministry of Finance, MITI makes most of the decisions relating to trade and trade related policies.

2.3.6 Multi-track Trade Policymaking

Malaysia succeeded into the GATT in 1957 but did not participate actively in the global trade policy debate. This was a reversal during the Uruguay Round. Malaysia, together with the other four main members of ASEAN[37] formed a strong common stance on market access issues especially relating to manufacturing trade. Similarly, on agriculture issues, Malaysia as a member of the Cairns group, argued against agriculture subsidies in developed economies (U.S. and the E.U.) and various other distortions.[38]

At the same time, Malaysia has also pursued various bilateral trade agreements in goods and services. The trade agreements negotiated include closer economic partnership/cooperation (CEP/CEC) agreements, or agreements that go beyond goods and services and include areas such as investment, trade facilitation, competition policies, intellectual property rights, standards development, conformity assessments, education and training, research and development and small and medium enterprises development. As at the 2006, Malaysia was at various stage of negotiation with its partners.

Table 10: Trade Policy Agreements

Trade Agreement Level	Status
Multilateral	
WTO Doha Development Round	Negotiations ongoing (2001-)
Regional	
ASEAN Free Trade Agreement (AFTA)	Framework Agreement Completed 1992[39]

[37] Singapore, Thailand, Indonesia and Philippines
[38] Athukorala P.C. (2005). Malaysia subsidies its rice industry under special and differential treatment (food security, rural development and employment), Malaysia is also a net-importer of rice. It's position in the Cairns group is motivated mainly by its interest in oil palm where it is the largest exporter and competes with other vegetable oils from the U.S. and E.U.
[39] The framework agreement was completed in 1992. The agreement is implemented through various protocols with the most common being the Common Effective Preferential Tariff (CEPT)

Trade Agreement Level	Status
ASEAN-China FTA	Framework Agreement Concluded (2002-2010/15) Agreement in Trade in Goods Concluded
ASEAN-India CEC	Negotiations ongoing (2004-)
ASEAN-Japan CEP	Negotiations ongoing (2003-12)
ASEAN Economic Community	Negotiations ongoing (2003-2020)
ASEAN-Republic of Korea	Framework agreement concluded (2004)
Bilateral	
Malaysia-Japan Economic Partnership Agreement	Framework Agreement Concluded (2003-2012)
Malaysia-Australia FTA	Negotiations ongoing (2004-)
Malaysia-New Zealand FTA	Negotiations ongoing (2004-)
Malaysia-United States FTA	Negotiations (2006-)
Others	
Global System of Trade Preferences Among Developing Countries (GSTP)	1989
Trade Preferential System Among Organisation of the Islamic Conference	2004
Preferential Trading Arrangement (PTA) Among Group of Developing Eight (D8)	2004

Source: UNDP Malaysia 2006

2.3.7 Crisis management

The three major crises that have contributed to trade reforms were the race riots of 1969, the global recession and public sector debt of 1985/87 and the financial crisis of 1997/98. On all occasions the government had taken immediate measures to protect first and foremost the interest of the ruling class. After the race riots of 1969, the NEP was implemented in response to the demands of UMNO through state-owned enterprise. The pervasive involvement of the state caused since the mid-1970s prolonged deficit spending, and things came to a head during the global recession of 1985/87.

The government correctly liberalised export related sectors and relaxed NEP requirements. Further liberalisation of state/Bumiputera controlled sectors (e.g. Education, state –owned enterprises, etc) was promised to the non-Malay political parties in the National Front, especially to the Malaysian Chinese Association, for supporting Dr. Mahathir when he was challenged for leadership of UMNO. The privatisation of state-owned assets to crony-capitalists was the order of the day during the hay-days of the late 1980s and early 1990s. The financial crises however laid to bare the hollow entrepreneurial capabilities of the crony capitalists. The government responded by bailing out corporations linked to the government. At all times, after a crisis, the state emerges stronger. This has led to the ascendancy of the state over other democratic institutions such as the Parliament, the Judiciary, and the civil service.

3. Outcomes and consequences

By and large, trade reforms in Malaysia have been progressing steadily in sectors that are not critical to the ruling party. Large sections of the domestic economy remain within the direct and indirect control of the government.

3.1 Protection Levels Today

Tariffs are the main instrument used to regulate the importation of goods into Malaysia. Overall, bound tariff rates in Malaysia have steadily decreased. The trade-weighted average bound tariffs for all products has decreased to 4.2 percent. This is significantly lower than other most major Asian economies.

