

BTI 2010 | Malaysia Country Report

Status Index	1-10	6.19	# 47 of 128	
Democracy	1-10	5.30	# 74 of 128	➔
Market Economy	1-10	7.07	# 27 of 128	➔
Management Index	1-10	5.60	# 49 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	26.5	HDI	0.83	GDP p.c.	\$	13518
Pop. growth	% p.a.	1.7	HDI rank of 182	66	Gini Index		37.9
Life expectancy	years	74	UN Education Index	0.85	Poverty ²	%	7.8
Urban population	%	69.4	Gender equality ¹	-	Aid per capita	\$	7.5

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

From 2007 to 2009, Malaysia experienced political instability and considerable macroeconomic fluctuation. Malaysia's political reforms toward liberal democracy are still insufficient and in some cases stalled. The outcome of the last general election on 8 March 2008, however, is an important first step toward the improvement of democratic institutions and processes in Malaysia. The election result – though the election was not completely free and fair – has been regarded as a political tsunami, because the ruling government coalition Barisan Nasional (National Front, BN) lost its two-thirds parliamentary majority and suffered its worst electoral performance since Malaysia's independence in 1957. The Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC), both subsidiary parties of BN, saw their percentages of the overall vote fall significantly, indicating dissatisfaction among ethnic Chinese and Indians with the ruling coalition. BN's lack of promised democratic reform drove voters to cast their ballots for the opposition.

The opposition parties, consisting of the Democratic Action Party (DAP), the Parti Islam Malaysia (PAS) and the Parti Keadilan Rakyat (PKR), won 82 out of 222 seats in parliament and gained control of five out of Malaysia's 13 state legislatures (Kedah, Perak, Selangor, Penang and Kelantan), compared to only one (Kelantan) during the last election. After the election, the opposition parties formed a People's Alliance (Pakatan Rakyat) under the de facto leadership of Anwar Ibrahim, who returned to parliament after winning the Permatang Pauh by-election on 26 August 2008. Anwar Ibrahim claimed that defections from the ruling BN would enable opposition members to form a new federal government by 16 September 2008.

Though the BN still formed the federal government, its poor election results led to increasing discord within the party. Prime Minister Badawi, who once represented the hope of sustainable reforms, lost the support of several key members of his party, the United Malays National Organization (UMNO). Most prominently, his predecessor, Mahathir Mohamad, publicly

questioned Badawi's ability to lead the country and resigned from UMNO on 19 May 2008. With opposition mounting within the BN, Prime Minister Badawi declared that he would step down during the UMNO's general assembly in March 2009 and assign his office to Deputy Prime Minister Najib Tun Razak.

Despite the opposition's success during the last general election and the increasing intensity of parliamentary debates, democratic transformation has not progressed. Malaysia's elections have not been free and fair, the media is severely limited, the dominating executive has regularly violated the rule of law, effective and efficient democratic institutions are still not in place, consensus-building is insufficient, and tensions continue between the Malay and Muslim majority on the one hand and ethnic Indians, Chinese and the non-Muslim minority on the other. The Badawi administration, under pressure after the poor electoral results, continued to use repressive measures against political and civil society actors. These actions included imprisoning several activists in September 2008 under the Internal Security Act (ISA) and banning the organization Hindu Rights Action Force (Hindraf – a coalition of 30 Hindu NGO's committed to the preservation of Hindu community rights) one month later. In addition, the Malaysian government failed to take effective action against corruption.

Though Malaysia's economic transformation from 2007 to 2009 is more favorable than its political development, the global financial crisis had a significant impact on Malaysia's economic development and considerably affected the country's macroeconomic stability.

Malaysia has a strong institutional foundation for its market economy, such as the basic rules of organization, and high levels of socioeconomic development. The banking sector remained stable during the period under review. Malaysia's economic development is based on a fairly developed education system. In addition, property rights are well defined. Private consumption continued to grow steadily during the period under review, forming a cornerstone in the Malaysian economy. At the same time, the political leadership implemented tax reforms, invested in development projects and strengthened the competitive character of the market economy.

Under the influence of the global financial crisis, the Malaysian government gave up its budget discipline in 2008 and adopted two economic stimulus packages aimed at strengthening private consumption and generating economic growth. As a consequence, the budget deficit grew steadily to a projected 4.8% of GDP in 2009, while inflation increased to a 27-year high of 8.5% in August 2008. Notably, the high costs of food and transportation weakened private consumption and continued to burden Malaysian households during the period under review. Since April 2008, the Malaysian ringgit lost much of its value compared to the U.S. dollar. Low interest rates continue to put pressure on the ringgit.

These developments indicate that despite positive macroeconomic data in 2007 the country's market economy, because of its export-oriented character, is not immune to the downside risks faced by the rest of the world. The government's inability to take effective measures to control inflation and the increasing budget deficit raised skepticism among investors about whether

Malaysia is still a worthy destination for their investments. Malaysia's political instability and declining macroeconomic performance intensified doubts among global investors.

History and Characteristics of Transformation

The federation of Malaysia was established in 1963 with the territories of Malaya, Singapore, Sabah and Sarawak. Two years later, in 1965, Singapore was expelled from the federation. Today, Malaysia consists of 13 states and three federal territories. It is a constitutional monarchy based on the British Westminster model, a legacy of British colonialism. At the federal level, there is a bicameral legislature. The House of Representatives (lower house) is composed of members elected every five years in a first-past-the-post election from single-member constituencies. The Senate (upper house) consists of 70 members, of which 26 are indirectly elected by the states, and the other 44 are appointed by the king. Executive power lies with the prime minister and the cabinet. Each of the 13 states has its own legislature.

Politically and officially, the country's population is divided into two categories: Bumiputera and non-Bumiputera. The Bumiputera group is made up of Malays and other indigenous peoples, while the non-Bumiputera group consists mainly of Chinese and Indians. This divide is evident in every facet of Malaysian life, from politics to food to university admissions.

Most of the Chinese and Indians first came to Malaysia during colonial times when the British actively recruited them to open up the economy. After independence, the British left political power largely in the hands of the indigenous Malays. The Malay leaders then forged a political alliance with the major Chinese and Indian parties. This set a pattern in which the office of the prime minister was to be held by a Malay from the United Malays National Organisation (UMNO). The current president of UMNO, Abdullah Ahmad Badawi, is Malaysia's fifth prime minister and will be succeeded in March 2009 by Najib Tun Razak, eldest son of Abdul Razak, who was the second prime minister of Malaysia. The alliance system collapsed in May 1969 when emergency rule was declared and the constitution suspended after race riots broke out between the Malays and the Chinese in the wake of a bitterly fought election. Once the constitution was reinstated in 1971, new legislation was passed ensuring Malay political supremacy, which in turn allowed the UMNO to enhance its powers and aggressively promote its main supporters, the Malay population. A New Economic Policy (NEP) was promulgated, providing extensive benefits to the Bumiputera (i.e., Malay) community through quotas, bank loans, scholarships, special licenses, and so on. The government justified the affirmative action character of the NEP, claiming that the wide economic gap between the Malay and the non-Malay (i.e., Chinese) threatened racial harmony and had prompted the May 1969 riots. Although the NEP discriminated against the non-Bumiputera, the UMNO-led government was careful to allow a free market economy to develop. The government gave the non-Bumiputera a free hand

in the economy, as long as quotas and shares were allocated for Malays. This strategy, which emphasized growth with ethnic distribution through significant foreign direct investment in the 1970s and 1980s, was so successful that Malaysia became one of the “Asian Tiger” economies.

