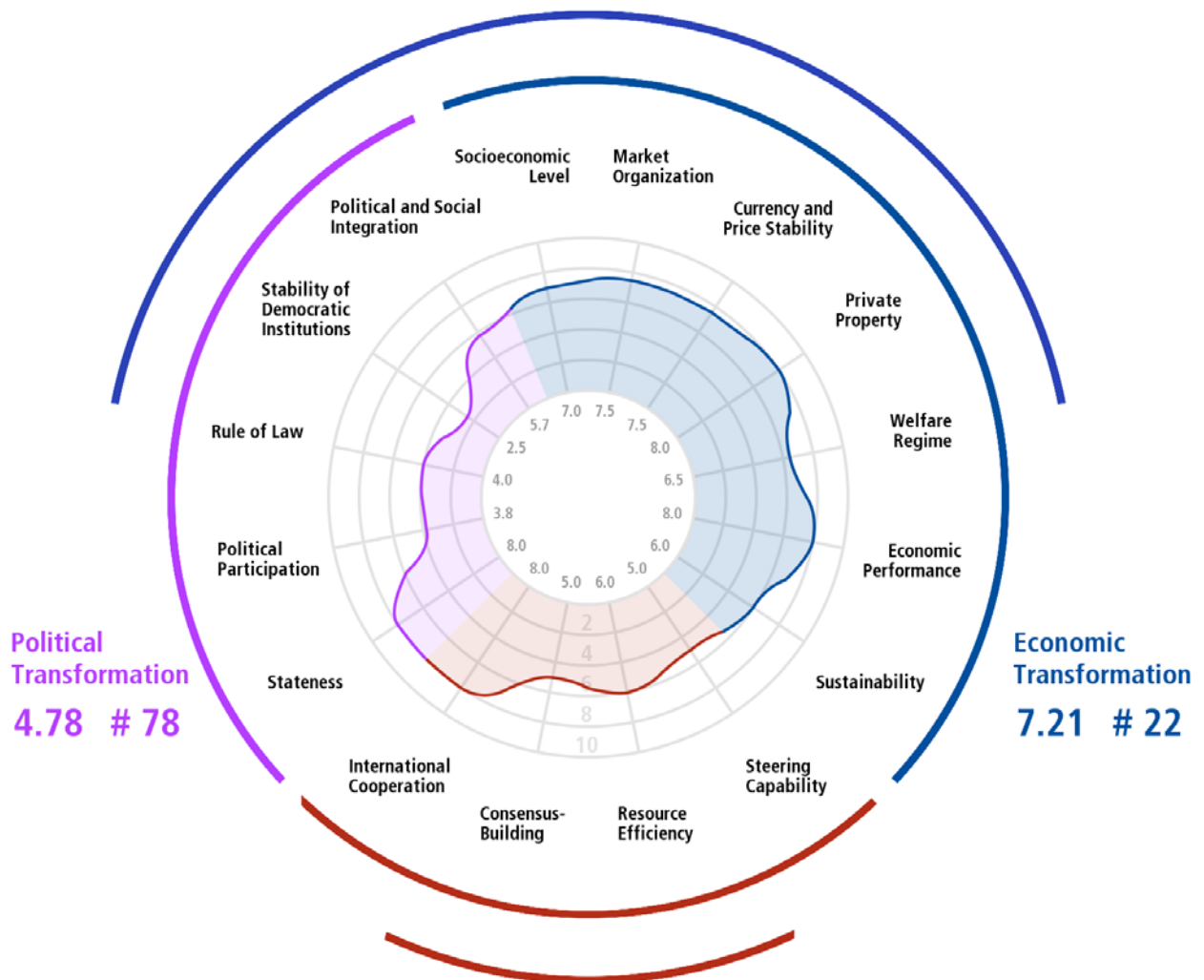


Malaysia

Status Index

6.00 # 53

on 1-10 scale out of 129



Governance Index

5.20 # 54

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	31.2	HDI	0.789	GDP p.c., PPP \$	27681
Pop. growth ¹	% p.a.	1.5	HDI rank of 188	59	Gini Index	46.3
Life expectancy	years	75.2	UN Education Index	0.717	Poverty ³	% 3.1
Urban population	%	75.4	Gender inequality ²	0.291	Aid per capita \$	0.0

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

Malaysia's democratic transformation stalled or even reversed between 2015 and 2017. In contrast, its economic transformation produced mixed results. During the period under review, a massive scandal involving a state development fund, 1 Malaysia Development Berhad (1MDB), negatively impacted on the country's economic and political transformation. In July 2015, several newspapers published evidence that directly connected Prime Minister Najib Razak to money that had gone missing from 1MDB. The reports indicated that some \$700 million had been transferred from the fund to the prime minister's personal bank accounts. The prime minister strongly denied wrongdoing, claiming that the money came from Saudi Arabian donors. The upheavals that resulted and the Malaysian government's response to them severely undermined democratic norms. Institutionally, the government passed several new laws, such as the National Security Council Act 2016 and the Prevention of Terrorism Act 2015, in order to further constrain opposition. It also made extensive use of the new Sedition Act, and Communications and Multimedia Act. These actions indicate that the Malaysian government is unwilling to allow any democratic change that could challenge its power. It focused intently on opposition leaders and societal activists, as well as critics within the dominant party, the United Malays National Organization (UMNO). This included the deputy prime minister, who has been critical of the prime minister's involvement in the 1MDB scandal, and many media outlets, such as financial newspapers and online media sites. During the period under review, one of the largest independent online news sites in Malaysia, the Malaysian Insider, was closed down due to financial problems, which had been exacerbated by the government's blocking of the website after the news site covered the 1MDB scandal. Accordingly, the period 2015 to 2017 must be seen as a period of democratic rollback for the Malaysian political system, which will further limit the competitiveness of the next general election, expected in late 2017 or early 2018.

Malaysia's economic transformation from 2015 to 2017 was more positive. However, the implications of the 1MDB scandal were also visible in the economic sphere. The poor performance of the 1MDB fund and the unclear involvement of the Malaysian prime minister, who is at the

same time the country's finance minister, diminished foreign investors' confidence in the country's political leadership and prospects. A weak ringgit, and low petroleum and palm oil prices on the global market put Malaysia's economy under pressure during the period under review. Although the Malaysian central bank unexpectedly cut its benchmark interest rate by a quarter point to 3% to bolster economic growth in July 2016, the ringgit stood at MYR 4.43 to \$1 in January 2017, not far from its historic all-time low of MYR 4.71 to \$1 in January 1998. However, several economic reforms undertaken by the Malaysian government indicated that the government is committed, at least when facing balance of payments deficits, to transform the country's economy into a more market-based economy. To this end, it reduced subsidies on cooking oil, rice and wheat flour, producing a positive impact on the federal budget. Low unemployment rates, GDP growth rates between 4% and 5%, and moderate inflation rates indicate that the state of the country's marketization has advanced far more than the country's democratic transformation. A roadmap to broader economic reforms was laid out in the 11th Malaysia Plan (2016-2020) which was tabled in parliament in May 2015 and which specifies the government's economic development policies.

History and Characteristics of Transformation

The Federation of Malaysia was established in 1963, combining the territories of Peninsula 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 has adopted forms of 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 (the 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, 26 of which are indirectly elected by the states, while the other 44 are appointed, at least formally, 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 originally came to Malaysia during colonial times, when the British actively recruited them to help in developing a commodities-based economy. After independence, the British left political power largely in the hands of the indigenous Malays. The Malay leaders organized the United Malays National Organization (UMNO), then forged a perennially victorious electoral coalition with the major Chinese and Indian parties, the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC). After the May 13, 1969, incident (see below), this coalition was labeled the National Front (Barisan Nasional, BN). This set a pattern in which the office of the prime minister was to be occupied by a Malay from UMNO. The current president of UMNO, Najib Tun Razak, is Malaysia's sixth prime minister. He is the eldest son of Abdul Razak, who was the second prime minister of Malaysia. However, this alliance

system was transformed 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. The 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 market economy to develop. The government left the non-Bumiputera with a free hand in many economic sectors, as long as positions and ownership stakes were allocated on a quota basis to Malays. This strategy, which emphasized economic growth with ethnic redistribution, was funded by significant foreign direct investment during the 1970s and early 1980s. Indeed, this was so successful that Malaysia became one of the “Asian Tiger” economies. Although the NEP officially ended in 1991, economic policies since that time have changed little in character. They continue to include special rights for the Bumiputera, while at the same time promoting rapid economic growth to ensure that all ethnic groups receive their share of the economic pie.

