

Malaysia

Status Index (Democracy: 5.07 / Market economy: 7.11)	6.09	Management Index	5.58
HDI	0.796	Population	24.4 Mio.
GDP p. c. (\$, PPP)	9,512	Population growth¹	2.5%
Unemployment rate	3.4	Women in Parliament	13.1%
UN-Education Index	0.83	Poverty²	<2%
		Gini-Index	49.2
Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003).			

A. Executive summary

In the past few years, Malaysia has made significant progress in deepening the workings of market economy. There is a high degree of stateness, an absence of undemocratic veto powers and stable institutions. The institutional hardware of market economy, such as the basic rules of organization of the market economy, is firmly in place. The levels of socioeconomic development are high. Currency, prices and economic growth are stable. Economic development is based on a well-developed education system, and sustainable for some time to come. Property rights are well defined, and high growth rates have compensated for a lack of a welfare system.

However, political reforms toward liberal democracy are still wanting. This is caused mainly by the political structure and political dynamics driven by ethno-religious tensions. The three major groups; Malays, Chinese and Indians maintained their own religion, culture and language and resist strongly any moves to dilute them. Political parties and mobilization are based along ethnic and religious lines. The same divisions have also meant that there is lack of consensus building. Beside ethno-religious tensions, corruption and fundamentalist Islam pose serious threats to state institutions and a secular government. Thus far, there is a low level of political violence and extremism.

Despite all these problems, there is remarkable political stability, attested by the smooth transfer of political power from Mahathir Mohammad to Abdullah Badawi in October 2003. Mahathir had been in power for 23 years. A key reason for political stability has been the good record of economic management by the ruling Barisan Nasional (National Front, BN) coalition. The BN has been in power since

independence and has just won its biggest electoral victory for the past two decades during the March 2004 general elections. Their long tenure in office has meant consistency and pragmatic approach to economic policies resulting in Malaysia having one of highest growth rates in the region. Poverty rates were more than halved during the past two decades and the biggest problem now appears to be the widening gap between the rich and poor. Although the country was hurt by the Asian Financial Crisis in 1997-98, it has successfully recovered and the growth rates for three years have been positive with GDP growth of 5.3% in 2003 and 7% in 2004.

B. History and characteristics of transformation

The federation of Malaysia was established in 1963 with the territories of Malaya, Singapore, Sabah and Sarawak. Two year later in 1965 Singapore was expelled from the federation. Malaysia consists of 13 states and two 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- House of Representatives (Lower House) where members are elected every five years in a first-past-the-post election from single-member constituencies. The Senate (Upper House) are all 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. Bumiputera consists of Malays and other indigenous peoples while the non-bumiputera grouping consists mainly of Chinese and Indians. This divide is evident in every facet of Malaysian life; from politics to food to university intake.

Most of the Chinese and Indians first came to Malaysia during colonial times when the British actively recruited them to open up the economy. When the country gained 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 the pattern of politics whereby it became an unwritten law that the prime minister position will always be held by a Malay, specifically from the United Malays National Organisation (UMNO). This system collapsed in May 1969, when racial riots broke out between the Malays and the Chinese after a keenly fought election. The whole country was placed under emergency rule and the constitution suspended. When the suspension was finally lifted in 1971, new laws were passed to enshrine Malay political supremacy. UMNO became all-powerful and aggressive in the promotion of the Malays, its main supporters. A New Economic Policy (NEP)

was promulgated providing extensive benefits to the bumiputera community through quotas, bank loans, scholarships, special licenses, etc.

The government justified the affirmative action on the basis that the economic gap between the bumiputera and the non-bumiputera were so wide that it threatened national security and racial harmony. Although the NEP discriminated against the non-bumiputera, the UMNO-led government was careful to allow a free market economy to develop and gave the non-bumiputera a free hand in the economy if some shares were reserved for the bumiputera. This strategy based on growth was successful and Malaysia became one of the Asian Tiger economies in the 1980s. In 1991, NEP ended and economic policies since then retained the core character of the NEP: special rights for the bumiputera and rapid economic growth to ensure that all ethnic groups received their share of the economic pie.

Since independence, the government has been head by UMNO and the ruling coalition, BN has won every general elections. The BN regularly gets more than two-thirds majority in Parliament, allowing it to amend the constitution at will and gave the executive to pursue any policies without opposition. The successful management of the economy has allowed the government 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 - maintaining a stable and growing economy and relatively stable politics despite ethno-religious conflicts.