Although the NEP officially ended in 1991, economic policies since then have changed little in character. They continue to include special rights for the Bumiputera, while at the same time promote rapid economic growth to ensure that all ethnic groups receive their share of the economic pie.

Since independence, the government has been headed up by the UMNO whereas the ruling coalition, the BN, has won every general election. The BN regularly achieves more than a two-thirds majority in parliament, allowing it to amend the constitution at will and give the executive the leeway to pursue policies without opposition. Having successfully managed the economy, the government has been able to proclaim that, by 2020, Malaysia will be a fully developed and industrialized country. Today, Malaysia is generally regarded as a success story among developing countries by maintaining a stable and growing economy and a relatively stable polity – despite its ethno-religious conflicts.

Transformation Status

I. Democracy

1 | Stateness

The Malaysian state is strong and faces virtually no challenges to its monopoly on the use of force throughout the country. The longtime territorial dispute with Singapore over the island of Pulau Batu was resolved on 23 May 2008 when the International Court of Justice decided that the island fell under Singapore's sovereignty. The loss in front of the International Court of Justice stoked criticism within the Malaysian state that the Badawi administration did not effectively represent Malaysian interests in the international community. This criticism, however, did not interfere with state affairs. Malaysia's remaining territorial dispute is with the Philippines over the northern part of Sabah on the island of Borneo. The Philippines' claim to the territory stems from the sultan of Brunei's act of ceding Sabah to the sultanate of Sulu in the seventeenth century. The Sulu lands now belong to the Philippines. In 1798, the territory was leased to the British North Borneo Company and brought under direct British control in 1946. Malaysia contends that the territory was purchased by the British North Borneo Company and is therefore a part of Malaysia.

Monopoly on the use of force

All Malaysian citizens have the same civic rights and accept the nation-state as legitimate. Malay identity and Islam, however, shape the character of the Malaysian state. The separation in daily life between the Malay majority and the mainly Chinese and Indian minorities is evident. Ethnic Malays dominate the country's key political institutions, such as the sultans, parliament, the bureaucracy and the armed forces. The monarchy is also a distinguished Malay institution. This Malay predominance engenders constant criticism from the Indians and Chinese, who make up about 40% of the population. Minority discontent with Malay dominance was clearly reflected in the success of the opposition parties during the last general election in March 2008. During the campaign, these parties actively cultivated a multiracial constituency.

State identity

The Malaysian Constitution defines the state as a secular order. Nevertheless, Islam has considerable influence on the Malaysian legal system and functional aspects of

No interference of religious dogmas

the country's politics. Notably, Malaysia's court system in civil matters has a parallel structure with state Shari'ah courts operating alongside civil courts. Though the Shari'ah courts have jurisdiction only over matters involving Muslims, they remain highly influential, because their decisions frequently affect non-Muslims. Islam also plays an important role in public policy. The government tries to present itself as the preserver of Malay and Muslim rights. The opposition party, Parti Islam Malaysia (PAS), questions the government's sovereignty over religious questions. PAS supports the implementation of hudud laws, which draws high criticism from the Democratic Action Party (DAP) and the Parti Keadilan Rakyat (PKR). As a reaction to these challenges, the Malaysian government under Badawi has promoted the idea of 'Islam Hadhari' (Moderate Islam).

The Malaysian state has a highly trained and professional administration, which implements the policies of the elected government. The state is able to fulfill its proper jurisdictional function and to enforce the law throughout the country. However, ethnic Malays dominate the state apparatus to the exclusion of minority groups. This underrepresentation leads to dissatisfaction among ethnic Indians and Chinese.

Basic
administration

2 | Political Participation

Malaysia has established universal suffrage and regularly holds general elections to fill leadership positions. During the last general election in March 2008, the opposition parties broke the two-thirds majority of the ruling coalition for the first time in almost 40 years and won control of five of the 13 state parliaments. Despite this, elections cannot be considered completely free and fair. The ruling coalition, the Barisan National (BN) frequently uses repressive laws to restrict the opposition and control the media. Cases of gerrymandering, using government resources to ensure consistent victories and electoral fraud, such as manipulating voter's registration lists, reflect an undemocratic strain within the BN government. Nevertheless, the opposition's success in the last general election and most recently during by-elections in two constituencies indicates that BN's electoral success and dominance is declining.

Free and fair
elections

In principle, elected rulers have the effective power to govern as far as the classical veto powers (armed forces, landowners or business groups) are concerned. In practice, the strong ethnic religious politics in Malaysia narrow the ruling coalition's ability to change policies. This is especially the case with regard to the special rights of the Malay population. In addition, Islamic interest groups put constant pressure on the government to maintain Malaysia's Muslim identity or to even further Islamize the country.

Effective power to
govern

Although NGOs and civil society groups have greatly increasingly in number over the last few years, independent political and civic groups do not have the right to freely associate and assemble in Malaysia. Union activity is subject of restrictive regulations, which violate international conventions on labor rights. Federal laws, such as the Societies' Act, ensure that organizations that are notably critical to the government can be banned or refused registration. In October 2008, for example, the ruling Barisan National (BN) coalition declared the Hindu Rights Action Force (Hindraf) an illegal organization. The immediate effect was that five leaders of the organization were taken into custody under the Internal Security Act (ISA).

Association /
assembly rights

In Malaysia, the public sphere and public debate are vulnerable to distortion and manipulation by massive government intervention. Laws restrict freedom of information and speech. The Internet, an area in which freedom of expression was generally protected by law in the past, became more restricted during the period under review, including the temporary closing of anti-government websites, such as Malaysia Today, in August 2008. Political bloggers, most have been temporarily detained under the Internal Security Act (ISA) in an attempt to silence online criticism. The most prominent case of this was the arrest of Raja Petra Kamarudin in September 2008. Furthermore, the Printing Presses and Publication Act (PPPA) continues to curtail the freedom of speech in Malaysia. The act stipulates that it is a criminal offense to possess or use a printing press without a license granted by the home affairs minister. The licenses must be renewed annually. This empowers the home affairs minister to silence critical newspapers or journals by not renewing their licenses. The Press Freedom Index 2008, published by the organization Reporters Without Borders, ranked Malaysia at 132nd (the country's lowest ranking ever), down from 124th place in 2007.