Table 11: Weighted Mean Tariff Barriers, Selected Asian Countries (percentage)

Country	Year	All Products	Primary Products	Manufactured Products
China	1992	32.1	14.1	35.6
	2004	6.0	5.6	6.0
India	1990	56.1	34.1	70.8
	2004	28.0	36.1	25.3
Indonesia	1989	13.0	5.9	15.1
	2003	5.2	3.1	5.8
Japan	1988	3.6	4.4	2.7
	2004	2.4	3.9	1.6
Korea	1988	14.0	8.3	17.0
	2004	10.0	19.0	5.0
Malaysia	1988	9.7	4.6	10.8
	2003	4.2	2.1	4.6
Pakistan	1995	44.4	36.1	49.2
	2004	13.0	8.9	15.7
Philippines	1988	22.4	18.5	23.4
	2003	2.6	5.0	2.0
Singapore	1989	1.1	2.5	0.6
	2003	0.0	0.0	0.0
Thailand	1989	33.0	24.3	35.0
	2003	8.3	4.4	9.3
Vietnam	1994	20.6	46.7	13.1
	2004	13.7	16.7	12.5

Source: UNDP Malaysia (2006)

The simple average applied MFN tariff rate is approximately 8.56 percent. However, duties are higher for tariff lines where there is significant local production. The level of tariff protection is generally lower on raw materials and increases for value-added goods. Furthermore, a sales tax of 10 percent is levied on most goods. However, this sales tax is not applied to raw materials or machinery used in export production.

Although the tariffs are low in Malaysia, 17 percent of Malaysia's tariff lines (mainly in the construction equipment, agricultural, mineral and motor vehicles sectors) are subject to non-automatic import licensing designed to protect import-sensitive or strategic sectors. Trade distortions remain, due to wide dispersion in tariffs as well as tariff peaks. Tariff peaks are highest in automobiles where the MFN applied rate can be as high as 300 percent due to the government's policy to protect the national car project.

However, tariffs on automobiles have been reduced drastically under the AFTA and bilateral PTAs in recent times underscoring the government's inability to continue to protect Proton. Furthermore, the government is currently looking for a strategic partner for Proton as it realises the futility of turning Proton a profitable corporation. Proton, after 20 years of protection, has been on most counts a disaster having failed to penetrate any export markets. Unlike the Japanese and South Korean carmakers (after which the idea of Proton was modelled) who successfully managed to penetrate and dominate the competitive export markets of U.S. and E.U., Proton survived purely with the support of the government and a protected domestic market.

3.2 Macroeconomic Impact

Economic openness has been managed prudently. During the 1960s the government remained fiscally conservative and maintained balanced or surplus budgets. However, to achieve NEP objectives in the 70s and 80s, budgets deficits were tolerated and were financed mainly through the Employees Provident Fund (EPF) and newly discovered oil revenues. Budgetary deficits grew from 3.7 percent of GDP in 1970 to around 19 percent of GDP in 1982 and remained around 14 percent of GDP during 1983-87.[40]

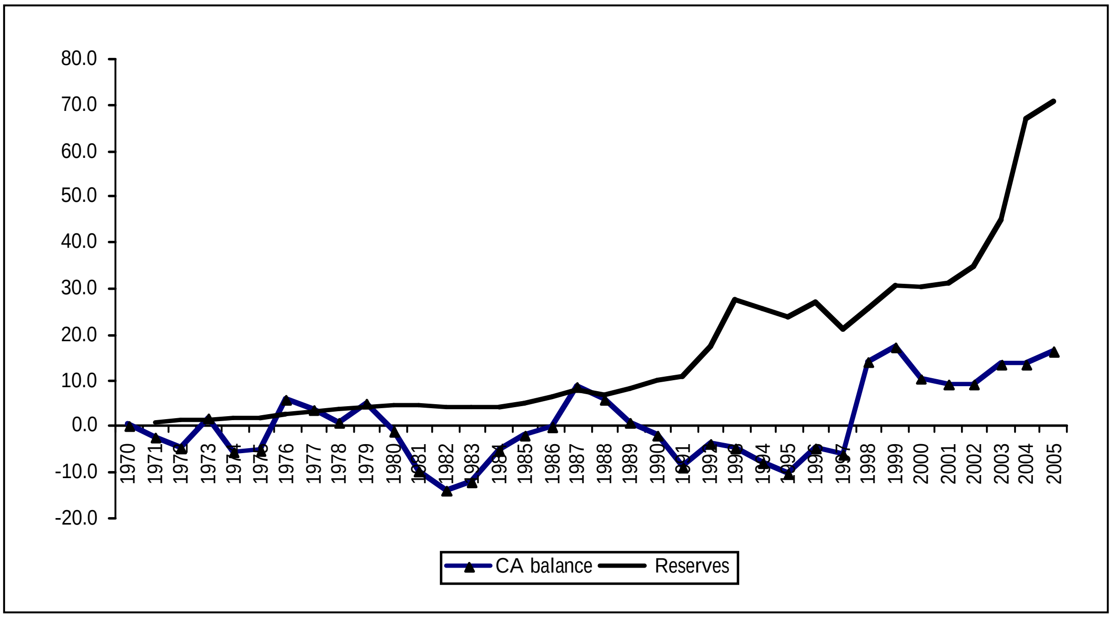
The rising budget deficits forced the government to borrow externally and external debt grew from RM15.4 billion in 1981 to RM53 billion in 1986. The country then recorded budget surpluses for the period 1993-97. Since the financial crisis, the country has again been recording budget deficits to bolster economic growth. The external debt to GNP ratio increased from 14.3 percent in 1981 to 59 percent in 1987 mainly due to the devaluation of the ringgit against the yen, which had financed Malaysia's heavy industrialisation policy. However, the external debt position has since been managed through voluntary structural adjustment policies and has been capped at about 40 percent of GDP.