C. Assessment

1. Democracy

Democratic transformation in Malaysia has continued during the review process. Although key shortcomings of democratic consolidation remain, particularly regarding the electoral process, free media, political representation, rule of law, the effective and efficient working of the democratic institutions, and consensus building, Malaysian democracy made progress over the past years.

1.1. Stateness

Citizenship and the state’s monopoly on the use of force are undisputed. The Malaysian state is strong and sovereign. Although there are territorial disputes with the Philippines (over Sabah state) and Singapore (a small island), these are not

deemed important by the polity and do not intrude into the workings of the state. The key political institutions of the state such as the bureaucracy, armed forces, Parliament, monarchy are all dominated by ethnic Malays ensuring that the state has a strong Malay flavor. Although the country is constitutionally secular, political Islam plays an increasing role in public policy as the state tries to negotiate between a small but vocal band of fundamentalist Islamists and the secular majority. Parti Islam Malaysia (PAS), one of the two main opposition parties, advocates the creation of an Islamic theocratic state. In 2002, the former Premier Mahathir called Malaysia an Islamic country, but he did not alter the constitution. His definition of an Islamic country is because about 60% of Malaysia's population is classified as Muslims. The new Badawi administration has also adopted a similar stand.

1.2. Political participation

Malaysia has established universal suffrage and more than half of the registered voters regularly take part in elections. Elections have been held on time (roughly every five years) since independence. Although there is not much complaint about the running of the elections, elections in Malaysia cannot be considered free and fair. The ruling party, BN, has never lost a general election since independence and most analysts would put their excellent record of winning elections on a mixture of using repressive laws to restrict the opposition, strong influence over the media, and using government resources to ensure victories. Although there are signs of increasing political activism among the non-governmental organizations (NGOs) and civil society groups, there are half a dozen laws that restrict their growth and development. For example, Amnesty International has been denied permission to establish a branch in Malaysia, despite several applications. The same laws are used to restrict the growth of trade unions or other independent enclaves of political activity. Freedoms of information, speech and assembly are restricted by law. The only area where the law has not caught up is the Internet where all forms of political expression are grudgingly tolerated.

1.3. Rule of law

Rule of law is generally respected in Malaysia as long as it does not interfere with the government's main political agenda. The government can change the law at will because the ruling BN has a two-thirds majority of Parliament, allowing it to amend the constitution at any time. During the administration of Mahathir Mohammad (1981-2003), the federal constitution was amended almost annually. Far more seriously, the judiciary came under assault from the executive, resulting in the forced

removal of the chief justice and two Supreme Court justices. The new Badawi Administration has tried to restore confidence by adopting a more professional approach to the appointment of judges but the consensus is that it will take many years for the Malaysian judiciary to regain its reputation. A black spot on the judiciary, the jailing of Anwar Ibrahim, was somewhat removed when he was released by an Appeals Court in September 2004. A few years earlier, a senior judge wrote a letter detailing corruption at the highest level of the judiciary. The charges were never properly investigated and the judged retired quietly, leading to speculation that a cover-up took place.

Corruption is a key threat to the rule of law. Although there is no accurate measure of corruption in Malaysia, there is widespread perception that corruption is widespread among the nation's political and business elite. The government's affirmative policy of awarding huge infrastructure projects to selected bumiputera (read Malay) businesses without an open tender and giving special licenses to the same group has encouraged corruption. The close nexus between the ruling elite and business is called "money politics" and the former PM Mahathir cried out in public complaining that corruption will destroy UMNO, his political party and the most powerful party in the ruling coalition. The current PM has said the elimination of corruption is one of his main priorities.

At the lower level, corruption is dealt with effectively by the Anti-Corruption Agency (ACA). However, few political elite or big business has been arrested by the ACA. The general view is that there is a different set of rules for the "big fish" and the "small fish" when it comes to corruption. In 2004, the government launched the National Integrity Plan with anti-corruption as one of its key platforms, however, it remains to be seen how effective it will be, given that there is little political will to tackle corruption at the higher levels.

The various laws restricting political participation and free expression are used to curb civil liberties. The most famous of these laws is the Internal Security Act (ISA), which allows for indefinite detention as long as the Interior Security Minister signs the order. The police are held in low esteem by the public. Reports of police torture and petty bribery are common, causing the government to establish a Royal Commission to stamp out corruption in the force and to make it more professional. The Commission is due to report in May 2005. The Human Rights Commission, established in 1999, has tried to deal with issues relating to police abuses and abuse of power by the bureaucracy. However, it has been ineffective, given that there is no political will to implement the recommendations made.