Freedom of
expression

3 | Rule of Law

The constitution provides a structure for the separation of state powers in Malaysia. In practice, the executive has an ongoing monopoly on power and frequently colonizes the two other branches of government. Although after losing its two-thirds majority in the national parliament in the last general election the ruling coalition BN cannot amend the constitution randomly anymore, the legislative branch still lacks appropriate instruments and possibilities to control the government. The functioning of checks and balances has not improved in Malaysia during the period under review.

Separation of
powers

Though the judiciary is institutionally differentiated, its decisions and doctrines are subordinated to political authorities, especially to the prime minister's office. The judicial system has drawn constant criticism since the 1988 judicial crisis and most recently during the Altantuya murder case, when twists and turns in the trial led to fears of outside interference (the murder suspect, Abdul Razak Baginda, was a close

Independent
judiciary

associate of Deputy Prime Minister Najib Razak). In an attempt to restore confidence in the judiciary and to grant it more independence, especially in the appointments of judges, the Badawi administration launched a reform bill (Judicial Appointments Commission (JAC)) after three days of parliamentary debate in December 2008. Although the government claimed that the bill represented substantial progress toward an independent judiciary free of executive intervention, the bill is widely considered a public relations exercise. The prime minister cemented his influence on the judiciary by obtaining the right to appoint the members of the commission.

While corrupt officeholders are increasingly prosecuted under established laws, they regularly slip through political, legal or procedural loopholes. Over the last couple of years, political society, civic actors and the public were highly sensitized to political corruption. The government even identified the fight against corruption as a key component of its policies. Yet, implementation of effective measures against corruption at higher levels did not take place. Corruption is still common among the nation's political and business elite, whose close ties form what is often referred to as "money politics." On 24 September 2008, Malaysia became the 125th country to ratify the United Nation Convention Against Corruption (UNCAC). Foreign Minister Dr. Rais Yatim, who ratified the document, claimed that the ratification is proof that Malaysia is serious about taking measures to eliminate corruption. Moreover, in December 2008, the Badawi administration established the Malaysian Anti-Corruption Commission (MACC). This new commission is generally seen as an improved version of the old Anti-Corruption Agency (ACA) that still lacks the force to fight corruption effectively. Little political will exists to eradicate corruption at higher levels. When it comes to corruption "big fish" and "small fish" play by different rules.

Prosecution of
office abuse

Civil rights are partially violated in the Malaysian state. The Malaysian authorities continue to deprive individuals of rights to justice by using laws that allow detention without trial. Most prominently, the Internal Security Act (ISA) allows the state to continuously detain people by enabling detention orders to be renewed every two years. This strategy is frequently used to silence criticism. Five members of the Hindraf organization remain in custody since their imprisonment on December 12, 2007. Several government critics, most prominently MP Teresa Kok, were temporarily detained under the ISA in September 2008. Federal laws, such as the Official Secret Act (OSA), which automatically classifies all government documents as secret, and the Sedition Act, which criminalizes speeches with seditious tendency without specifying the definition of seditious, provide the government with the legal cover to take action against its critics, thereby violating civil rights in Malaysia on a massive scale. The government continues to ignore recommendations made by the Human Rights Commission of Malaysia (Suhakam).

Civil rights

The public holds the police in low esteem. A Royal Commission report in 2005 found widespread corruption within the police, routine police torture and little respect for human rights. The government, however, has not adopted the commission's key recommendation, the formation of an Independent Police Complaints and Misconduct Commission (IPCMC), despite significant public support, especially articulated by several nongovernmental organizations. The death of Kugan Ananthan while in police custody after his detention for interrogation at the Subang USJ Taipan police station on 20 January 2009, highlights the urgent need for such a commission.

The role of Islam in civil cases and the dual system of civil courts poses serious constraints on equal treatment before the law. During the period under review, cases in which Islamic authorities have forcibly taken the bodies of recently deceased individuals from their immediate family continue to occur. The authorities claimed that the deceased were converts and that they needed to be given an Islamic burial. The non-Muslim families of the deceased often fervently dispute these claims. In these cases, non-Muslim family members are asked to appear before the Shari'ah court in order to determine the religion of the deceased. This is unacceptable for these families, since appearing before the Shari'ah court implies the recognition of the Islamic court's jurisdiction. These cases occur despite the fact that the law clearly states that the Shari'ah court can only deal with Muslims. At the same time, decisions by federal courts strengthened the position of non-Muslims before the law. In December 2007, the federal court decided that Shari'ah courts cannot dissolve a civil marriage. Furthermore, on 8 May 2008, a Shari'ah court in Penang allowed a Chinese convert to renounce Islam. This was the first case of such kind. Taken together, these cases underscore the ambivalence of the developments in Malaysia's judicial system during the period under review.

4 | Stability of Democratic Institutions

Although Malaysia's system of checks and balances is weak, its key institutions are mostly stable. The executive is still strong, though discontent increased during the period under review, and opposition groups and civil society actors openly confronted its authority. The administration system is sound and sophisticated. The main concern is the dominant position of the executive. The prime minister and the cabinet make all key political decisions. Though the intensity of parliamentary debates has increased, which reflects the increased power of the legislature after the 2008 election, executive dominance continues to block democratization.

At present, the Barisan National (BN) government is not committed to democratic institutions. Though, during the period under review, the government dominated by the United Malays National Organization (UMNO) came under pressure and lost much of its support within the Malaysian population (reflected in the loss of votes

Performance of
democratic
institutions

Commitment to
democratic
institutions

during the last general election), its commitment to democracy and democratic institutions remained dubious. The Malaysian government makes no secret of the fact that it considers liberal democracy unsuitable for Malaysia.

5 | Political and Social Integration

The Malaysian party system is fundamentally established and socially rooted. After the general election in March 2008, the party system can be described as more competitive. Two major blocks compete for the Malaysian votes, the Barisan National (BN) and Pakatan Rakyat. The ruling coalition, the BN, is comprised of 13 parties (the Sabah Progressive Party (SAPP) withdrew from BN on 17 September 2008), each of which represents an ethnic group or a region. Historically, the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC) formed, together with the biggest party, the United Malays National Organization (UMNO), the backbone of BN. Both of these parties lost votes during the last general election, reflecting strong resentment among the non-Bumiputera of the ruling coalition and the state's discrimination in favor of the Bumiputera. The BN's loss of votes in the last general election posed a serious threat to the ruling coalition's stability. This instability was magnified by the call of BN affiliates Sabah and Sarawak for more autonomy from the federal government. Opposition parties are similarly divided along ethnic lines. Parti Keadilan Rakyat (PKR) seeks to exploit social justice and anti-corruption themes, while the Democratic Action Party (DAP) promotes secular and multiracial ideals. After the last general election on 1 April 2008, the two parties united with the Islamist Parti Islam Malaysia (PAS) to form a political coalition called Pakatan Rakyat. Although the new political coalition pledges to support the rights and interests of all Malaysians, the coalition, like the Malaysian party system in general, is still influenced by ethnic and religious divisions.