The government has been headed by the UMNO since independence, while the ruling coalition, the BN, has won every general election since its formation. Before 2008, the BN regularly achieved more than a two-thirds majority in parliament, allowing it to amend the constitution at will and giving the executive the leeway to pursue policies without significant opposition. Having successfully managed the economy, the government has been able to claim that Malaysia will be a fully developed and industrialized country by 2020. Today, Malaysia is generally regarded as a success story among developing countries in the sense of maintaining a stable and growing economy. However, the polity has become significantly unstable in the past years, mainly due to increasing ethnic-religious conflicts.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The Malaysian state's monopoly on the use of force is established nationwide in principle, although it is challenged by minor guerrilla groups active on and off the coast of Borneo. In addition to international disputes in the South China Sea, which do not touch on questions of the state's monopoly on the use of force, but have to do with contested national boundaries, and issues of regional cooperation, such as the territorial conflicts with Thailand in the southern area of the Gulf of Siam remain active. In addition to this conflict, Malaysia's inability to effectively control its border with Thailand was evident on at least two different occasions during the period under review. On August 11 and 12, 2016, terrorist attacks in Thailand caused four deaths. According to security officials, most of the bombs used in the attacks were assembled in Malaysia and moved across the border. Furthermore, Malaysian SIM-cards were used to trigger the bombs, indicating that Thai southern insurgents moved across the Thai-Malaysian border. As a reaction to these security problems, Malaysian and Thai officials discussed the possibility of building a wall along the border to minimize the illegal flow of weapons, insurgents, goods and labor in September 2016.

The inability of Malaysian security officials to effectively secure its borders in the northern part of the Malaysian peninsular had already been demonstrated in May 2015, when Thai and Malaysian police discovered more than 100 mass graves of human trafficking victims in Songkhla province and Perlis on both sides of the Thai-Malaysian border. Most of the victims are believed to be Rohingya people from Burma and Bangladesh. In the past, U.S. and U.N. officials repeatedly criticized Malaysia's inability to fight human trafficking and questioned whether government officials were involved in the trafficking in both countries. Trafficking in people and drugs with the possible collaboration of security officials constitutes a potential threat to the concept of a Malaysian state.

Malaysia's territorial dispute with the Philippines over the northern part of Sabah on the island of Borneo remains unresolved. In addition to this dispute, insufficient

Question
Score

Monopoly on the
use of force

9



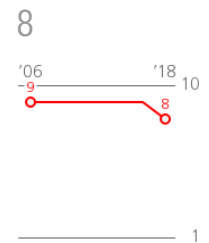
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border controls along the coast of Sabah led to several kidnappings and killings during the period under review. Although security forces belonging to the Eastern Sabah Security Command (ESSCOM) increased their activities, the danger of kidnappings by fighters of the extremist Abu Sayyaf group increased in 2016. The Abu Sayyaf group identified Sabah as a hideout after the Filipino government increased their operations against the extremists in June 2016. The group is believed to be responsible for the kidnapping of several fishermen in September 2016. In 2016 alone, 16 people were kidnapped in Sabah, the highest number in the last decade. As a reaction to the kidnappings, the Malaysian government deployed 20 armored vehicles and four helicopters, and installed radar and coastal surveillance systems at five locations on Sabah's east coast in September 2016. In December 2016, security forces killed one member of the Abu Sayyaf in a shootout in waters off Sabah and two more members in Lahad Datu in eastern Sabah.

Most Malaysian citizens accept the nation-state as legitimate. However, citizenship rights vary across ethnic and religious communities, with non-Bumiputera communities confronted by systematic discrimination in the distribution of state benefits. Malay-Muslim identity strongly shapes the procedures and policies associated with Malaysian state. Ethnic Malays dominate the country's key political institutions, such as the parliament, the bureaucracy and the security forces. Thus, the prime minister, as well as head of state, the Yang di-Pertuan Agong, must be Malay. This Malay predominance draws criticism from Indians and Chinese, who make up 30% of the population and report feeling like second-class citizens. In addition, indigenous groups in Sabah and Sarawak, although classified as Bumiputera, have repeatedly voiced discontent with Malay dominance in their states. Calls for greater autonomy and even independence grew louder in Sabah and Sarawak during the period under review. These sentiments were echoed by advocacy groups, such as Sarawak for Sarawakians, which reject the notion of a Malaysian nation-state. Although these advocacy groups did not receive widespread support, the debate about the degree of autonomy for the east Malaysian states of Sabah and Sarawak became an important political topic in 2016. Since the governing Barisan Nasional (BN) coalition heavily depends on support from these two states, the demands for independence (or at least greater autonomy) must be seen as a serious threat to state identity. Demands for greater autonomy for both states are based on the so-called 20 points, which consist of assurances made by Malaysian government officials to Sabah and Sarawak when the Malaysian government proposed forming a federation with both states in 1963. To ease tensions between West and East Malaysia, the government promised to transfer some bureaucratic powers back to the two east Malaysian states. However, there has been little substantive progress in this regard.

The Malaysian constitution defines the state as secular, but Islam has considerable influence on the Malaysian legal system and the country's political institutions. Although Malaysian law is mainly based on the common law legal system, state Shariah courts operate alongside civil courts in civil matters. Though the Shariah

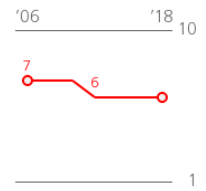
State identity



No interference of religious dogmas

6

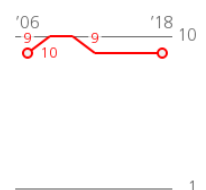
courts have jurisdiction only over matters involving Muslims, they remain highly influential in general, because their decisions frequently involve conversions to Islam, which in turn affect such matters as child-custody, burial rites and inheritance. The policy record is not consistently Islamist in tone, however. In November 2016, the Malaysian government tabled an amendment to the Law Reform (Marriage and Divorce) Act which explicitly states that the consent of both parties in a civil marriage is needed for their child to convert to Islam. The amendment also applies to those cases which are still pending in the courts. It states too that a child remains in the religion of his or her parents at the time of marriage, should one of the partners later convert to Islam. Civil rights groups view the amendment as strengthening the rights of non-Muslims parents. Even so, an overall trend persists in which Islam is gaining influence over the Malaysian legal system. In May 2016, the Malaysian government allowed a private member's bill to be tabled by the Islamist opposition party, PAS. This bill would allow stricter punishments under Shariah law, known as hudud, to be introduced in the state of Kelantan. More specifically, the bill would amend the Shariah Courts (Criminal Jurisdiction) Act 1965. Although the amendment only applies to the Muslim population in the state of Kelantan, non-Malay parties within the ruling coalition and secular opposition parties have strongly opposed the bill. In addition, civil rights activists strongly criticized the planned amendments since the stricter punishment would even allow whipping and amputations as punishment for specific crimes. In addition, the polarization of the Malaysian society with regard to the question of how far religious norms define daily public life for all Malaysians became evident in a series of incidents over the course of 2016, when the Malaysian Islamic Development Department (Jakim) criticized several food chains over their lack of halal food. Jakim's campaigns even against global food giants can be seen as evidence of the deepening influence of Islamist agencies and polices in everyday life in Malaysia.



The Malaysian state has a differentiated administrative structure throughout the country, providing all basic public services. A reasonably well-trained and professional administration implements the policies of elected Barisan governments at the federal and state levels. However, outside technical departments, the civil service recruits few non-Malays/Muslims. And where parties in opposition at the federal level win power at the state level, civil servants often display little cooperation with the respective state governments. The state is mostly able to fulfill its proper jurisdictional functions and enforce laws throughout the country, though sometimes in highly partisan ways. The country's transport network is diverse and well developed, with a particularly extensive road network. According to the government's 11th Malaysian Plan which was published in May 2015 major infrastructure projects such as the Pan-Borneo Highway in eastern Malaysia, which would stretch from Sabah to Sarawak, and the West Coast Expressway should be completed by 2020. The first phase of the Klang Valley Mass Rapid Transit (MRT) opened in December 2016, significantly improving the traffic options for commuters

Basic administration

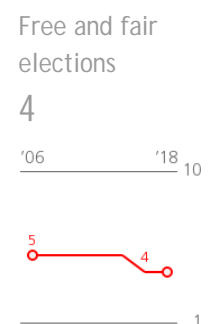
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around the capital. The same month, Malaysia signed with neighboring Singapore a bilateral agreement for a high-speed train connecting the two capital cities. The railway will be about 350 km long and the travel time will be 90 minutes, significantly decreasing the travel time between the two cities. Some trains will also make stops along the Malaysian west coast, thereby improving travel within Malaysia too. Another important infrastructure project was initiated in October 2016, when the Chinese government announced that it will provide low-interest loans for the East Coast Rail Line project (ECRL). The line is planned to run through four Malaysian states and will connect Port Klang on the west coast with Tamput on the west coast. Doubts have arisen, however, over the opaque ways in which contracts for these rail projects were awarded to state-owned companies based in mainland China. Meanwhile, infrastructure in the states of Sabah and Sarawak remains underdeveloped compared to peninsular Malaysia. Only 96% and 98% of the population, respectively, has access to water sources and sanitation, indicating that infrastructure problems continue to persist in East Malaysia since nearly all citizens have access to a water source in West Malaysia. However, serious droughts in recent years have depleted West Malaysia's water reservoirs, especially in the state of Johor.