One disturbing trend is the increasing role of Islam in civil cases. Islam is the official religion in Malaysia and there is no provision for conversions out of Islam. Presently Muslims can opt for Shariah law on family matters such as divorce and child maintenance. These Shariah courts have no jurisdiction over non-Muslims. A recent judgment may suggest otherwise. In 2004, Shamala Sathiyaseelan, a Hindu women went to the civil courts to challenge the conversion of her two young children, both under five years. Her estranged husband had converted to Islam together with the children without her knowledge. Under civil law, children under 18 cannot be converted without the consent of the parents. Yet the Shariah Court awarded the custody of the children to her husband based on the fact the children were Muslims. As a non-Muslim she has no legal standing in a Shariah Court, and could not even appear before the court to fight the case. The Civil Court refused to intervene and ruled that while she can keep the children temporary, she cannot expose them to any non-Islamic religions or practices. Rather than taking her chances, she went into hiding with the children. The case was just the tip of the iceberg; there had been many cases of an estranged husbands converting to Islam to escape from alimony payments or to marry someone else without divorcing their first non-Muslim wife. The law says that once a person is Muslim, they come under the Shariah Court but makes no provisions for cases of Muslim conversions where one partner retains their non-Muslim faith.

In early 2005, the Bar Council tried to establish an Inter-Faith Commission to deal with issues arising out religious conflict. All religions attended but it was boycotted by leading Muslim organizations that claim that the commission would undermine Islam as the official religion. The government has not made a decision whether to support the commission.

1.4. Stability of democratic institutions

Subject to the aforementioned reservations about the problems of a working mode of checks and balances, key institutions are stable. The government is strong and in control. As long as there is the political will, things happen and work gets done. The only concern here is the omnipresence of the political executive. All key decisions are taken by the Prime Minister and the cabinet with little regard to the wishes of Parliament. For the most part, Parliament acts like a rubber stamp approving the executive's decision. Despite the dominance of UMNO in government and the marginalization of non-Malays, the system is remarkably stable, as attested by the smooth transfer of power from Mahathir to Badawi. Key institutions such as the police, bureaucracy and the judiciary are, largely, accepted by the polity as legitimate.

1.5. Political and social integration

The Malaysian party system is remarkably stable despite ethno-religious tension. The stability comes from two sources. It comes first from the ruling coalition BN, which is comprised of 14 parties each representing an ethnic group or a region. Although UMNO dominates the BN, other coalition parties are allowed to champion their ethnic agenda and concessions are made to preserve the working of the coalition. Thus while UMNO gets proportionately more, others do get a share, thus ensuring that political stability is preserved.

Second, opposition parties are also similarly divided along racial lines ensuring that all mainstream political parties mobilize along ethnic lines. This indirectly forces the leaders of these ethnically based parties to seek compromises among themselves in order to ensure social stability. This elite bargaining allows most sensitive issues to be resolved.

The only area of concern is the strong push by Parti Islam Malaysia (PAS) to establish a theocratic state. If this happens, some 40% of the population who are non-Muslims would effectively be disenfranchised from the political system. Thus far, the votes have shown a preference for secular parties.

The state-defined and state-enforced social divide between the bumiputera and the non-bumiputera remains the cornerstone of ethnic relations in Malaysia. As long as the state discriminates in favor of the bumiputera, there will be resentment among the non-bumiputera. The level of resentment will depend much on the performance of the economy; ethnic tensions tend to be lowest during periods of high growth.

2. Market economy

2.1. Level of socioeconomic development

The key indicators show a medium level of development. Among the group of transformation countries in Asia and Oceania, Malaysia ranks third in terms of the UNDP's Human Development Index. The country's level of socioeconomic development permits adequate freedom of choice for all citizens, subject to affirmative actions by the state in favor of the bumiputera. Muslims cannot legally leave the religion.

There is no fundamental social exclusion because of poverty, unequal access to education or deep gender discrimination although the state actively maintains a quota for the bumiputera in education and business. This has led to some exclusion at the lower level of society among the non-bumiputera although high growth in the past decade has ensured that even the most marginalized groups have benefited somewhat. Poverty rates have come down across the board and it is generally acknowledged that poverty reduction programs in Malaysia are one of the most successful in the Asia-Pacific region.

Nevertheless problems remain. Throughout the review period, the single biggest problem is the growing inequality between the rich and poor. The top 20% of the population owns more than half of the country's wealth while the bottom 40 % owns less than 15%.