Party system

Malaysia's interest groups continue to be relatively weak in terms of mediating between societal interests and the political system. Civic groups can only act within the narrow limits set by the Malaysian authorities. In practice, this means that they cannot broach issues of race and religion or criticize the government. Though most of the civic groups promote the ideals of a multiracial and open society, they are organized along ethnic and religious lines. Historically, employers' associations and trade unions, such as the umbrella organization Malaysian Trades Union Congress (MTUC), have no political weight.

Interest groups

Malaysians have an ambivalent relationship to democracy norms. Though Asiabarometer data from 2007 indicate that 70.5% of Malaysians believe that democracy is the most suitable form of government for the country and 77.8% believe that democracy governance is the most suitable way to solve the country's problems, 65.3% are satisfied the semi-democratic status quo. In addition, a

Consent to
democratic norms

majority (59.6%) of the respondents believe that economic development is more important than democratic governance and 84.3% feel that the relationship between the government and people is similar to that between a parent and a child.

A growing number of autonomous, self-organized groups, associations and organizations have formed in Malaysia, despite political, socioeconomic and cultural barriers. However, Malaysia's semi-democratic political order limits associational life, and the country lacks traditions of civic sociability. Social and cultural barriers divide the major ethnic and religious groups. The level of interpersonal trust is remarkably low in Malaysia. Asiabarometer data from 2007 show that only 4.8% of the respondents agreed that most people can be trusted. The overwhelming majority of Malaysians (94.3%) believe that they have to be very careful concerning personal contact with other people. Accordingly, social capital is notably low in Malaysian society.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Key indicators show a medium level of development in Malaysia. The country ranks 63rd with a score of 0.823 in the 2008 UNDP's HDI. The country's level of development permits freedom of choice for all citizens. The Ninth Malaysia Plan aims to reduce poverty to 2.8% in 2010 from 5.1% in 2002 (people living below the national poverty threshold) and there is an absence of fundamental exclusion, for example because of poverty, unequal access to education or deep gender discrimination. However, the Gini coefficient increased over the last years (from 0.461 in 2000 to 0.492 in 2006) indicating the widening gap between the rich and the poor. Malaysia stands out as an exception, as a country with a relatively high level of development but also with relatively high inequality. The state's affirmative action in favor of the Bumiputera has excluded the non-Bumiputera from participation at many social levels. At the same time, the government did not completely erase poverty among the Bumiputera. Large income disparities within this group remain. Furthermore, existing development imbalances among the various regions were not reduced during the period under review, although the country's oil revenues come from the poorer states. The government should promote greater regional development, especially in Kelantan and Sabah, two of the poorest states in the union. Though poverty reduction programs in Malaysia can be seen as some of the most successful in the Asia-Pacific region, serious problems in terms of poverty and social inequality still remain.

Socioeconomic
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	124749.5	137953.8	156408	186718.6
Growth of GDP	%	6.8	5.3	5.8	6.3
Inflation (CPI)	%	1.5	3.0	3.6	2.0
Unemployment	%	3.5	3.5	3.3	3.2
Foreign direct investment	% of GDP	3.7	2.9	3.9	4.5
Export growth	%	16.1	8.3	7.0	4.2
Import growth	%	19.6	8.9	8.5	5.4
Current account balance	\$ mn.	15079.4	19979.9	25488.4	28931.4
Public debt	\$ mn.	25570.3	22449.3	22598.8	18440.9
External debt	\$ mn.	52155.6	51980.7	56490.9	53716.7
Total debt service	% of GNI	7.8	7.1	5.0	5.5
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	12.6	12.3	11.9	12.2
Public expnd. on edu.	% of GDP	5.9	7.5	4.6	-
Public expnd. on health	% of GDP	2.2	1.8	1.9	-
R&D expenditure	% of GDP	0.6	-	0.6	-
Military expenditure	% of GDP	2.3	2.3	2.1	2.1

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

The foundations of a competitive market economy are largely assured in Malaysia. The informal sector plays a minor role. In the formal sector of economy, market competition has a solid institutional framework. Nevertheless, the Malaysian market economy has several shortcomings. The open bidding system is not used for key government contracts, because the government has pursued a policy of ensuring Bumiputera equity, while all smaller government contracts are only open to Bumiputera companies. National interest ensures that state-owned enterprises are

Market-based
competition

heavily protected by tax rebates and excise duties. European Commission ambassador Thierry Rommel strongly criticized this system of protectionist policy in June 2007. He stated that Malaysia has to reform its pro-Bumiputera policies in order to attract European investors or make headway in the European market.

However, Malaysia has taken some visible steps toward a more competitive market economy during the period under review. The World Bank “Doing Business Index” ranked Malaysia at 20 out of 181 economies, rising from 25 in 2008. Malaysia improved in almost every category. Most notably, amendments to the Companies Act simplified business registration and reduced the time required by introducing online filing of registration documents. Malaysia abolished the real property gains tax and reduced the corporate income tax rate to 26%, making business more profitable. The reform also introduced a single-tier tax system, in which profits are taxed only after dividend payments are exempted. Still, a high level of bureaucratic procedures in terms of documents (7 compared to 4.5 in OECD-countries) and days (18 compared to 10.7 in OECD-countries) required to export goods to Malaysia prevented better overall results.

At present, Malaysia has no law against monopolies or the formation of monopolies and oligopolies. Monopolies and oligopolies are only occasionally regulated. Though the Malaysian government expressed its will to enhance the competitive environment in the Asia Pacific region in the past, several oligopolies built by mainly private-public enterprises continue to exist.

Anti-monopoly
policy

In principle, foreign trade and the capital markets are liberalized, but significant exceptions remain. The government’s policies of ensuring Bumiputera equity and protectionist policies for key enterprises constitute high barriers for foreign investors. In June 2007, the European Commission ambassador Thierry Rommel pointed out that the New Economic Policy (NEP), in other words pro-Bumiputera policies, makes Malaysia an uninviting destination for Foreign Direct Investment (FDI). Long-running free trade talks with the United States concerning a free trade agreement (FTA) have stretched on for eight rounds without producing an agreement, similarly to EU-ASEAN FTA talks, which also remain in limbo. Consequently, according to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2008, FDI outflow from Malaysia surpassed inflow in 2007 for the first time ever. Within the 10-member ASEAN trading bloc, Malaysia was the only country to record a negative inflow, stoking fears that investors might be losing confidence in the country’s economic policies. However, on 28 August 2008, negotiations between ASEAN, Australia and New Zealand over a free trade agreement (AANZFTA) successfully concluded at the 13th annual meeting of the ASEAN Economic Ministers-Closer Economic Relations (AEM-CER) consultations in Singapore. The single undertaking agreement between ASEAN, Australia and New Zealand is the most comprehensive trade agreement that ASEAN has ever negotiated.