- *Current account balance*

Malaysia has always enjoyed a favourable balance in the merchandise account of its balance of payments. More often than not, the surplus trade balance was large enough not only to finance the perennial deficit in the services account but also to post a sizeable current account surplus. Furthermore, FDI and portfolio flows have also contributed to the current account surplus. Overall, the performance of the current account position was mixed but the external reserves had always been on an uptrend, resulting in gross reserves in 2005 of USD70 billion.

[40] Wong Hwa Kiong & K.S. Jomo, pg. 58

Chart 1: Current Account Balance and Foreign Exchange Reserves (US billion)

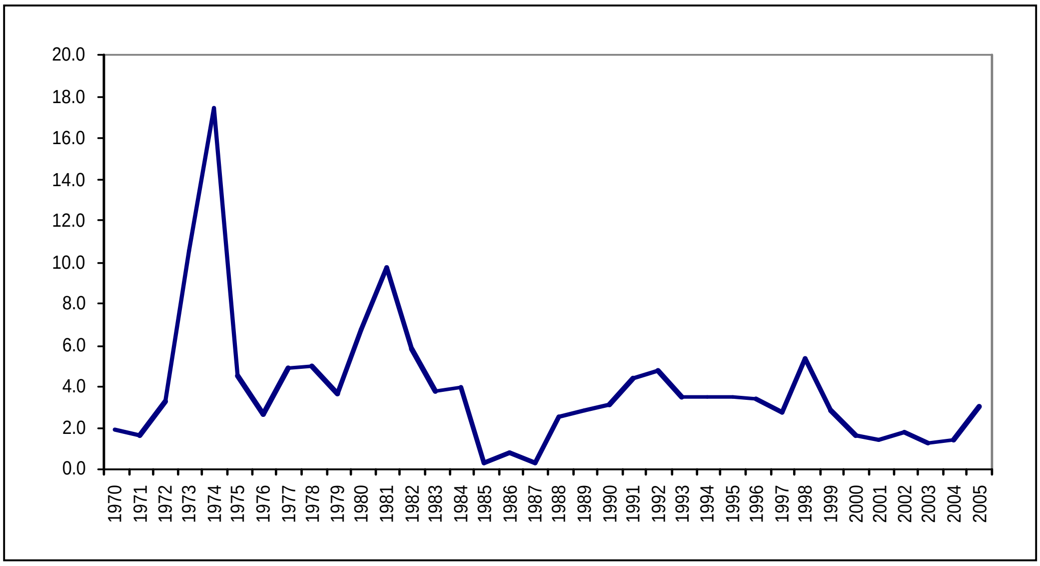


Source: Nambiar 2007

Malaysia’s rapid growth has also been achieved without undue inflationary pressure. Except for the periods during the oil shocks and the financial crisis, inflation rate has been stable at around 4 percent. The main reason for the low inflation rate is due to extensive intervention by the Central Bank (Bank Negara Malaysia-BNM) in the open market. BNM consistently mops liquidity in the financial system and manages the exchange rate to contain inflationary pressures on the economy. It allows the exchange rate to appreciate when the economy is overheating (as in the period before the crisis). Another important reason that inflationary pressure is contained in Malaysia is due to the many controlled items.[41] The government controls many essential items (e.g. food, fuel and utilities) and provides subsidies in key commodities (e.g. rice, fuel).

[41] The Ministry of Domestic Industry and Consumer Affairs controls the price of many products such as rice, sugar, flour, cooking oil, chicken, beef, mutton, etc. Furthermore, government also controls tariffs in the utilities sector and fuel prices by providing subsidies. Prices of services of privatised projects are also regulated by the government (e.g. toll fares of privatised roads, fees charged by private concessionaires, etc)

Chart 2: Inflation



Source: Nambiar 2007

In general, the government's efforts to provide a stable macroeconomic environment have enabled Malaysia to attract FDI, which has helped finance current account deficits. FDI have also contributed significantly to surpluses in the long-term capital account.