2 | Political Participation

Malaysia has established universal suffrage (over age 21) and regularly holds general elections at the state and federal levels at intervals required by the government. Opposition parties are able to run in the country's elections and political posts are generally filled according to the electoral outcome. Despite this fact, elections cannot be considered free and fair. The ruling coalition, the Barisan Nasional (BN), frequently uses repressive laws to restrict the opposition and control the media. Extreme gerrymandering and malapportionment of constituencies, the use of government resources during campaigning and electoral fraud including manipulation of voter registration rolls reflect an abusive and authoritarian strain within the BN government. These undemocratic attitudes were clearly displayed in the Sarawak state elections in May 2016. The ruling BN won a two-thirds majority while the opposition parties lost five seats compared to the last elections in 2011. The opposition now controls only 10 out of 82 seats in the Sarawak state assembly. The poor results for the opposition were not only related to internal fights and friction, but can also be explained by the uneven playing field between opposition parties and the ruling BN. Most importantly, opposition politicians from West Malaysia were repeatedly prevented from entering Sarawak. The travel restrictions on opposition politicians such as Amanah's Mohamad Sabu were directly ordered by Sarawak's state government. In addition, the Coalition for Free and Clean Elections (Bersih) reported several incidents of vote buying in the days before the elections, leading it to demand the resignation of the chairman of the Malaysia's highly partisan Election Commission (EC). Bersih also reported that threats and intimidation were directed at members of the opposition. On election day, some voters claimed that they were

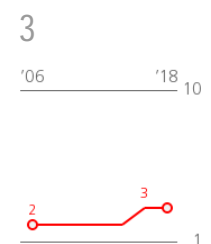


offered envelopes containing between MYR 20 and MYR 40, provided they supported the ruling BN. In addition, the revision of electoral boundaries in 2015 tilted the electoral playing field further in favor of the ruling BN. First, the creation of more rural seats ordered by the EC and ratified by the Barisan-controlled parliament favors the incumbent government. Since the BN has more resources to campaign in these constituencies by using helicopters instead of boats as the opposition does, rural seats are usually won by the government. Second, the delineation process exacerbated malapportionment, which increased the already deep disparities in the number of voters across constituencies. It is noticeable that the country's three largest constituencies are all urban seats with a majority Chinese population. Historically, opposition parties fared best in these areas. In Sarawak, the constituency with the lowest number of voters is Sadong Jaya at 6,749, while the most populated seat is Pelawan with 32,233 voters. These problems indicate that the electoral process in Malaysia suffers from several irregularities.

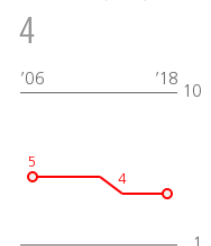
Political decision-makers come to office through elections but contestation is neither free nor fair. Members of the upper house of parliament, who may hold cabinet positions, are appointed rather than elected. Actual policy-making occurs mostly in the cabinet with the prime minister as the dominant force within this circle. In principle, the government's effective power to govern is unhindered by potential veto-holders such as the military, clerics, landowners, business elites or external actors. However, it is worth remembering that after the current prime minister, Najib Razak, came to power, he was prevented by nativist groups (e.g., Perkasa) from implementing reforms that would have brought more equality of economic opportunity to Malay and non-Malay business communities. On the other hand, during the 1MDB scandal, it became clear that the prime minister holds almost unlimited power over government appointments, enabling him to remove any officeholder within the government and state bureaucracy who challenged his massive accumulation of funds. As a result, the deputy prime minister, the rural and regional development minister and the attorney general were dismissed while key members of parliament's Public Account Committee were transferred.

Association and assembly rights are seriously limited. Federal laws such as the Societies Act ensure that organizations critical of the government can be banned or refused registration. According to the website of the Registrar of Societies, 36 organizations have been denied registration in the first nine months of 2016. Even when political parties or other organizations are granted registration, the Registrar of Societies may hold officeholders liable or dissolve the group in the event of rule violations or irregularities. Opposition parties and NGOs that accept contributions from foreign sources are vulnerable to harassment or formal charges. Malaysian trade unions are strictly controlled under the Trade Unions Act and the Industrial Relations Act. The Peaceful Assembly Act guarantees Malaysian citizens the right to assemble. Though the law is less restrictive than the Police Act which regulated the procedures to assemble beforehand, citizens who want to exercise their assembly rights still face

Effective power to govern



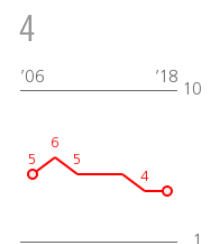
Association / assembly rights



intimidation, harassment and threats by various group. An alarming trend during the period under review involves the government's use of various auxiliary groups, such as the nativist Red Shirt Movement, to harass non-Malay protesters and even small business people. When opposition and student activists demonstrated in August 2016 against the government in the wake of the breaking 1MDB scandal and demanded the arrest of the prime minister, the police called in activists for questioning and investigated whether participants of the rally should be prosecuted for seditious remarks. Although no participant was imprisoned, this behavior by security officials clearly displays the government's tactic of intimidating people who are critical of the leaders in power. This pattern of behavior was also visible before a rally organized by Bersih in November 2016, when political activist, rally organizer and Bersih co-chairperson Maria Chin Abdullah was taken into custody under the Security Offences (Special Measures) Act 2012 on November 18, 2016, one day before the rally. She was released after 11 days in detention.

Freedom of expression is increasingly limited in Malaysia. Laws such as the Official Secrets Act (OSA) and the Sedition Act restrict freedom of information and of speech. All mainstream media outlets are indirectly controlled by the government through companies such as Media Prima Berhad or Utusan Melayu Berhad, both of which have close links with the UMNO. While online media was able to operate in relative freedom in the past, the government cracked down on several online outlets. In sum, the degree of freedom of expression has deteriorated severely in Malaysia since 2015. The reason for the government's harsh crackdown on independent media outlets was the coverage of the 1MDB scandal. In July 2015, the London-based online news site Sarawak Report and the Wall Street Journal presented material which directly connected Prime Minister Najib to money that went missing from the state investment fund 1Malaysia Development Berhad (1MDB). The reports indicated that \$700 million from the fund were wired to the prime minister's bank accounts. As a direct reaction to these reports, the Malaysian Communications and Multimedia Commission (MCMC) blocked access to Sarawak Report's news site and other news sites under the Communications and Multimedia Act (CMA) when these sites further investigated the scandal. The Malaysian Insider, one of the largest independent online news sites in Malaysia, had to go offline due to financial problems which were caused by the government's blocking. The censorship of online news media is in stark contrast to an announcement made by the Malaysian prime minister in 2011 in which he promised to refrain from censorship of online media. During the period under review, the Malaysian government also took draconian measures against independent journalists who published reports critical of the government. Four journalists of the Malaysian Insider had been arrested earlier in 2015. In March 2016, two Australian journalists were arrested in Kuching. Though no official charges were brought against the journalists, the two had to leave the country immediately. The government also issued a warrant against the editor of Sarawak Report. In addition to these arrests, the Malaysian government made repeated use of the Sedition Act to silence activists,

Freedom of expression



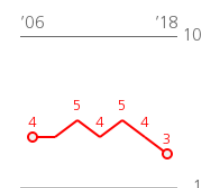
journalists and members of the opposition. In November 2016, well-known political cartoonist Zulkiflee Anwar Ulhaque, also known as Zunar, was arrested under the Sedition Act and held in custody for one day. The same month, MCMC officials raided the office of the independent online news site Malaysiakini. After the raid, the International Federation of Journalists criticized the government and urged the officials to refrain from any intimidation tactics against journalists. In 2015 alone, 91 people were arrested, investigated or prosecuted under the Sedition Act, an all-time high. In summer 2016, the government announced its plan to amend the CMA. Activists fear that the planned amendments would further restrict freedom of expression.