Liberalization of
foreign trade

The growing competitiveness and the ongoing consolidation process in the banking sector helped Malaysia to facilitate the orderly functioning of economic and financial activities during the period under review. Supervision of the banking system became more efficient, and non-performing loans have decreased. Despite the global financial crisis, the country's financial institutions remained stable and had ample liquidity according to the central bank (Bank Negara Malaysia). On 16 October 2008, the Malaysian government announced that it would guarantee all ringgit and foreign currency deposits at commercial, Islamic and investment banks. Islamic banking, based on Shari'ah law forbidding interest payment in favor of profit sharing, and therefore guaranteeing that every transaction must be covered by real assets, featured a high degree of stability, despite the financial crisis. According to the Heritage Foundation's 2009 Index of Economic Freedom, which ranked Malaysia at 58th place in the world's free economies (down from 51st in 2008), Islamic banking accounts for around 12 % of total banking assets in Malaysia. However, Malaysian banks continue to be poorly capitalized by international standards, and foreign banks' access to the Malaysian market is still restricted.

Banking system

8 | Currency and Price Stability

Though controlling inflation and an appropriate foreign exchange policy are recognized goals of economic policy, they have not been consistent during the period under review. The global financial crisis in 2008 had a significant impact on the Malaysian economy in terms of an increasing inflation rate and a weaker ringgit compared to former years. Although inflation eased to 5.7% in November 2008 from its 27-year high of 8.5% in August 2008, consumer prices remained high in comparison to former years (consumer prices rose by 2.0% on average in 2007). The high inflation rate was mainly driven by escalating food and transportation costs. Despite public protests, on 4 June 2008, the Badawi administration decided to cut the spiraling costs of oil subsidies. Gasoline prices increased by 78 sen, which meant a 40.6 % spike in price from RM 1.92 to RM 2.70 per liter. This further heated up the inflation rate. The government decided to cut fuel prices twice in November 2008 as oil prices plummeted worldwide, reducing prices to RM 1.80 per liter. The inflation risk has subsided, but high costs for food continue to burden Malaysian households.

Anti-inflation /
forex policy

Following the end of the currency peg, the ringgit depreciated to as low as 3.16 to the U.S. dollar in April 2008. Since April 2008, the ringgit has declined further to 3.6 to the U.S. dollar, losing more than 4.25% of its value. The ringgit may take another three years, instead of the projected two, to reach its fair value of 2.8 to the U.S. dollar.

Malaysia, in principle, followed a stable policy over the last years, notwithstanding inconsistencies of institutional safeguards, which became very obvious in 2008. The

Macrostability

global financial turmoil challenged Malaysia's trend of years of a stable macroeconomic situation and decreasing federal government fiscal deficit. The budget deficit had declined to 3.2% in 2007 since hitting a high of 5.5% of GDP in 2000. Malaysia's debt-to-GDP ratio dropped to 34.8%. Because of the financial crisis, Malaysia's budget deficit in 2009 is projected at 4.8% of GDP, far higher than the original target of 3.6% of GDP. The growing deficit is largely due to a government economic stimulus package in the range of \$2 billion. At the end of January 2009, the Malaysian government declared that a second stimulus package will result in an even higher budget deficit. Federal government revenue for 2008 was estimated to grow at a slower rate of 3.7%, compared to the 14.7% increase in 2007. In conclusion, the growing budget deficit during the period under review challenged fiscal management in Malaysia.

9 | Private Property

Property rights and the regulation of the acquisition of property are well defined in terms of acquisition, benefit, use and sale. Exceptions occur in some areas in Borneo, where the relocation of locals and the indigenous population creates a recurring conflict between the population and the Malaysian state, which is promoting infrastructure projects, such as the construction of large dams.

Property rights

Private companies represent the backbone of the economy, but there are still state companies and strong market concentrations such as oligopolies, especially in the construction, lighting, telecommunication and transport sectors. Officially, the government is promoting further privatization, like in the case of the Malaysian auto brand Proton, as long as Malay interests continue to be protected. State-owned enterprises continue to dominate in the banking, infrastructure and transportation sectors.

Private enterprise

10 | Welfare Regime

In principle, social networks exist but do not cover all risks for all strata of the population. Several social security programs provide benefits for different groups of workers. Government employees receive the best benefits, while employees in the informal sector gain virtually nothing. The Employees Provident Fund (EPF) is the primary social security institution in Malaysia, covering more than half of the workers in the private sector in 2000. The current rate of contribution is 23% of the annual salary. Nevertheless, Malaysia is still dependent on informal community assistance and a growing number of NGOs have become newly active in the social safety sector. In the past years, Malaysia has experienced an increasing trend of privatization in the health care system. Private health care facilities are projected to match the public sector by the year 2020. However, health care services continue to

Social safety nets

be heavily subsidized at minimum or no costs by the government, which has ensured a safety net for the needy population.

Though Malaysia has a number of institutions to compensate for gross social differences, inequalities continue to exist. Social services helping to fight poverty and inequality have been quite successful in the past but feature several shortcomings. The disparity of income distribution is severe with a Gini coefficient of 0.492 in 2006, the highest rate among Southeast Asian countries (no data available for Laos and Burma). Discrimination against women limits their equal access to education and public services. Due to continuing affirmative action policies for Bumiputera, Chinese and Indians are deliberately disadvantaged in public office, state bureaucracy, public enterprises and the armed forces.

Equal opportunity

11 | Economic Performance

After a period of stable economic growth in 2007, key macroeconomic data indicate that Malaysia's economic performance was significantly affected by the global financial crisis in 2008. This is due to the country's export-oriented economy. At the end of 2008, Malaysia was slipping into a technical recession with negative economic growth in the fourth quarter of 2008 and the first quarter of 2009. GDP growth rates for 2008 declined from 5.5% to 5.1% with an even more negative outlook for 2009 (Citigroup Global Market downgraded Malaysia's GDP forecast for 2009 from 3.1% to 0.5% though the government still forecasts a GDP growth of 3.5%). Jobless rates for 2009 are predicted to rise to 4.5%. In November 2008, as a reaction to these negative macroeconomic data, the central bank cut interest rates by 25 basis points to 3.25%. This was the first interest rate cut in two and a half years. Further cuts were expected at the beginning of 2009. Though GDP growth rates for 2010 are estimated at 4.2%, softening export demands in the palm oil and electronic sector as well as lower foreign direct investment inflow testify to the country's economic vulnerability to external shocks.