2.2. Market and competition

The institutional "hardware" for a competitive market-based economy is firmly in place. However, in practice, this may not be the case when deals involve individuals with high-level political access. The open tender system is not used for key government contracts as the government pursues a policy of ensuring bumiputera equity, while some smaller government tenders are only open to bumiputera companies. National interest ensures that state-owned enterprises such as Proton, the national car maker, are heavily protected using tax rebates and excise duties. Most public utilities cannot raise prices without government permission. At present there is no law against monopolies although there are no monopolies such as South Korea's chaebols.

The banking system underwent massive consolidation during the review period. This process is driven by the central bank as it prepares the local banking industry for competition when Malaysia has to open up its financial markets in line with WTO requirements. The government's plan is consolidate the 36 financial institutions into six "anchor" banks, all supposedly with adequate capital to compete, at least in the region. There is however, agreement, that Malaysian financial institution cannot hope to compete globally, and that further rationalization may be needed. In 2005 the government made a significant move to liberalize the capital markets when it issued full licenses to selected foreign brokerage firms. Hitherto, foreign brokerage firms had to have a majority Malaysian partner.

Competition will intensify in the coming years as Malaysia implements Free Trade Associations (FTAs) with countries such as United States, Singapore and Australia.

The ASEAN Free Trade Area (AFTA) will also come online by 2008, leading to even fiercer competition.

2.3. Currency and price stability

For the period under review, the Malaysian government has successfully pursued a sound macroeconomic policy. Inflation has been low, around 1.3% in 2004. The Malaysian currency is remarkably stable, in part due to the ringgit peg of 3.8 to the U.S. dollar. The peg was imposed in 1998 during the Asian Financial Crisis. Unfortunately the weakening of the U.S. dollar in the past two years has meant that the ringgit is undervalued by as much as 20% and there is pressure to move to a free-float. The only question is the timing. The government is worried that sudden revaluation of the ringgit will benefit speculators.

2.4. Private property

There is no problem with property ownership rights and the regulation of property acquisition. The economy is overwhelmingly based on private ownership. Nevertheless, the government is a key player in the economy by virtue of being the major shareholder of major utilities companies such as those dealing with power, telecommunications and transport. More than 35% of the market capitalization in the Kuala Lumpur Stock Exchange is owned by Government-Linked Companies (GLCs). The government is officially committed to privatization of as many government assets as possible.

2.5. Welfare regime

There is no state-sponsored social welfare system in Malaysia. Rather, all employees and employers must contribute to a provident fund that can be withdrawn upon retirement. There are some government-run homes but these are mostly for the destitute. The family remains the core defense against social risk. The government has invested heavily in providing basic medical care for all at a nominal cost while specialist care is available at public hospitals at a heavily subsidized price.

2.6. Economic performance

GDP growth has been relatively strong in Malaysia for the past two years. GDP growth was 5.3% in 2003, 7% in 2004 and in the region of 6% in 2005. There was some concern over budget deficit when the last three years of Mahathir's rule when it hit more than 5%, but these fears have come down when the Badawi administration said that it intends to bring the deficit down to below 5% by the end of 2005. As an export-oriented economy, Malaysia's economic performance is tied very much to the global economy and the Chinese economy. If there is a global slowdown, it will affect Malaysia. Likewise, if Chinese revalues the Yuan, it will have a negative effect on Malaysia. Although the official unemployed rate is about 3.4% in 2004, in reality there is full employment. There are currently close to 1.5 million foreign workers (mostly Indonesians, Filipinos and from the Indian sub-continent) in the country.

2.7. Sustainability

Environmental concerns have grown in recent years among citizens, lawmakers and the government. However, the overriding objective of the government is economic growth; environment lobbies have never won a major battle against a key development project. An example is the Bakun Hydroelectric Dam project; despite overwhelming objections from international and Malaysian environmental NGOs, the government is adamant that this project will go ahead. The Bakun Dam project envisages the creation of a lake about the size of Singapore.

Malaysia has a comprehensive education system and a modern infrastructure, and continues to invest heavily in education, especially in science and engineering. Unfortunately, quality issues have emerged regarding public universities - the quality of local academic staff and local graduates is deemed low by international standards. Starting in the 1990s, the government liberalized tertiary education, encouraging foreign institutions to establish campuses in Malaysia and allowing private tertiary institutions to compete with public universities. The government is also actively encouraging foreign students to study in Malaysia.