3 | Rule of Law

While the constitution provides a structure for the separation of powers, the executive has disproportionate power, frequently influences the other two branches of government and even increased its influence during the period under review. In December 2015, the Malaysian parliament passed the National Security Council Act 2016 which provides wide-ranging powers to the prime minister. According to the law, the prime minister can, together with the Security Council that he appoints, designate any area in the country a “security area.” In these areas, any restraints on police powers are suspended, and authorities have the right to conduct arrests, searches and seizures without warrants. The suspension of basic freedoms in these areas can be valid for up to six months. Although the parliament has the right to block the designation of security areas, in practice there seems little that prevents the prime minister from exercising full discretionary powers. The law was widely criticized among opposition politicians, activists and human rights groups. The European Parliament passed a resolution in December 2015 in which it called for the act’s repeal. The chief executive’s dominance was made evident in additional ways during the period under review. After several newspapers extensively covered the prime minister’s connection to the 1MDB scandal and critical voices within the different branches urged the prime minister to address the allegations, the prime minister swiftly moved against his critics. Deputy Prime Minister Muhyiddin Yassin and Rural and Regional Development Minister Shafie Apdal were forced to resign from their posts. In addition, the Attorney General Abdul Gani Patail was sent into early retirement, citing health reasons. The move, however, was widely perceived as politically motivated since the attorney general had established a task force to investigate the allegations against the prime minister and was even said to have drawn up a charge sheet. The strong executive influence on the legislative branch became evident when the parliamentary Public Account Committee that was investigating the scandal was dissolved and four of the committee’s members were removed by “snap promotion” to the cabinet. In December 2016, former opposition leader Anwar

Separation of powers

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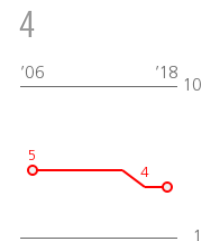


Ibrahim lost his final appeal against his conviction on sodomy charges when the Federal Court unanimously rejected Anwar's application for a review.

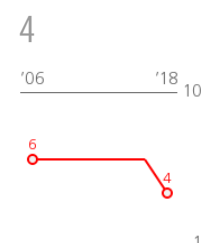
The judiciary is institutionally differentiated and has formal ability to interpret and review legislation and policies. Channels of appeal are in place, and the court administration appears to function reasonably efficiency. However, in practice, the judiciary possesses partial autonomy from the executive. Indeed, it typically performs a passive legitimating role. Yet during the period under review, there were important exceptions to this pattern. Specifically, after an opposition politician, Mat Shuhaimi Shafiei, and a blogger, Muhammad Safwan Bin Anang @ Talib, were convicted of sedition, the Court of Appeal ruled that the convictions were unconstitutional. These rulings can be seen as evidence of judicial autonomy. But these displays of autonomy are unusual. More typical was the Federal Court's decision to reject former opposition leader Anwar Ibrahim's final appeal against his conviction on sodomy charges. In addition, a court sentenced an opposition Parti Keadilan Rakyat (PKR) lawmaker, Rafizi Ramli, to 18 months in prison for releasing classified information related to the 1MDB scandal in November 2016. Specifically, Rafizi used official documents to show that 1MDB's losses were impacting on pension fund payments made to the country's military veterans.

High-level officeholders who break the law and engage in corruption are rarely prosecuted adequately. But owing sometimes to media attention and the ceaseless dissemination of rumors, they may attract adverse publicity. Efforts to hold high-level officeholders accountable for corruption can be gauged in light of the 1MDB scandal: the executive has consistently obstructed investigations, and cracked down hard on groups and individuals who have reported on, or even discussed through social media, the role of the prime minister in the scandal. The government's influence over the Attorney General's Chambers and the Malaysian Anti-Corruption Commission (MACC) became evident when the attorney general issued a statement in August 2015 clearing the prime minister of all allegations in the 1MDB scandal, and ordered the MACC and other regulatory bodies to cease their investigations. In August 2016, MACC chief Abu Kassim stepped down from his post two years ahead of his contract completion date. Two of his deputies also left the commission. The change at the top was seen as strong evidence of the government's influence on the commission. In addition, Abu Kassim was accused of a plot to topple the government by the youth wing of the ruling UMNO, actions that amounted to severe harassment. On August 1, 2015, the police arrested a deputy public prosecutor with the MACC, a former MACC adviser and an official from the Attorney General's Chambers due to allegations that they had leaked information related to the 1MDB scandal to the press. At lower levels in the civil service, however, prosecution over corruption frequently takes place. During the period under review, several government officials were prosecuted over corrupt practices. In January 2017, officials arrested the secretary-general of the rural and regional development ministry, and his two sons after gold assets and cash worth about \$600 million belonging to the three were discovered in

Independent
judiciary



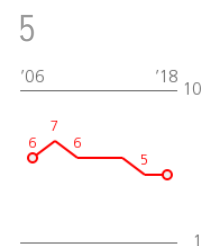
Prosecution of
office abuse



several safe deposit boxes. One month earlier, a former director of the Sabah water department, his wife and a former deputy director were charged due to corrupt practices. Despite these arrests, however, the MACC seems on balance to be an extension of the executive branch and a toothless tiger when it comes to fighting corruption within the government's topmost ranks. As a result, high-ranking government officials who break the law can do so without the fear of legal consequences.

Civil rights are constitutionally guaranteed but are nevertheless violated. Mechanisms and institutions to prosecute, punish and redress violations of civil rights are partly in place, but often prove to be ineffective. The Malaysian authorities' attitude toward civil liberties remains ambivalent. During the period under review, discrimination based on political allegiance significantly increased. The government's frequent use of the Sedition Act resulted in 91 arrests, charges and investigations for sedition in 2015 alone. Although the judiciary ruled in several cases that the charges under the Sedition Act were against the law, the act remains one of the most important instruments for the Malaysian rulers to keep the opposition in check. In addition, the government violated civil rights such as freedom of expression by silencing opposition activists and journalists with the help of the Communications and Multimedia Act. Furthermore, the passing of the Prevention of Terrorism Act 2015 (POTA) in April 2015 indicates the government's intention to deny the protection of basic civil rights. Under the new law, Malaysian authorities can detain terror suspects without trial for a period of two years. Human rights groups such as Amnesty International and Human Rights Watch heavily criticized the passage of POTA and urged the government to abolish the law. With the National Security Council Act 2016 in August 2016, the government can now suspend basic civil rights in designated areas.

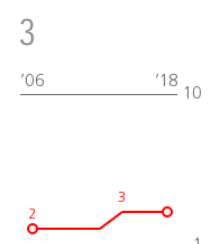
Civil rights



4 | Stability of Democratic Institutions

The democratic content of Malaysia's political institutions is weak, but not nonexistent. Malaysia's system amounts to what may analysts label as a hybrid or electoral authoritarian regime. Further, the key institutions that make up this regime type are exceedingly stable. In this arrangement, the executive's dominant position greatly restricts the separation of powers, as well as horizontal and vertical accountability. As underscored throughout this assessment, the prime minister and key cabinet members make all major decisions, with the parliament clearly subordinated to these institutions. The judiciary is subject to interference by the executive. Opposition parliamentarians' rights are frequently violated. Local governments in cities and towns are appointed by the political parties that control the respective state government and are unable to function independently, being subject to both party pressures and separately appointed local officials. Despite Malaysia's formal federal structure, a very high level of fiscal and administrative centralization

Performance of democratic institutions



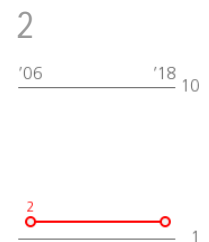
limits the ability of state and local governments to function effectively. In September 2016, the highly partisan Election Commission published its redelineation exercise of parliamentary and state boundaries as a prelude to the next general election. Members of the opposition and the state government of Selangor criticized the redelineation exercise, and complained that the proposed plan heavily favors the ruling coalition and would help to strengthen the government's victory in the next general elections. Opposition activists filled a suit against the exercise. Several analysts stated that at least 68 parliamentary seats and 162 state seats are either excessively under-represented or excessively over-represented under the latest redelineation. The heavily pro-Barisan constituency of Putrajaya, populated largely by civil servants, for example, would have 15,991 voters, while the pro-opposition constituency, Kapar, would have 144,159 voters, further exacerbating the extraordinary maldistribution that prevailed even before the redelineation exercise. The frailty of democratic institutions was further evidenced by the utter inability of parliament to resist this measure.