Output strength

12 | Sustainability

Environmentally compatible growth is taken into account at the institutional level in important aspects of economic life but tends to be subordinated to growth efforts. Deforestation and air and water pollution are the nation's primary environmental problems. Deforestation problems mainly affect the island of Borneo. Environmental concerns have grown in recent years among citizens, resulting in an increasing number of environmental organizations. The government has developed plans to build 12 massive dams during the next decade in order to harness hydroelectric power. These plans were made public in 2008. Environmental groups expressed their concerns that hundreds of Sarawak's native communities will lose

Environmental policy

their traditional land. Furthermore, the plans threaten the World Heritage status of the Mulu National Park. The problem of uncontrolled hillside development in Malaysia became evident on 6 December 2008 when a massive landslide killed five people in Bukit Antarabangsa.

During the period under review, the Badawi administration allocated more funds to improve the infrastructure of the country's transportation and education systems. In consequence, Malaysia has a modern infrastructure. Beyond the state, private institutions for education, training, research and development are strong and in some areas even quite advanced. The quality of public universities, however, continues to be deemed low by international standards. The state's expenditures for education, at 6.2% of GDP in 2005, can be considered high, even with reference to international standards. However, the Malaysian educational system still exhibits weaknesses in terms of low attainment rates at the secondary level. This was highlighted in the World Economic Forum's Growth Global Competitiveness Report 2008-2009, which ranked Malaysia 21st out of 134 countries. Over the last couple of years, the Malaysian government has established the Northern Corridor Economic Region (NCER), the Iskandar Malaysia and the East Coast Economic Region (ECER) in order to revitalize the Malaysian economy, accelerate economic growth, elevate income levels in every part of the country and promote research and development. These development projects should help the Malaysian economy compete with other countries in the region. The development corridors are projected to become world-class economic regions, especially in the fields of agriculture, tourism, biotechnology, education, manufactured products and electronics.

Education policy /
R&D

Transformation Management

I. Level of Difficulty

The Badawi administration faces only moderate socioeconomic and structural constraints on its capacity to govern when measured in terms of the national poverty level, infrastructural development, and the quality of Malaysia's educational system, Corruption, weakness of democratic institutions and civil society, and significant ethnic and religious heterogeneity, on the other hand, continue to be structural constraints, though heterogeneity has not bred severe ethnic or religious conflict. Nevertheless, the Malaysian government must confront regional disparities in economic development and infrastructure, especially on the island of Borneo. The country's exposure to external economic shocks narrows management capacity and has to be seen as the country's most severe structural constraint.

Structural
constraints

Despite more frequent civil mobilizations in 2007 and active engagement of pressure groups, traditions of civil society remain weak. Notwithstanding an increase in new NGOs (especially since the 1990s), the landscape of voluntary organizations is still slim and plagued by scarce organizational resources. So far, two different cultures of civil society have emerged within the growing number of NGOs in the last years. On the one hand, a group of more liberal organizations has intensified its work, such as monitoring human rights or observing the government's reform agenda. On the other hand, a more welfare-oriented part of civil society has also gained strength, especially when it comes to informal community assistance for the poor at local level. According to recent data from Asiabarometer, social trust is extremely low. Malaysia is at the bottom in terms of interpersonal trust compared to all other Southeast Asian countries. In contrast, trust in institutions, such as the prime minister or the government remains relatively high.

Civil society
traditions

Malaysian society is polarized along ethnic and religious lines. Since independence, the political elite have managed ethnic and religious cleavages by forming a multiracial ruling coalition in which the three largest race-based parties are included. Though this bargain led to a political spectrum split along religious and ethnic lines, it helped stabilize a divided Malaysian society and inhibited major

Conflict intensity

violent conflicts for three decades. In recent years, however, small protest movements, which call for a further Islamization, have become stronger. These movements display a significant level of illiberal and intolerant behavior. Ethnic tension grew in 2007 when a local authority demolished two Hindu temples. These actions sparked a massive demonstration by Malaysian Indians. Furthermore, when the ruling coalition lost much of its support in the general election in March 2008, some parts within the United Malays National Organization (UMNO) abandoned the path of mitigating the country's ethnic and religious cleavages and instead called for an expansion of affirmative action for the Bumiputera in order to present the party as the preserver of Malay-Muslim rights. This increasing interest in mobilizing ethnic and religious groups dims the prospect for coherent conflict management.

II. Management Performance

14 | Steering Capability

The political leadership claims to pursue long-term goals, but in 2008, the government showed inconsistencies in its policies with regard to its stated aims. The Ninth Malaysia Plan (2006-2010) continues to be the comprehensive blueprint for the government's goal of developing the market economy in order to maintain macroeconomic stability. During the period under review, however, the government did not maintain its strategic priorities in periods of crisis. In the face of the global financial turmoil, the government's shift to addressing short-term interests to silence public criticism, instead of adhering to its long-term aim to consolidate the country's budget, significantly damaged its management capacity. Moreover, the government's strategic long-term aims do not include a further democratization of the public sphere or the extension of democratic norms. In conclusion, the government continues to prioritize the development of the country's market economy to its full capacity, which the Badawi administration views as incommensurate with the aim of strengthening liberal democracy.

Prioritization

New and effective economic policies have been implemented during the period under review. Examples are the reorganization and new establishment of the three development regions (NCER, ECER and Iskandar Malaysia). Furthermore, the government simplified business registration and abolished the real property gains tax, reduced the corporate income tax rate to 26%, and introduced a single-tier tax system, in which profits are taxed only after dividend payments are exempted. For

Implementation

this reason, economic policies are designed in a fairly rational manner and implemented effectively as long as they are in line with government priorities. Nevertheless, the executive has not carried out structural and qualitative changes in the political system in order to facilitate transformation toward democracy. Though the government launched new reform bills, such as the Judicial Appointments Commission (JAC) and the Malaysian Anti-Corruption Commission (MACC), the reforms provoked sharp criticism among political and civil society actors. The reform bills are widely seen as a late attempt by the Badawi administration to regain some reformist credibility by realizing some long-promised structural changes in the political system.

Overall, the Badawi administration has not implemented effective or major reforms in the political system. High levels of corruption and political patronage have stalled the administration's implementation of economic reforms. The Malaysian government has failed to realize important steps, such as the formation of the Independent Police Complaints and Misconduct Commission (IPCMC).

Malaysia's political leadership tries to respond to mistakes and failures with changes and reforms. The government shows a considerable degree of flexibility and learning capability with reference to market reforms. The political elite, however, continue to refrain from implementing democratic reforms and show a low degree of political will to learn from past mistakes in order to facilitate democratic changes. Thus, the leadership remains stuck in the same routines. Signs of this inertia include the return to a populist style of politics and the government's executive-centered, nearly unilateral decision-making process, as well as the prime minister's authoritarian attitudes. Civil society and oppositional actors strengthened their position after the electoral success in the general election in March 2008. They continue to express a strong demand to the country's leader to govern in a more democratic manner. In addition, they urge political elites to implement reforms. Despite this, the government's reform projects cannot be considered proof of its learning process or commitment to democratic norms. They are insufficient instruments to facilitate liberal democracy.