Malaysia also tried to establish itself as a major information and communications technologies (ICT) hub. The previous administration established a Multi-Media Super Corridor (MSC) to attract international collaboration in investment in ICT. However, these efforts have not been successful.

Despite all these moves, Malaysia is still weak in research and development (R&D). In 2001 Malaysia was ranked 27 in the Technology Index Rank of the World Economic Forum's Growth Competitiveness Index.

3. Management

3.1. Level of difficulty

Throughout the review period, there appears to be three constraints on governance. Firstly, the ruling coalition BN is constrained by the ethnic equation. Although UMNO dominates the coalition, it cannot ignore the interests of other coalition members who represent other ethnic groups, two of which (Chinese and Indian) collectively make up more than one-third of the population. Secondly, there is an increasing trend towards "Islamization", which makes it difficult for the BN to pursue more liberal policies that touch on Islamic sensitivities. Nonetheless, the BN has made remarkable progress and has managed to keep the country on a secular path. Thirdly, there is pressure on the government to provide more opportunities and subsidies to the bumiputera population, in addition to existing affirmative programmes and quotas.

Profile of the Political System

Regime type:	<i>Autocracy</i>	Constraints to executive authority:	2
System of government:	<i>Parliamentary</i>	Effective number of parties:	1.2
Head of State:	<i>Tuanku Syed Sirajuddin Yang di-Pertuan Agong XII of Malaysia</i>		
1. Head of Government:	<i>Mahatir Mohanmad</i>	Cabinet duration:	<i>1981- 19/2003</i>
Type of government:	<i>single party majority</i>	Parties in government:	1
2. Head of Government:	<i>Haj Abdullah b.Hj Ahmad Badawi</i>	Cabinet duration:	<i>31/10/2003-present</i>
		Number of ministries:	26
		Number of ministers:	26

Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Number of ministries/ ministers denotes the situation on 1 January 2005.

3.2. Steering capability

The steering capability of the government is high. As it has been in power since independence, it has near total control of all the state institutions. Policies, especially economic, are drawn up in a fairly rational manner and implemented effectively as

long as they are in line with government priorities. Reviews and reforms of policies are done regularly, although these are often prone to political interference. The government's aim and objectives are widely published and understood by the professional community. The only area of concern is the reluctance of the ruling elite to widen democracy and liberalize politically. There is, however, no reluctance to reform the economy or to adopt new economic policies.

3.3. Resource efficiency

The government makes efficient use of available economic and human resources for its economic and social policies. Reforms of the financial markets, banking sector and corporate sector have been largely adequately planned and effectively implemented. The government bureaucracy is relatively professional although politics have ensured that it is almost totally dominated by bumiputera. At the elite Malaysian Administration and Diplomatic Service (PTD), there is a quota of 4:1 (bumiputera: non-bumiputera) in its composition. The government regularly consults experts and takes input from the private sector when it draws up the budget and economic policies. Major conflicts over economic or social policies are effectively dealt with at the cabinet level. Corruption in the civil service is probably the lowest in the region after Singapore.

However, those awarded public infrastructure projects and privatization exercises are often seen as cronies of the ruling parties; political considerations are the most important criteria for the awarding of big contracts. There is evidence of rent seeking behavior.

There is also concern over the government's continued indirect subsidies for 'national' projects such as the national carmaker Proton. Many of these projects were initiated under the previous Mahathir administration. The new Badawi administration has said that there will be a major review of these "mega-projects" and that the thrust of the present government will be on social capital.

3.4. Consensus-building

All major political and social actors agree on the goal of a market-based economy. There is no politically relevant actor who can derail either the reform process or the deepening of the market economy. On liberal democracy, however, there is no consensus. Due to the structure of the ruling coalition, political competition between the different ethnic groups and a major religious divide between Muslims and non-

Muslims, different groups have diverse ideas about democracy. The official government stand is that liberal democracy as practiced by the West is unsuitable for a pluralist country like Malaysia. It is of the opinion that full democracy will lead to chaos, attested by the racial riots in 1969. The Islamists, on the other hand, reject democracy out of hand and want Malaysia to be a theocratic state. They see moves to strengthen western-style democracy as un-Islamic. Racial identification is so strong that moves to promote consensus such as *Bangsa Malaysia* (Malaysian race) are met with strong resistance by the various ethnic groups who sees it as an attempt to dilute their culture, language and religion.