The deficiencies mentioned above mean that Malaysia's political regime must be classified as one of (moderate) authoritarianism. While the Barisan Nasional (BN) government is not committed to liberal democracy, it does work through national, state, and local governments, and it has allowed occasional judicial decisions that go against the government's preferences. However, during the period under review, the UMNO-dominated government made extensive use of the Sedition Act and the Communications and Media Act to silence opposition activists including those in elected office. In addition, the enactment of new repressive laws, such as National Security Council Act 2016 and the Prevention of Terrorism Act 2015, indicate that the Malaysian government does not plan to change its autocratic modus operandi in order to remain in power. Civil society groups and other organizations make use of the judicial system as well as encouraging voting and informal lobbying in support of particular policies, suggesting that some of these actors do appear to accept such institutions as legitimate. The military has never openly challenged civilian supremacy or state institutions.

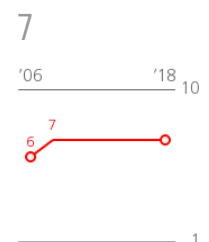
5 | Political and Social Integration

The Malaysian party system is fundamentally established and rooted in society. During the period under review, the polarization and the fragmentation of the party system significantly increased as evidenced in the breakup of the opposition coalition Pakatan Rakyat and the foundation of several new political parties. At the moment, the ruling coalition Barisan Nasional (BN), the Parti Islam Se-Malaysia (PAS), and the newly formed opposition coalition Pakatan Harapan compete for votes. The fragmentation of opposition parties had a negative impact on their percentage of votes in the Sarawakan state elections, while the BN profited from this development and seems to be well-positioned for the next general elections. Despite these

Commitment to democratic institutions



Party system



developments, the party system is still far more resilient in Malaysia than in numerous other countries in the region.

The ruling coalition, the BN, comprises of 13 parties, most of which represent an ethnic group or (for Sabah and Sarawak) a state. Historically, the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC), along with the largest party, the United Malays National Organization (UMNO), have formed the backbone of the BN. Since the 2008 general elections, the MIC and the MCA lost support among their respective ethnic groups. During the period under review, however, the results of by-elections seem to indicate that Barisan is regaining some support among minority communities. In this context, top MCA politicians have retaken ministerial posts within the cabinet. At the same time, UMNO has strengthened ties to religious scholars and the PAS in order to form a united Malay community. This decision made by UMNO must be viewed as a tactical move in order to win the votes of the Malay majority population in the next general elections. This has also helped UMNO overcome the split that became evident when the deputy prime minister and several other high-ranking UMNO members such as the former menteri besar of Kedah, Mukhriz Mahathir, left the party in 2016 in the wake of the 1MDB scandal. In September 2016, the ousted UMNO members formed a new party called Malaysian United Indigenous Party (PPBM), which is led by former Prime Minister Mahathir Mohammad and former Deputy Prime Minister Muhyiddin Yassin.

In regards to the opposition, with PAS split into two factions, one conservative and “pro-ulama,” the other more progressive and “professional,” the cooperation between the opposition parties steadily diminished since different opinions on central policy issues such as the influence of Shariah law in the Malaysian legal system have become evident. With the death of PAS’s leading figure, Nik Abdul Aziz Nik Mat, in early 2015 and the ousting of all members of PAS’ progressive wing in central party positions in June 2015, the party grew narrower and more united. The ousted progressive wing took over the Malaysian Workers Party and renamed it Parti Amanah Negara (PAN). PAN immediately formed a new opposition alliance with the Parti Keadilan Rakyat (PKR) and the Democratic Action Party (DAP) under the name Pakatan Harapan. However, the division and instability among opposition parties, which led to several so-called three-corner-fights in the Sarawak state elections, has significantly hurt the opposition’s ability to oust the incumbent Barisan coalition in the next general elections and damaged its reputation among the Malaysian population.

There is a very wide range of interest groups in Malaysia, even if important social interests such as indigenous groups are under-represented. Certain interests dominate, and there is a risk of polarization, especially as many occupational and other categories are engaged by parallel secular and Muslim organizations. The spectrum of interest groups ranges from social movements, such as environmental groups and community organizations providing local assistance to the poor, to professional

Interest groups
5

associations, such as the Malaysian Bar Council. However, civil society groups can act only within the narrow limits set by Malaysian authorities. In practice, this means that issues of race and religion, or criticism of the government, are out of bounds. Though most civil society groups promote the ideals of a multiracial and open society, they are predominantly organized along ethnic and religious lines. Employee associations and trade unions, such as those under the Malaysian Trade Union Congress (MTUC), an umbrella organization, have little political influence.

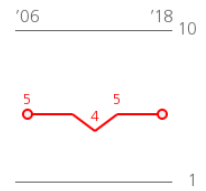
Malaysians have an ambivalent relationship to democratic norms. According to data provided by the World Value Survey, 93% of Malaysians express a desire for democracy, and 77.8% of Malaysians believe that democracy is the most suitable form of government for the country. In addition, 67.5% of respondents believe that choosing leaders in free elections is an essential characteristic of a democratic system. However, half of Malaysians prefer to have a strong leader unburdened by parliament or elections. And a significant portion of Malaysians are favorably disposed toward procedures associated with authoritarian governance: 33% of the Malaysian population believe religious interpretation of the law is an essential characteristic of democracy. In addition, 23.5% of Malaysians believe the army should take over if the government is incompetent and only 60.4% of Malaysians think that women should have the same rights as men. Furthermore, 53% of Malaysians support Hudud law according to data provided by the Merdeka Center.

There is a relatively low level of inter-communal trust within the Malaysian population, although anecdotal evidence suggests higher levels of intra-communal trust. Social and cultural barriers divide the major ethnic and religious groups and became more entrenched during the period under review. Only 20% of Malaysians hold membership in any form of societal association, according to data provided by the World Value Survey. In addition, 91.5% of Malaysians think that people cannot be trusted, pointing to markedly low stores of social capital in Malaysian society.

II. Economic Transformation

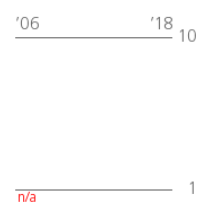
6 | Level of Socioeconomic Development

Poverty and inequality are limited and only marginally structurally ingrained in Malaysia. The country's level of development serves to reduce social exclusion among all citizens, although certain areas (such as the Borneo states of Sabah and Sarawak) and communities (such as the indigenous Orang Asli) suffer from lower levels of development and social mobility. Key indicators reported by the UNDP point to a high level of human development. The country's score in the UNDP's 2015 Human Development Index was 0.779. The score exceeded both the average of 0.744



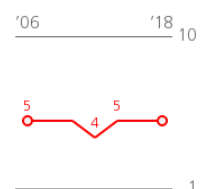
Approval of democracy

n/a



Social capital

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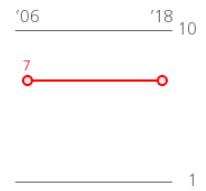


Question Score

Socioeconomic barriers

7

for countries in the high human development group and the regional East Asia and Pacific average of 0.710. Malaysia was ranked 62nd overall. Between 1980 and 2014, Malaysia's HDI value increased from 0.569 to 0.779, an increase of 37% or an average annual increase of about 0.93%. The UNDP noted that - compared to 1980 - the average Malaysian was now living seven years longer, had six more years of schooling and 211.2% more gross income. Life expectancy at birth was now 74.7 years. According to World Bank data from 2009, 2.3% of Malaysians live below the poverty threshold of \$2 per day. Although the government's New Economic Model (NEM) explicitly aims at reducing disparities of wealth between the poorest and richest segments of the population, the gap between the rich and the poor did not significantly decrease during the period under review. With a Gini Index value of 46.3 (data from 2009), Malaysia still has one of the highest gaps between rich and poor in Asia. Gender inequality remains a problem in Malaysian society. The country has a Gender Inequality Index value of 0.209, ranking it 42 out of 155 countries. The 2014 female HDI value for Malaysia is 0.753 in contrast with 0.795 for males, and only 14.2% of parliamentary seats are held by women. In addition, the female labor-market participation rate is 44.4% as compared to 75.0% for men indicating a serious gap between men and women in Malaysia.