3.1 Microeconomic Impacts

It is unclear how much of the productivity gains can be attributed to trade reforms. TFP growth has been erratic over the various plan periods. It is also unclear whether the impacts of trade reforms were the cause of productivity improvements or not. However, during the ISI-II (1981-85), TFP growth was negative. In general, the sectors that were exposed to international competition, such as manufacturing, and the modernised sectors such as the large plantations and selected services performed better than the sectors that were protected. TFP growth has consistently been highest in the manufacturing and services sector compared to agriculture and mining[42].

Table 12: TFP, Capital and Labour (Growth) and Its Contribution To GDP Growth 1976-2000

Period	Rate of Growth (%)				Contribution to Growth (%)		
	GDP	TFP	Capital	Labour	TFP	Capital	Labour
1976-80	8.48	2.64	4.13	1.71	31.1	48.7	20.2
1981-85	5.15	-1.04	4.16	2.03	-20.2	80.8	39.4
1986-90	6.23	1.87	2.17	2.19	30.0	34.8	35.2
1991-95	9.47	3.15	3.84	2.49	33.2	40.5	26.3
1996-00	4.88	0.42	2.67	1.79	8.6	54.7	36.7

Source: Chew and Wong (2004)

FDI has contributed significantly to the financing of development in Malaysia and has covered the savings-investment gap in the country. The stock of FDI in Malaysia was US$48 billion in 2005[43], down from US$53 billion in 2000. The lower FDI stock in 2005 can be attributed to structural adjustments in the Malaysian economy as foreign companies operating in Malaysia in labour intensive industries close their operations or relocate to countries with lower labour costs such as China and Vietnam. Other reasons for the lower FDI stocks are attributed to repayment of loans to parent companies and depreciation of assets.

Table 13: Contribution From Foreign Direct Investment (1980 – 2005)

Subject	1980	1985	1990	1995	2000	2005
FDI-stock (US million)	5,169	7,388	10,318	28,731	52,747	47,771
FDI-stock (% of GDP)	21.11	23.68	23.44	32.34	58.40	36.52
Value added (US$ million)	4,328	4,944	7,683	21,159	n/a	n/a
Export (US million)	5,365	4,459	11,648	37,390	n/a	n/a

Source: WIR 2006

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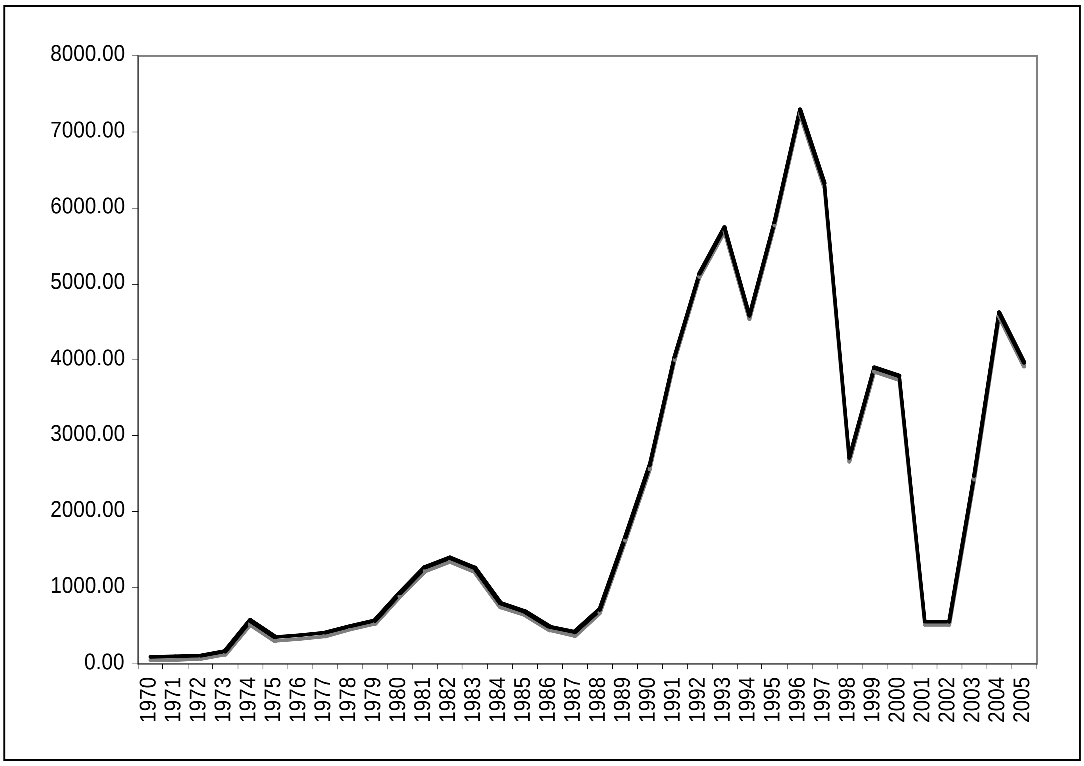
[42] National Productivity Report (various years)
[43] Neither UNCTAD nor Bank Negara Malaysia has disaggregated data on foreign corporation that close or relocate their operations. FDI captured is only inflows and outflows (locally incorporated firms investing abroad).