Policy learning

15 | Resource Efficiency

The Badawi government efficiently uses most available economic, human and cultural resources to pursue its development policies. However, the high deviation of actual budget expenditures from associated planned expenditures and the government's affirmative action policy, which establishes a Bumiputera quota for all of its economic activities, remain highly concerning. Although the government's administrative personnel is generally seen as professional, the existence of competitive recruiting procedures is limited by the Bumiputera quota system.

Efficient use of assets

This negatively impacts the functioning of the administrative system at the lower levels of the Malaysian bureaucracy.

Although the political leadership is generally committed to a carefully balanced budget, including a transparent financial planning and implementation, the actual level of state debt increased considerably in 2008 – as a result of two fiscal stimulus packages in order to support the Malaysian economy. This debt will be difficult to manage in the long term. In sum, the government's efficient use of assets is subject to restrictions.

The government generally coordinates conflicting objectives and interests, but intra-governmental friction became evident during the period under review. In the past, the cabinet, under Prime Minister Badawi's hierarchical leadership, has effectively handled the major conflicts over economic or social policies in order to achieve policy coherence. Nevertheless, with the government, and especially Prime Minister Badawi, under pressure after the electoral defeat in the last general election, the Malaysian Law Minister Zaid Ibrahim (UMNO) stepped down from his office in September 2008 in protest against the use of the Internal Security Act (ISA) to detain several political opponents. This pronounced criticism by a member of the ruling party and the cabinet indicates on the one hand growing disagreement within the ruling coalition over an appropriate response to the loss of votes in the last general election and on the other the weakened position of Prime Minister Badawi within the ruling party. This weakness resulted in Badawi's announcement that he would step down from his office in March 2009. These intra-governmental frictions, however, did not lead to a failure of policy coordination in Malaysia. The government's capability to coordinate conflicting objectives and interests continues to be fairly effective compared to other countries in the region.

Policy
coordination

During the period under review, the government identified corruption as an important problem within the state structures, although corruption in the civil service is probably the lowest in the region after Singapore. Political connection continues to be the strongest criterion in awarding large state contracts and infrastructural projects. Moreover, the government's motivation to implement reforms is ambivalent. Despite the Badawi administration's establishment of the Malaysian Anti-Corruption Commission (MACC), at present, the government has not implemented the necessary integrity mechanisms to effectively fight corruption at every level of the state. The MACC itself draws a lot of criticism, mainly because it lacks independence from the prime minister's department. The newly created Special Committee on Corruption does not report to parliament but to the prime minister. Furthermore, under the new MACC bill, prosecuting power continues to stay with the attorney general. The attorney general is widely seen as an institution with close ties to the prime minister and accused of practicing selective prosecution. In the past, the Anti-Corruption Agency (ACA) reported about cases of corruption at the higher levels and advised the attorney general to take action, but the attorney

Anti-corruption
policy

general refused to do so (for example, in an investigation against former International Trade and Industry minister Rafidah Aziz). No major political figure has been arrested or found guilty of corruption in the past two years.

16 | Consensus-Building

In principle, all major political and social actors agree on the goal of a market-based economy. The exceptions to this are some environmental groups, who criticize that environmentally compatible growth tends to be subordinated to growth efforts, and fundamentalist Islamists. In addition, there is no politically relevant actor who can derail either the reform process or the expansion of the market economy. With regard to liberal democracy, however, the political and social actors can reach no such consensus. The ruling coalition continues to refrain from implementing democratic reforms aimed at facilitating transformation. Instead, it emphasizes that liberal democracy as practiced in the West is unsuitable for Malaysia's ethnic and religiously heterogeneous society. Even within the new established opposition coalition (Pakatan Rakyat) divergent opinions exist about the goal of a liberal democracy. Some members of the Parti Islam Malaysia (PAS) express the intention to introduce hudud laws in the event that the coalition would form the next federal government.

Consensus on goals

Although the ruling Barisan Nasional (BN) lost its two-thirds parliamentary majority in the last general election, reformers continue do have no power to bring about democratic reforms. The government still refuses to enhance democratic transformation. Fundamentalist Islamists reject democracy categorically and want Malaysia to be a theocratic state. The military does not pose a threat to a potential democratic process, because the armed forces are effectively subordinated to the civilian rulers.

Anti-democratic
veto actors

The political leadership has until now prevented cleavage-based conflicts from escalating. Taken into account the ethnic and religious heterogeneity of the Malaysian society, with significant ethno-religious cleavages, the government was more or less successful with respect to the political management of social differences. Nevertheless, following its dismal performance in the March 2008 general elections, some members of the ruling coalition questioned the political leadership's strategy to follow a policy of national integration and reconciliation based on the principles of affirmative action and segmented autonomy. In order to regain its electoral strength, political actors within the ruling coalition tried to raise fears among the Malay majority as well as among the mainly Chinese and Indian minority, that the opposition's success would seriously threaten the political bargain between the different ethnic groups. According to ruling coalition, a takeover of the federal government by Pakata Rakyat would endanger the quota system for the Bumiputera and the development of a free market economy in which the non-

Cleavage /
conflict
management

Bumiputera were given a free hand. Furthermore, controversial remarks about the country's social cleavages made by high ranking members of UMNO indicate that frictions within the ruling coalition persist over a policy of national integration. On 23 August 2008, Datuk Ahmad Ismail, UMNO Penang's Bukit Bendera division chief for more than 20 years, characterized Chinese as "squatters" and questioned the fact that they have equal rights. His speech drew nationwide criticism, and Prime Minister Badawi expressing his anger and regret over these remarks. Though Ismail was suspended from UMNO for the next three years, stronger action against him had been expected. Additionally, regional and economic disparities within the Malaysian state persist and continue to deepen the center-periphery cleavage between East- and West-Malaysia.

The political leadership only recognizes and accommodates the interests of the civil society actors as long as they are not seen as interfering with government policies. Laws pertaining to NGOs and other civil society groups continue to limit the space for civic activity. Women's rights groups, however, have successfully lobbied for institutionalized safeguards against domestic violence. Malaysia's Domestic Violence Act, adopted in 1994, was significantly influenced by the work of women's rights groups. Nevertheless, in cases of conflict between the interests of the Malaysian government and the demands of the civil society groups, the government frequently ignores civil society actors and formulates its policy autonomously. The influence of civil society actors in the political debate must be seen as insufficient.