Economic indicators		2013	2014	2015	2016
GDP	\$ M	323276.8	338069.0	296283.2	296359.1
GDP growth	%	4.7	6.0	5.0	4.2
Inflation (CPI)	%	2.1	3.2	2.1	2.1
Unemployment	%	3.1	2.9	3.1	3.3
Foreign direct investment	% of GDP	3.5	3.1	3.7	4.6
Export growth	%	0.3	5.0	0.6	0.1
Import growth	%	1.7	4.0	1.2	0.4
Current account balance	\$ M	11205.2	14846.5	8959.6	-
Public debt	% of GDP	56.4	56.2	57.9	56.2
External debt	\$ M	188794.8	196587.4	190951.4	200364.3
Total debt service	\$ M	11695.2	12921.5	13503.4	10385.0

Economic indicators		2013	2014	2015	2016
Net lending/borrowing	% of GDP	-3.8	-3.3	-3.2	-
Tax revenue	% of GDP	15.3	14.8	14.3	-
Government consumption	% of GDP	13.7	13.3	13.1	12.6
Public education spending	% of GDP	5.5	5.2	5.0	-
Public health spending	% of GDP	2.2	2.3	-	-
R&D expenditure	% of GDP	-	1.3	1.3	-
Military expenditure	% of GDP	1.5	1.5	1.5	1.4

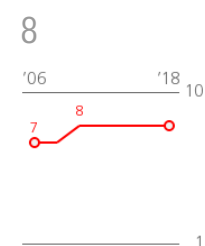
Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Market competition has a strong institutional framework, but competition rules are not the same for all market participants. The informal sector is small but administered prices still play a role in some sectors. However, the government has scaled back subsidies on several goods during the period under review. After cutting fuel subsidies in 2013 and 2014, the government also cut subsidies for wheat flour and most packages of cooking oil at the end of 2016. In November 2015, the government announced that it would abolish subsidies for Super Tempatan 15% broken (ST15) rice. Figures in the 2016 budget revealed that the Malaysian government reduced more than 45% of subsidies. The cuts will save between MYR 8 billion and MYR 10 billion per year. In December 2016, the government announced plans for further subsidy reductions, for example, to electricity tariff rebates and sugar subsidies. During the period under review, the government stuck to its policy of favoring Bumiputera companies for small government contracts. Although the government took further steps toward a more competitive market economy, the country only ranked 23 out of 190 countries in the World Bank's 2017 Doing Business Index, and fell five places compared to 2014. Compared to other east Asian nations, it still takes more procedures and days to register a firm in Malaysia on average. However, these numbers are expected to improve because the government passed the Companies Act 2016 which will bring improvements in the business registration process. After Singapore, Malaysia scored best among all southeast Asian nations in the ranking.

Competition laws designed to prevent monopolistic structures and conduct exist, but are enforced inconsistently. The most important competition law in Malaysia is the Competition Act 2010. It is designed to prevent large companies from engaging in monopolistic or cartel-like activities. The Malaysia Competition Commission

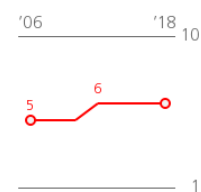
Market-based competition



Anti-monopoly policy

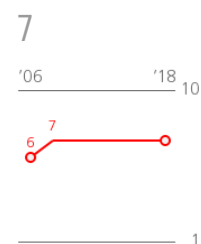
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(MyCC) oversees enforcement of the act and has initiated several law suits against companies which did not comply with the law during the period under review. In June 2016, MyCC fined MY E.G. Services Bhd (MyEG) MYR 2.27 million for abusing its dominant position in managing online foreign worker permit renewals. MyCC also imposed several remedial actions on MyEG. The commission started its investigation against MyEG after several parties filed complaints. Between 2013 and 2016, MyCC imposed penalties on 50 companies. The imposed penalties amounted to more than MYR 25 million. In addition to these penalties, the commission is still investigating pharmaceutical and general insurance companies for price fixing. In July 2016, MyCC successfully challenged the decision of the Competition Appeal Tribunal which set aside a MYR 10 million fine imposed on two local airline companies, Malaysia Airlines (MAS) and AirAsia Bhd, for breaching the Competition Act 2010 before the High Court. The High Court's decision was seen as an important step in the fight against cartelistic structures. Nonetheless, Malaysian enterprises responded sluggishly to MyCC's efforts to promote free market enterprise during the period under review.



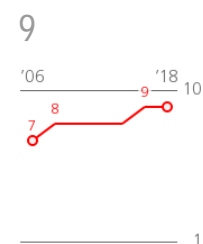
Foreign trade is liberalized in principle, but significant exceptions remain, including differentiated tariffs and privileged treatment for domestic industries. Bumiputera equity quotas and protectionist policies shielding key enterprises continue to constitute high barriers for foreign investors during the period under review. Since 2009, Malaysia has at least most-favored nation (MFN) status with its trading partners while providing tariff preferences to China, Japan, Pakistan, the Republic of Korea, Turkey and ASEAN countries. Compared to the regional average, Malaysia has a relatively open trade regime. At 5.6%, the effectively applied average MFN tariff rate was lower than the Asia-Pacific average. Major trading partners for agricultural products include China, India, the European Union and Singapore; for nonagricultural products, China, Singapore and Japan. Malaysia is one of the countries that will be negatively affected by the de facto suspension of the Trans-Pacific Partnership Agreement (TPP). Had the TPP worked, Malaysia could have slashed taxes and import duties for 95% of its palm oil products, thereby doubling palm oil profits. To soften the economic impact, Malaysia is currently exploring market opportunities for exporting palm oil to the Middle East. In addition, Malaysia intensified its involvement in the Regional Comprehensive Economic Partnership (RCEP), a planned agreement between the 10 ASEAN countries, Australia, China, India, Japan, the Republic of Korea and New Zealand. In late 2015, the ASEAN countries intensified their efforts to further enhance economic integration in the region by launching the ASEAN Economic Community (AEC). One of the central building blocks of the AEC will be the ASEAN Single Window which will allow traders to submit trade-related documents in one place through electronic exchange among ASEAN countries. The core objective of the AEC is to forge a better investment climate in the region. Currently, Malaysia has implemented seven bilateral free trade agreements (FTA) and six regional FTAs.

Liberalization of foreign trade



Malaysia's banking system and capital markets are differentiated and oriented to international standards, with functional banking supervision. Capital markets are open to domestic and foreign capital flows and banks remained well capitalized during the period under review. In 2015, the bank capital-to-assets ratio was 10.5%. The risk-weighted and core capitals stood at 14.3% and 12.9% respectively as of November 2013. Both numbers were above levels required by national authorities and Basel III standards. In December 2016, concerns over the asset quality of Malaysian banks were voiced, since loan ratios increased to 2.0% in 2016 from 1.75% in 2015. However, the ratio of nonperforming loans declined to 1.6% in 2015, an improvement over the 1.8% ratio at the end of 2013. In May 2016, credit rating agency Moody's described the Malaysian banking system as "stable." At present, there are 24 commercial banks, 16 domestic Islamic banks, five international Islamic banks, 15 investment banks and two other financial institutions. The Malaysian Islamic banking sector has a 15.5% share of the global Islamic banking sector.

Banking system



8 | Currency and Price Stability

Inflation and foreign exchange policies are treated in concert with other economic policy goals and have an adequate framework in Malaysia. During the period under review, the inflation rate (based on average consumer prices) decreased after peaking at 4.2% in February 2016. For 2016, the average stood at 2.1%, the same rate as in 2015 and lower than the average in 2014 (3.1%). Despite higher prices for food and beverages (3.8% and 4%), the decrease was largely related to significantly lower prices for transportation (3%). The low inflation rate in 2015 and 2016 came as a surprise since the new goods and services tax (GST) was introduced in April 2015. A report published by the central bank (Bank Negara Malaysia) in 2015 indicated that the GST contributed only 0.7 percentage points in 2015. Originally, the central bank expected an inflation rate of almost 4% for 2015. The higher prices for food were largely related to the government's decision to cut subsidies for rice and cooking oil. Throughout the period under review, the inflation rate remained within the comfort zone set by the independent central bank. However, the weak performance of the ringgit throughout the period under review raised macroeconomic concerns. Falling oil prices and declining investor confidence in the Malaysian government amid the 1MDB scandal weakened the ringgit. After the ringgit continued to weaken relative to the U.S. dollar and fell to a nine-year low of MYR 3.7608 to \$1 in June 2015, the central bank unexpectedly cut its benchmark interest rate by a quarter point to 3% to bolster economic growth in July 2016. Nevertheless, the currency's weak performance continued and fell to an all-time low against the Singapore dollar in November 2016. In January 2017, the ringgit stood at MYR 4.43 to \$1, not far from its historical all-time low of MYR 4.71 to \$1 in January 1998. In November 2016, Bank Negara Malaysia requested foreign banks to stop trading ringgit in the offshore

Anti-inflation / forex policy



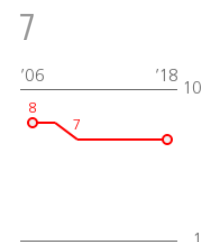
non-deliverable forwards market. The real effective exchange rate index (year 2000 = 100) decreased from 100.6 in 2013 to 91.9 in 2015.