FDI flows have risen from a low of US$94 million in 1970 when Malaysia first began EOI to almost US$4 billion in 2005. However, there has been a decline in FDI flows from the boom years of the mid-90s when FDI reached a peak of US$7 billion in 1996, just before the financial crisis. There are two explanations for this – (i) the Malaysian government is becoming more selective in approving FDI focusing on FDI in high value added sectors (high technology – e.g. biotechnology, ICT, etc) and (ii) foreign investors are heading to more favoured destinations such as China and Vietnam.

Chart 3: FDI Inflows (US million) 1970-2005)



Source: WIR2006

The manufacturing sector is the leading sector of the economy and generates significant foreign exchange and employment. It is also the only sector (except for automobiles) that has been fully liberalised.

Table 14: Malaysia: Manufacturing Value Added (MVA) Share of GDP and Employment, 1947-2005[44]

Year	MVA of total GDP (%)	Manufacturing Employment ('000) [A]	A as a % of total employment
1947[a]	5.7	126	6.7
1957[a]	6.3	136	6.4
1960[a]	8.7	n.a.	n.a.
1965	10.4	217	8.4
1970	13.1	270[d]	9.2[d]
1975	16.4	398.2	10.1
1980	19.6	755	15.8
1985	19.7	836	15.1
1990	26.9	1,290	19.5
1995[b]	27.1	2,027.5	25.3
2000[c]	31.9	2,565.8	27.7
2005[c]	31.4	3,132.1	28.7

Note: [a]-1947-1965 figures refer to Peninsular Malaysia only. [b]-8th Malaysia Plan, [c]-9th Malaysia Plan, [d]- 2nd Malaysia Plan.
Source: Adapted from Jomo K.S. (1994) and Malaysia Plans (8&9 Malaysia Plan)

3.2 Development Impacts

It is difficult to prove that liberalisation was the driver of economic growth in Malaysia, especially when government intervention is pervasive in all sectors of the economy. Since Malaysia attained independence in 1957, real gross domestic product (RGDP) has grown, on average, at 6.5 percent per annum until 2005. Within the same period, GDP per capita in current prices grew by 7.0 percent per annum[45]. Malaysia's per capita income has increased from USD334 in 1978[46] to USD5042[47] in 2005. Poverty has been reduced from 49.3 percent in 1970 to 5.7 in 2004 (Table 3).

Table 15: Average Annual Growth Rates of Real GDP, 1971-2005 (%)

Growth rate	1971-75 2MP[48]	1976-80 3MP	1981-85 4MP	1986-90 5MP	1991-95 6MP	1996-00 7MP	2001-05 8MP
Average annual growth rate of RGDP	7.1	8.6	5.8	6.7	8.7	4.7	4.5

Source: UNDP Malaysia (2006)

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[44] Jomo K.S. (Ed) 1994. *Malaysia's Economy in the Nineties*. Pelanduk Publication. Kuala Lumpur.
[45] 9MP
[46] Ariff (1994)
[47] International Monetary Fund GDP per capita rankings
[48] MP – Malaysia Plan

It is however worrying that the falling RGDP growth rates has coincided with greater economic openness. For the 2MP, the economy recorded and impressive 7.1 percent average annual growth rate of real GDP (AAGRGDP), followed by a more spectacular AAGRGDP of 8.6 percent during the 3MP. Malaysia still managed a respectable 5.8 percent AAGRGDP despite the global recession during the 4MP. AAGRGDP continued to grow for the 5MP and the 6MP, recording 6.7 and 8.7 percent respectively. Since the advent of the East Asian Financial Crisis, the Malaysian economy has not fully recovered to its pre-crisis levels. AAGRGDP for the seven and 8MP were 4.7 and 4.5 percent, respectively.