Civil society
participation

The effects of the May 13 incident, when race riots broke out, are still visible in the Malaysian society, as the affirmative action policies implemented at the time for the Bumiputera are still in place. The government persists with these discriminatory policies, though their loss of votes during the last general election is widely seen as an indicator that especially the Chinese and Indian minority groups are increasingly dissatisfied with the government's stance on this issue. Even within the ruling coalition, growing discontent with the affirmative action policies is clearly visible, largely because the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC) both lost significant support within their own ethnic communities. The members of the Chinese and Indian communities heavily criticized the MCA and the MIC for failing to challenge United Malays National Organization (UMNO) concerning the question of the New Economic Policy (NEP). As a result, tensions between the Malay-Muslim majority and the Non-Malay and Non-Muslim minorities continue to exist. The government shows no signs of ending the discriminatory NEP policies.

Reconciliation

17 | International Cooperation

Although the political leadership works with bilateral and multilateral international donors such as the World Bank, the IMF and the ADB, it only uses international aid to improve policies that suit the government's preferences. In specific, external advice with reference to affirmative action policies is considered undesired political interference. This became evident in the free-trade talks (FTA) with the United States that have been held during the period under review. The negotiations began in March 2006 and have yet to result in an agreement. In November 2008, Deputy Trade Minister Jacob Dungau Sagan emphasized the Malaysian position that Malaysia will not compromise on U.S. requests that relate to its sovereignty or that go against national policies. Sagan made these comments with regard to the country's affirmative action policies. The United States seeks access to lucrative Malaysian government contracts that favor Bumiputera. In addition to that, the Malaysian government blocks every attempt by international donors or organizations to facilitate democracy and civil rights in the country.

Effective use of support

In general, the Malaysian government acts as a credible and reliable partner in its relations with the international community and remains fully engaged with the World Bank, the IMF, the ADB and other international institutions. Tensions with Singapore have been kept low, though differences between the two countries concerning the borderline in the Strait of Johor persist. Malaysia's deportation of illegal immigrants from the Philippines and Indonesia intensified tensions with those countries in 2008. The governments in Manila and Jakarta expressed concerns that the reintegration of thousands of deported immigrants would result in acute problems for the countries' economies.

Credibility

The political leadership cooperates with many neighboring countries and complies with the rules set by regional and international organizations. Malaysia, a founding member of ASEAN, successfully promoted deeper relations between the member countries. On 15 December 2008, the ASEAN charter came into force. Malaysia had already ratified it on 20 February 2008. Though the charter drew criticism from NGOs and civil society groups, it was an important step toward improved relations between the member countries. The document sets out rules of membership, transforms ASEAN into a legal entity, envisages a single free trade area for the region and its 570 million inhabitants by 2015, and emphasizes the centrality of ASEAN for regional cooperation.

Regional cooperation

Strategic Outlook

The outcome of the last general election gave rise to high expectations among political and civil society actors. Nevertheless, democratic transformation in Malaysia has remained insufficient. Far from representing a watershed, the Malaysian government's unsatisfactory reforms prove that it does not intend to facilitate democratic transformation. The global financial crisis exposed weaknesses in Malaysia's management of its economic transformation. Malaysia needs strong policies and key reforms to face its political and economic challenges.

Malaysia's leadership will have to continue economic consolidation and make its economy more resistant to external influences. Furthermore, taken into account the outcome of the general election and the increasing protest concerning the government's repressive sanctions against opposition groups and bloggers, a continuation of draconian policies such as the common use of the Internal Security Act (ISA) would further divide and destabilize the country. A new transformation strategy should focus on four key elements.

First, Malaysia needs to strengthen the rule of law and the judiciary. Although the Malaysian government passed the Judicial Appointments Commission bill in order to strengthen the judiciary, the bill must be considered as insufficient. The ongoing executive dominance and monopoly on power, including its interference with trials, must stop in order to establish an effective judiciary and to regain public trust in democratic institutions. Moreover, a sound and sophisticated judiciary is needed to effectively fight corruption at every level. Thus far, the government has not displayed any intention of establishing a working system of checks and balances, which is needed to guarantee the rule of law. As long as the government continues to withhold effective democratic reforms, political protest and instability will increase. The government considers international efforts to foster the rule of law and a working system of checks and balances in Malaysia as undesired political interference. Consequently, these are not effective strategies for international donors.

Secondly, Malaysia should strengthen political and interethnic dialogue. From 2007 to 2009, political consensus was notably low. This was mostly due to the government's repressive policy of silencing its critics. The imprisonment of political opponents under the ISA further undermined the government's credibility and show that Malaysia's political leadership does not accept divergent political opinions. Nevertheless, increasing political protest and electoral success of the opposition coalition proved that large portions of Malaysian society are no longer willing to accept this situation. It is doubtful that the government's strategy to oppress the opposition will reestablish stability and order within the country. To a large extent, public unrest was an expression of growing discontent with the government's management of ethnic relations. Ethnic Chinese and Indians strongly feel disadvantaged and do not seem to be willing to accept their inferior standing in the Malaysian society any longer. The Malaysian government must make a serious effort to resolve these ethnic and religious tensions. External actors, such as

German party foundations, although they only have limited possibilities for activity in Malaysia, should more rigorously focus on facilitating political and interethnic dialogue.

Thirdly, Malaysia's government must abolish its Bumiputera affirmative action policy. The government's Bumiputera affirmative action policy is still one of the cornerstones of Malaysian politics. In order to advance reform and improve Malaysia's competitive capacity with reference to its economic output strength, however, the government needs to terminate its Bumiputera affirmative action policy, which continues to encourage rent-seeking behavior, impedes competition and facilitates corruption. Bilateral partners, such as the U.S. government, the European Union and international organizations have clearly said that the affirmative action policies constrain trade agreements with Malaysia. These partners have all emphasized the abandonment of such policies. The Malaysian government has repeatedly rejected the call for reforms and considers the international criticism to be undesired political interference. The Malaysian political leadership should rethink their policies not only to promote economic ties with their trade partners but also to reduce ethnic tensions. The widening gap between the different ethnic groups in Malaysia, the growing discontent within society and the Bumiputera affirmative action policy are interrelated. A reform of the Bumiputera policies, therefore, should be of highest importance.

Fourthly, the Malaysian education system needs to be strengthened. Although the Malaysian government increasingly invested in education in the past, which resulted in a fairly developed educational system, actions have to be expanded. The quality of public universities is still insufficient, and attainment rates at the secondary level are low. In order to compete with other emerging countries in the region, such as India and China, and to generate social and economic development, Malaysia needs to increase its investment in the education sector.

Finally, a number of factors suggest that Malaysia's transformation process is not yet finalized. These factors include the falling prices for primary commodities, especially palm oil, the fact that FDI outflow surpassing inflow in 2007 for the first time in Malaysia's history and increasing political instability.