3.5. International cooperation

Malaysia became a major player on the international scene when it simultaneously assumed the administration of both the Organization of Islamic Conference (OIC) and the Non-Aligned Movement (NAM) in October 2003. It has taken a strong stand against terrorism, against the war in Iraq and against failure of the West to help developing countries. On the economic scene, it prides itself as the only nation to reject IMF advice during the Asian Financial Crisis. Instead, it pegged its currency, ringgit. Despite this, the government remains fully engaged with the World Bank, IMF, ADB and other international financial institutions.

Malaysia is active in promoting “South-South” (Langkawi) dialogues, which bring mostly leaders of African countries to Malaysia to discuss economic and trade cooperation. Despite Malaysia’s strong anti-Western stand on key political issues, it has excellent trading links with the world. The government has skillfully separated trade from political issues.

The cornerstone of Malaysian foreign policy remains the Association of South East Asian Nations (ASEAN).

4. Trend of development

4.1. Democratic development

Malaysia has never been a fully democratic or an authoritarian country. Elements of both democracy and authoritarian can be found. The country’s multi-religious, multi-cultural and multi-ethnic population guarantees that development of a fully-fledged liberal democracy will be difficult. Since independence, the government has sought to concentrate on economic development rather than political development, believing

that once Malaysia is fully industrialized and developed, many of the contentious issues can more easily be resolved.

One negative development is the landslide victory of the BN in the March 2004 General Elections. The Opposition was pretty much wiped out and it currently holds less than 10% of the seats in Parliament. There is virtually no checks-and-balances mechanism for the term of this Parliament (2004-2009). On the positive side, the party that suffered the heaviest defeat was the Islamists' party PAS, which advocates the creation of a theocratic state.

One positive development in the period under review is the mushrooming of NGOs. Many of these groups promote democracy, human and women rights, the environment and inter-faith harmony. Easy access to the Internet has allowed these groups to organize and publicize their actions and goals and to recruit new members.

4.2. Market economy development

When Abdullah Badawi took over as PM on 31 October 2003, he announced that he will "get back to basics" concerning the economy. This was in stark contrast to Mahathir his predecessor. Mahathir was famous for his "mega projects" such as the world's tallest building, a new capital city and a national car project. Badawi promised to cut down the budget deficit to within 5% and a balanced budget by 2007. More significantly, Badawi revamped the GLCs such as Telekom, Tenaga Nasional (national power corporation) and Malaysian Airlines. New executives were appointed to these GLCs including a new chief executive for Khazanah Nasional, the government's investment holding company. Temasek Holdings, the investment arm of the Singapore government, was allowed to buy significant stakes in GLCs and a bank. Badawi also broke precedence by appointing a professional to be Finance Minister (II). The markets generally approved these economic reforms.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	8.5	0.3	4.1	5.3	7
Inflation in % (CPI)	1.5	1.4	1.8	1.2	1.3
Unemployment in %				3.6	3.4
Budget deficit in % of GDP	5.8	5.5	4.7	5.4	4.5

Source: Asian Development Bank; Statistics Dept, Malaysia

D. Strategic perspective

The overall picture of economic and transformation in Malaysia is a positive one. The government has consistently pursued rational and sound economic policies and it is committed to growth and further liberalization of the market.

However, institutional problems remain in democratic transformation. Ethnic tensions and the management of ethnic relations remains a perennial problem. The management of these relations has a direct bearing on the pace of democratization. While the majority of the Muslim population is moderate and progressive in its outlook, there is an active and vocal minority that advocates fundamentalist Islam, including the setting up of a theocratic state to replace the present one. Some of these radical groups advocate violence to achieve their aims. The government, backed up by an efficient security apparatus, has been able to thwart various attempts and many of these groups are now operating underground. These groups are not a threat to the nation-state as long as they remain outside mainstream Islam. There are encouraging signs that the main Islamic party, PAS, has rejected these fundamentalist groups and are willing to play by the rules, i.e., winning power through the ballot box.

On the economic front, much remains to be done. The Malaysian economy has to transform itself into a more efficient economy with priorities in the services sector. The financial sector, especially the banking sector, needs to consolidate further. None of the Malaysian banks has the capital or the expertise to compete against foreign banks. The greatest challenge will be on the manufacturing sector as AFTA will become a reality by the end of the decade. The manufacturing sector cannot hope to compete with cheap labor countries such as Vietnam and Indonesia. Their only choice is to move up the technological ladder. This transformation has already begun. The government must also tackle the issue of increasing gap between the rich and poor.