Table 16: Population, Labour Force Participation (million) and Unemployment Rate (%)

	1957^{e}	**1970^{e}**	**1975**	**1980**	**1985**	**1990**	**1995**	**2000**	**2005**
Population	6.279	8.810	12.249	13.879	15.864	18.010	20.68	23.49	26.75
Labour Force	n.a.	3.768	4.320	5.109	6.039	7.046	8.254	9.572	11.290
Unemployment	n.a.	8.0	7.0	5.7	6.9	6.0	3.1	3.1	3.5

Note: ^{e} – estimates
Source: Malaysia Plans (various years)

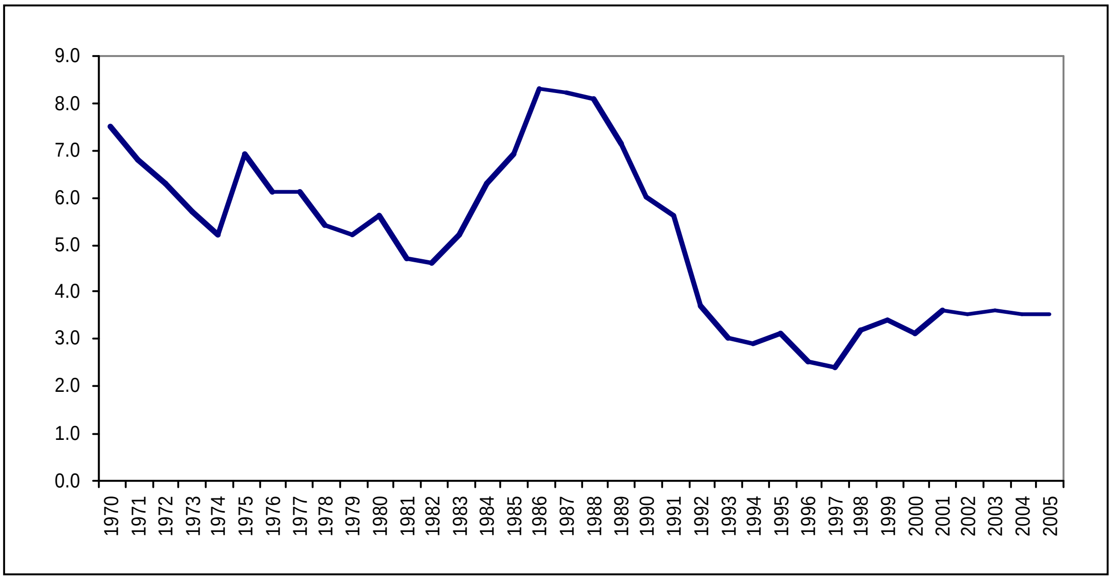
Due to the rapid economic growth, the unemployment rate has fallen from 8.0 percent at the beginning of the development policy period to 3.5 percent in 2005. Population growth has been stable although the increase in number of migrant workers in the country is worrying. As note earlier, the influx of migrant workers has effectively kept wages low. Officially, Malaysia has 1.8 million legal migrant workers[49]. Of that 35,000 are from the expatriate class. However, the number of illegal migrant workers is estimated to be at 700,000.[50] With migrant workers conservatively estimated at 23

[49] 9th Malaysia Plan (pg. 239)
[50] Kanapathy V (2006). The number of illegal immigrant workers is estimated and can vary from 700,000 to 5.0 million as noted by the President of the Malaysian Trade Union Congress.
www.mfasia.org/mfaStatements/MTUC%20statement%20on%20MWs%20in%20Malaysia.pdf

percent of the total labour force, it has become a source of worry especially when newer jobs created accrue to migrant labour.

The number of migrant workers has raised two key concerns to Malaysian policymakers – (i) the current phenomena of jobless growth and (ii) graduate unemployment. The phenomena of jobless growth is attributed to increased productivity through the use of technology while graduate unemployment is attributed to a mismatch between tertiary education outputs and actual market needs. Policymakers are now hard-pressed to meet the demands of the markets/business against the affirmative action policies for Bumiputera and legitimate demand for labour rights.

Chart 3: Unemployment



Source: Nambiar 2007

4. Looking Ahead

Malaysia has generally succeeded in undertaking the first generation reforms, which address border measures. However, it has yet to address the second generation (behind the border) measures comprehensively. There are still many sectors of the economy that are heavily regulated by the government. One key factor that is a detriment to remaining liberalisation is UMNO's raison d'etre as the "protector of the Malay race" which is used by the UMNO to remain in power by controlling the economy through the legacy of the New Economic Policy (NEP)[51]. The Malaysian government, which acts as a proxy for the UMNO, retains control of the commanding heights of the economy through Government Linked Companies (GLCs) and Government Linked Investment Companies (GLICs).

Therefore a key instrument for further liberalisation would be transparency. Transparency needs to be addressed, as most of the remaining behind the border measures and regulations are shrouded in secrecy and are developed arbitrarily and subjectively. However for this to materialise, democracy must be enhanced. Furthermore to achieve transparency, the country must grapple the issue of racism, as the government sees that any demand for good governance and transparency a challenge to the status quo.