The government's fiscal and debt policies generally promote macroeconomic stability, despite inconsistencies within the country's spectrum of institutional safeguards. In 2015, the budget deficit was at 3.2% of GDP, down from 3.5% in 2014 and 3.9% in 2013. The government is aiming for a budget deficit of 3.1% of GDP in 2016 and 3% in 2017. It aims to achieve a balanced budget by 2020. However, credit rating agency Moody's doubted that the government will achieve this aim without implementing major fiscal reforms. Overall public debt was the equivalent of 54.5% of GDP in 2015, decreasing from 55.6% of GDP in 2014. For 2016, overall public debt is expected to stay at 53.2% of GDP. However, this debt as a percentage of GDP remains higher than that of comparable countries according to Moody's. Federal government debt has nearly doubled since the current prime minister took power in 2009. The government expected to generate higher revenues from oil exports since the global oil prices increased in 2016 after low prices in 2015 which had a negative impact on Malaysia's budget. The government's anticipation of increased economic growth was premised on higher domestic demand, despite imposing a new goods and services tax (GST) of 6%, and recovery in global commodities prices. In 2016, government revenues decreased 3% compared to 2015. For 2017, government revenues are expected to rise 3.4% and should reach MYR 219.7 billion. Revenues from the GST are expected to be MYR 40 billion. Malaysia's total budget for 2017 is expected to stay at MYR 260.8 billion, up 3.4% from 2016. During the period under review, Malaysia's current account surplus shrank from MYR 34.7 billion in 2015 to MYR 16.4 billion. Expected numbers for 2017 should be even lower. Government consumption stood at 13.2% of GDP in 2015. The country's total reserves shrank to \$93.97 billion in 2015.

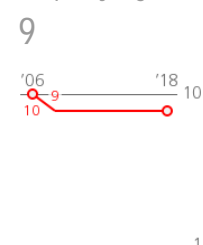
9 | Private Property

Rights and regulations governing the acquisition, benefits, use and sale of property are generally well defined, but problems with implementation or enforcement under the rule of law occasionally emerge. Registering property in Malaysia takes just 13 days and eight procedures according to World Bank data. Although Malaysia has acceded to the World Intellectual Property Organization (WIPO) Copyright and Performances and Phonograms Treaties in December 2012, there are several shortcomings in Malaysia's efforts to enforce property rights effectively. Key problems include the widespread availability of pirated and counterfeit products, and high rates of internet and book piracy. Malaysia does not protect pharmaceutical products against unfair commercial use effectively and has to address patent issues. Consequently, several states urged the country to accede to the WIPO Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure. Malaysia's score in the International Property Rights

Macrostability



Property rights



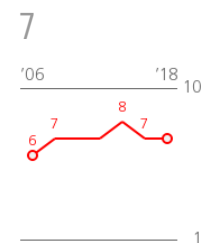
Index 2016 improved compared to 2015. Overall, the country ranked 26 out of 127 countries worldwide and 7th in the Asia and Oceania region. The relocation of residents and indigenous people creates ongoing conflicts between the national government, developers and the general population. In December 2016, the Federal Court in Sarawak decided that the indigenous Dayak people could not apply native customary land rights to claim virgin forests as their territorial domains and communal forest reserves. The ruling had far-reaching implications for the indigenous population because the verdict affects over 100 cases pending in the high courts. In June 2016, opposition politician Bill Kayong who worked on native land rights issues in Sarawak was shot dead.

Private companies are institutionally viewed as important engines of economic production and are given legal safeguards in Malaysia. Nonetheless, the revenues of Malaysia's state-owned companies and government-linked companies (GLC) constitute nearly a fifth of the country's GDP. The government earns about 30% of its income from taxes and dividends from state-owned oil companies. In the last decade, the top 20 GLCs saw their market capitalization grow by 320% to MYR 431.1 billion. The top 20 GLCs are controlled by five government-linked investment companies (GLICs), namely Employees Provident Fund (EPF), Khazanah Nasional Bhd, Lembaga Tabung Angkatan Tentera (LTAT), Lembaga Tabung Haji (LTH) and Permodalan Nasional Bhd (PNB). To improve the operating of GLCs, the Malaysian government implemented the 10-year GLC Transformation Program (GLCT) which was completed in July 2015. Despite the GLCs' increase of profitability, the Auditor General urged the Malaysian government to review the criteria for appointing directors to GLCs and state-owned enterprises (SOEs) since problems of cronyism and patronage still undermine company operations. The privatization of state companies does not fully conform to market principles, mainly because the privatization of projects requires Bumiputera participation. The World Bank's Doing Business Index 2017 ranked Malaysia 23 out of 190 countries and emphasized that the country is among the world's most business-friendly countries. Malaysia ranks among the top five economies in the East Asia and Pacific region.

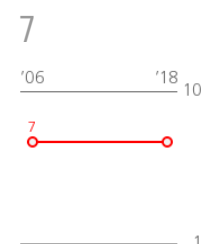
10 | Welfare Regime

In principle, social safety nets are well developed, but do not cover all risks for all strata of population. A part of the population is still risk of poverty in Malaysia with no state-funded unemployment benefits or individual retirement funding mechanism in place. Several social security programs provide benefits for various groups of workers. Government employees receive the most generous benefits, while employees in the small informal sector receive virtually nothing. The Employees Provident Fund (EPF) is the primary social security institution, covering more than half of the workers in the private sector as of the year 2000. In 2012, the EPF had 13.6 million members, of whom 6.4 million were active contributing members. Since

Private enterprise



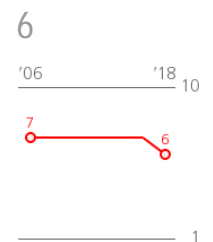
Social safety nets



January 2016, employees have the choice to contribute 11% or only 8% of their monthly salary, while employers contribute 12% (13% for employees who earn less than MYR 5,000 per month). These rates affect employees under the age of 60. However, even the EPF does not guarantee that workers have saved enough when they retire. A report in November 2016 has shown that 65% of EPF members have savings of less than MYR 50,000 at age 54. From January 2017 on, the recommended level of retirement savings will be MYR 228,000. These numbers clearly indicate that old-age poverty is a pressing issue. In addition, Malaysia is still dependent on informal community assistance and a large number of NGOs in the social security sector. This informal community assistance is also required because of low public expenditure on health (2.3% of GDP in 2014), despite Malaysia's widespread system of health care. A universal health care system coexists with a growing private health care sector. Small cash transfers (or redeemable vouchers, depending on the program) are also available, both from the federal government and from certain state governments, for families earning a below fixed level, single mothers, senior citizens and other targeted groups.

Equality of opportunity has not been fully achieved. Indeed, it is systematically avoided through prolonged policies of so-called reverse discrimination and informal stigmatization. To begin, discrimination against women, members of the LGBT community and ethnic groups persist. Although women's civil liberties are protected by law in Malaysia, traditional practices continue to distinguish between genders. In 2014, the country had a Gender Inequality Index value of 0.209, and ranked 42 out of 155 countries. Further, only 14.2% of parliamentary seats are held by women, lower than the regional average of 18.7%. In addition, the female labor-market participation rate is 44.4% as compared to 75% for men, according to UNDP data for 2015. Overall, Malaysia's Gender Inequality Index value is above the average for high HDI countries, and the average for the East Asia and Pacific region. The female literacy rate has increased to 93.1%, though remains lower than the male rate of 96.2%. Even more glaringly, affirmative action policies continue to favor "indigenous" Muslim-Malays, officially designated as "Bumiputera." Chinese and Indian citizens are thus systematically disadvantaged by quota systems and other exclusionary practices when seeking positions in political life, university educational systems, the state bureaucracy, public enterprises and the armed forces. Non-Bumiputera can participate more fully in economic life, though are still hampered by discriminatory government procurement policies, licensing approvals and contract awards, equity allocations, bank lending, ethnic-based discounts, and other barriers. Homosexuality is illegal and gender nonconformity (particularly in terms of dress) is proscribed for Muslim women and men. Infringement on either count is usually met with outright, legal discrimination.