Further trade liberalisation would also challenge the government's development policies of "Picking The Winners" and protecting strategic and sensitive sectors such as government procurement, services, utilities, energy sector, etc. It has been proven that these policies now mask the government's and ruling parties' favouritism for selected businesses closely aligned to the government--to maintain its support base. Further liberalisation will only come when the government rethinks its development

[51] In 1983, Rais Saniman (credited as one of the intellectuals behind the NEP) was one of the four Bumiputera Malaysia Finance Limited (BMF) officials who together with George Tan of the Carrian Group were ultimately convicted for conspiracy to defraud BMF. At that time it was the biggest financial scandal in Malaysia and cost the government approximately RM2.5 billion (OpinionAsia). R.S. Milne provides the perfect illustration of the corrupting influence of the NEP in "Levels of Corruption in Malaysia: A Comment on the Case of Bumiputera Malaysia Finance." Asian Journal of Public Administration.

policies, including its affirmative action policies. Furthermore, behind-the-border reforms cannot take place unless the government retreats fully from the market, except for the provision of public goods.

5. Conclusion

Malaysia is certainly committed to maintaining an open economy. Malaysia's openness is more remarkable as it is often done unilaterally in responding to changing global scenarios, and not in response to pressure from trade partners or donor conditionalities.

However, it must be noted that the trade reforms undertaken by Malaysia to date have suited the ruling party. The economic growth that has accompanied these reforms has come at the expense of democratic freedom. The state acting as an agent of 'development' has emasculated all other branches of a democracy (e.g. Parliament, Judiciary, civil service). Trade liberalisation has unfortunately strengthened the state and has allowed Barisan Nasional to remain in power as economic growth has been translated into delivery of 'bread and butter' for the citizens. It is also a reason to suppress contrary views that question the government's development policies. BN has utilised its position in government to control the resources of the nation (e.g. Petronas, Khazanah, etc) and reward its accomplice while elections are used to legitimise its racial political alliance.

The dominance of the ruling party has been both a condition for stability and otherwise. Protracted battles for power within political parties have manifested negatively such as in 1969, in 1987 and 1998 have taken a mass movement base often in support of particular leaders but still race based[52].

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[52] The three major crises in Malaysia was a corollary of struggles in UMNO. The 1969 riots mostly a fight between the Young Turks in UMNO (Razak, Mahathir, Musa, Razaleigh) against the old guard (Tunku Abdul Rahman), the 1987 crisis was a fight between Mahathir and Razaleigh while the 1998 crisis was a fight between Mahathir and Anwar. None of these fights is based on high principles but fight for the control of UMNO and the

Business interests are also divided along racial lines. The[53] major chambers of commerce are essentially based on racial groups while industries are also often delineated along racial lines. An illustration would be the negotiations of the U.S. – Malaysia Free Trade Agreement, where The Federation of Malaysian Manufacturers (FMM) supported the governments stand for further liberalisation in all sectors to enhance Malaysia's competitiveness. However, among the wide opposition from marginalised groups towards the FTA, various Malay chambers of commerce opposed the USMFTA because of their fear of losing their privileges (related to the requirements placed on foreign companies to compete). The Malaysian Trade Union agreed to the FTA as long as a strong labour chapter would be included.

Furthermore, the concentrated power vested in the government has allowed it to force through trade reforms and stifle dissent. The opposition political parties are weak, the trade unions are fragmented, and the chambers of commerce and businesses are most often aligned with the government.

However, the developments of bilateral and regional preferential trade agreements will certainly have an impact on behind the border liberalisation. The nature of modern free trade agreements, which are WTO plus, would ensure these second generation reforms take place. Whether it will be done unilaterally is doubtful, as

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power that comes with controlling UMNO. Except for the formation of Keadilan (Justice Party) in 1998 as a multiracial party, all former splinter groups of UMNO were motivated by personalities rather than principles.

[53] The National Chamber of Commerce and Industry of Malaysia (NCCIM) is an umbrella organisation grouping five principal Malaysian chambers of commerce. The five are (i) the Malaysian Indian entrepreneurs are represented by the Malaysian Associated Indian Chamber of Commerce and Industry (MAICCI), (ii) the Malaysian Chinese entrepreneurs are represented by the Associated Chinese Chamber of Commerce and Industry of Malaysia (ACCCIM) and (iii) the Malay entrepreneurs are represented by the Malay Chamber of Commerce (MCCM). The other members are (iv) the Federation of Malaysian Manufacturers (FMM) and (v) the Malaysian International Chamber of Commerce and Industry (MICCI). There are also industry wide associations such as Association of Computer and Multimedia Industry of Malaysia (PIKOM) and country based chambers of commerce such as Japanese Chamber of Trade and Industry of Malaysia. The only broad based chamber of commerce is the Malaysian International Chamber of Commerce and Industry (MICCI). It was also the first chamber of commerce in Malaysia.

Malaysia has used trade negotiations in the past to seek concession form trade partners.

It may be difficult to transfer Malaysia policies to South Africa, in principle and also from a pragmatic point of view. However, revisiting some of the key points about the NEP. First, we must keep in mind that the NEP is a pragmatic and not ideological policy and therefore it can be discarded when it is not useful. Secondly, the NEP can only work if there is economic growth. Liberalisation may bring growth but it will eventually erode the policy space for NEP type policies, as market forces will force changes.

Some of the key problems faced in Malaysia now are that the NEP is not ‘trickling down’ to its intended constituencies but being captured at the highest levels. Income disparity in Malaysia is highest in the very race that the NEP is supposed to have benefited.

Therefore, Malaysia’s trade reforms were driven by a government that while promoting growth, it essentially sought to redistribute the income and wealth generated for a particular race in its efforts to achieve ‘National Unity’. While the spirit in which the development policies were formulated may have been positive, its progress has now been tainted with “Malay Supremacy” or “the Malay Agenda.” Its performance from a strict economic perspective may have been commendable, as growth rates have been large enough to allow for redistribution. However, growth rates have been on a downtrend.

Furthermore, far from achieving national unity, it has alienated its citizens. Although the macroeconomic outcomes are laudable, the discontent raised and the loss of competitiveness due to affirmative action policies is worrying for the future of Malaysia. Malaysia’s ranking, both in Transparency International Corruption Index and its competitiveness rankings in the Global Competitiveness Report has been erratic at best and regressive at worst. Malaysia must now reconfigure itself and move away from race-based policies if it wants to continue its growth.

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Annexe

International trade objectives, strategies and policies during pre NEP period

Period	Objective & strategies	Policies
Pre NEP 1960-1970 Second Malaya Plan *ISI – 1957-1968* First Malaysia Plan 1966 – 1970 Shift from ISI to EOI	Fuller and more efficient use of natural resources. Expansion of economic base to reduce dependence on raw materials exports. Generation of higher income through expanding domestic production and increasing exports of manufactured products.	Promotions of traditional and new export possibilities. Industrial development led by the private sector. Favourable investment climate, industrial estates and transport; power & communication provided by the government. Foreign private entrepreneurship and capital welcomed. Protective tariffs for selected infant industries. Tax incentives and subsidies to facilitate industrial development.

International trade objectives, strategies and policies during OPP1

Period	Objective & strategies	Policies

OPP1 – NEP 1971-1990 Second Malaysia Plan 1971-1975 Third Malaysia Plan 1976-1980 Fourth Malaysia Plan 1981-1985 Second round of ISI on heavy industries Fifth Malaysia Plan 1986-1990 *Emphasis shifts towards High tech EOI*	Based on two-pronged approach: • Poverty reduction; and • Restructuring of society Increased production for export, including new industrial and agricultural items. Greater processing of raw materials. Further substitution of domestic production for imports. Malaysia Incorporated – emphasising close cooperation between government and private sector.	Increased direct government participation in industrial development. Improved export incentives. Free trade and export processing zones established. Promotional and publicity efforts by government to attract foreign capital and expertise. Promotion of domestic production of intermediate and capital goods. Emphasis on productivity increases and more intensive production methods. Progressive and selective privatisation of government services. Overall protection in industry reduced. Encouraging joint ventures with international corporations, using foreign technology and local resources. Ensuring availability of finance and exports. Liberalised equity guidelines.

International trade objectives, strategies and policies during the OPP2 period

Period	Objective & strategies	Policies

OPP2; NDP 1991-2000 Sixth Malaysia Plan, 1991-1995 *Seventh Malaysia Plan, 1996-2000*	Promotion of a balanced broad-based, resilient and internationally competitive economy. Enhance potential output growth, achieve further structural transformation, and attain balanced development. Moving towards capital-intensive and technologically sophisticated industries	Accelerating productivity and efficiency, primarily through private sector initiatives. Accelerating the diversification of industries. Re-orientating industries to target production for the world market. Encouraging large-scale production for economies of scale. Further liberalisation and deregulation of industries. Development of a modern, competitive and technologically innovative small and medium industry sector. Greater role of trade and industry associations to improve standards and quality. Establishment of new trade networks, especially within regional trade blocs. Development of industrial trade blocks.

Source: UNDP Malaysia (2006)

International trade objectives, strategies and policies during the OPP3 period

Period	Objective & strategies	Policies
OPP3; NVP Eight Malaysia Plan, 2001-2005 *Ninth Malaysia Plan, 2006-2010*	Greater responsiveness to challenges and opportunities from global competition. Enhance position as strategic and cost-effective location for investment. Improve knowledge management, accumulate new skills and change mindsets.	Developing domestic industries to be globally competitive. Strengthening resilience to external shocks. Focus on more efficient use of labour and capital as well as improvement in skills, technology and managerial capability. Greater application of information and communications technology and knowledge. Increased intra-regional trade using AFTA and other bilateral arrangements. Identifying and developing new sources of growth particularly in services, to become the regional hub.

Source: UNDP Malaysia (2006)