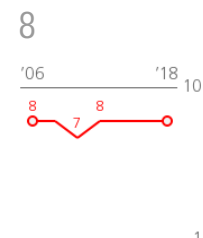
Equal opportunity



11 | Economic Performance

Malaysia's economic performance declined during the period under review. The country's economy was negatively affected by low commodity prices for oil and palm oil, Malaysia's main export goods, and consequently a weak ringgit. The ringgit fell to its lowest levels since the Asian financial crisis in 1997. In 2015 alone, the ringgit fell by almost 10% against the U.S. dollar, performing far worse than other currencies in the region such as the Thai baht (6.4%) or the Philippine peso (2.2%). The same year, global funds withdrew nearly \$3 billion from Malaysian equities, the biggest withdrawal since 2008. The overall GDP growth rate for 2015 was 5%, down from 6% in 2014, although this was better than the 4.9% that had been forecast. For 2016, GDP growth is expected to be at 4.2% and at 4.5% in 2017. GDP per capita (on a purchasing power parity basis) increased in 2015 to \$26,891, a level higher than before the global financial crisis. During the period under review, the inflation rate (based on average consumer prices) increased moderately, reaching 4.2% in February 2016. For 2016, the inflation rate averaged 2.1% for the year, the same rate as in 2015 and lower than the average for 2014 (3.1%). Malaysia's current account surplus narrowed during the period under review. The narrowing of the current account surplus was mainly caused by a lower trade surplus and wider services account deficit. Malaysia's current account surplus for 2016 in total will likely fall to MYR 11.3 billion. For 2017, Malaysia's current account surplus was expected to remain in surplus at 1% of GDP. The unemployment rate is expected to remain below 3.5% in 2017, one of the lowest rates in the region. Despite confidence in portfolio investment having been shaken by the 1MDB scandal, foreign direct investment (FDI) continued to flow into Malaysia. In 2014, FDI recorded a net inflow of MYR 35.3 billion, down from MYR 38.2 billion in 2013. In 2015, the budget deficit was at 3.2% of GDP, down from 3.5% in 2014 and 3.9% in 2013. The government is aiming for a budget deficit of 3.1% of GDP in 2016 and 3% in 2017. The Malaysian government aims to achieve a balanced budget by 2020. However, credit rating agency Moody's doubted that the government will achieve this aim without implementing major fiscal reforms. Overall public debt was the equivalent of 54.5% of GDP in 2015, decreasing from 55.6% of GDP in 2014. For 2016, overall public debt is expected to stay at 53.2% of GDP. However, this debt as a percentage of GDP remains higher than that of comparable countries according to the agency.

Output strength



12 | Sustainability

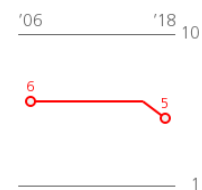
Environmental concerns may be taken into account by Malaysian policymakers, but are usually subordinated to efforts to promote growth. Environmental regulation and incentives are partly in place, but enforcement is deficient. Deforestation and climate change are the nation's primary environmental problems. The Environmental Performance Index (EPI) ranked Malaysia 63 out of 180 countries worldwide in 2016.

Environmental policy

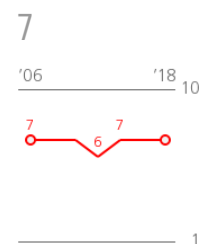
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During the period under review, Malaysia suffered from the worst haze it has experienced in recent years. The haze was caused by forest fires resulting from illegal logging on the Indonesian islands of Sumatra and Kalimantan. In September 2015, schools in the four states of Sarawak, Selangor, Negeri Sembilan and Malacca, together with the Federal Territories of Kuala Lumpur and Putrajaya closed temporarily. Malaysia tried to tackle the haze by sending cloud seeding aircraft to Kalimantan. During the period under review, the states of Kelantan and Terengganu again suffered from floods. After the historical floods in 2014 and 2015, 25,000 people had to again be evacuated from renewed flooding in January 2017, indicating little policy improvement. The main culprit in this flooding is deforestation, with illegal logging still a major problem. Overall, minimal attention is given to renewable energy sources, household recycling or conservation, or other means of raising environmental awareness and promoting sustainability

In principle, education policy ensures a nationwide system of reasonably sound education and training. The research and technology sector is broadly based. Public expenditure on education, totaling 6.1% of GDP in 2013, can be considered high, even with reference to international standards. Malaysia has currently 20 public universities, 33 polytechnics, and 72 private universities, university colleges and Malaysian campuses of foreign universities, and about 500 private colleges, with almost a million students enrolled in these institutions. However, the Malaysian educational system continues to suffer shortcomings. Gross enrollment ratios at the secondary and tertiary are low by international standards (79.0% and 29.7%) and graduate under-/unemployment remains a widespread concern. The World Economic Forum's Global Competitiveness Report 2016-2017 ranked Malaysia 25 out of 138 economies, a drop of five places from the previous report. The report highlighted the central weaknesses of Malaysia's education system, namely a low secondary education and tertiary education enrollment rate. In addition, the report urged the government to improve female participation in the labor market. According to a government study, only 25% of the Malaysian work force is highly skilled, less than half that of Singapore. A low level of technological readiness could significantly undermine Malaysia's efforts to become a knowledge-based economy. Expenditure on R&D amounted to only 1.3% of GDP in 2014. The overall literacy rate stood at 94.6% during the period under review.



Education policy / R&D

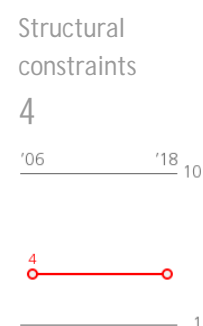


Governance

I. Level of Difficulty

The Malaysian government faces only moderate structural constraints with respect to its capacity to govern. Infrastructure development and extreme poverty are not serious constraints on the Barisan government. Although the country has not been exposed to pandemics, air pollution and floods indicate that the country is moderately exposed to natural disasters, which are partly related to the government's deficient policies. The continuing problem of severe haze, caused by slash-and-burn practices in Kalimantan and Sumatra as well as in Sabah poses a serious challenge to the Malaysian government. Though exact costs related to the haze are difficult to estimate, one of the biggest impacts of the haze is expected to be on tourism, and the reduced attractiveness of the region in terms of a place to come and work, especially for high-skilled foreign workers. The recurrent floods in Malaysia represent another structural constraint for the government. In January 2017, the Rural and Regional Development Ministry estimated that the cost of damage to infrastructure in the state of Kelantan due to the floods could reach MYR 30 billion. Although resources for flood mitigation are repeatedly included in the Malaysia budget, natural disasters have a strong impact on the daily life of thousands of Malaysian citizens. MYR 350 million alone have been put aside by the Malaysian government to repair bridges and roads destroyed during the floods at the end of 2016.

In addition, the Malaysian government has to improve public safety, especially in the state of Sabah. After the Abu Sayyaf group identified Sabah as a hideout after the Filipino government increased their operations against the extremists in June 2016, the group is believed to be responsible for the kidnapping of several fishermen in September 2016. In 2016 alone, 16 people were kidnapped in Sabah, marking the highest number in the last decade. The education system's output of high-skilled workers is also insufficient and the government must address regional disparities in economic development, especially on the island of Borneo. Wage growth has been muted and Malaysia is still seen as a "low-cost" country. The low-cost production model has been supported by inflows of low-skilled foreign workers. Though the New Economic Model (NEM) recognizes the need to develop a higher-quality workforce, the majority of jobs in Malaysia, especially in the private sector, are still low-skilled. In addition, women are under-represented in engineering, architecture

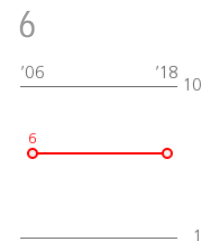


and other traditionally male-dominated fields. Corruption, a weak civil society, and ethnic and religious heterogeneity represent persistent structural constraints.

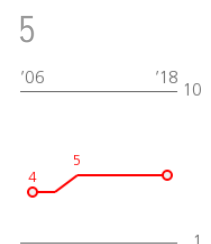
Civil society traditions remain fairly weak in Malaysia, and apart from religious and ethnic organizations, voluntary organizations are mostly found in urban areas. Though new NGOs have emerged in the last two decades, the country's voluntary organizations remain plagued by scarce organizational resources. However, civil society groups demonstrated that they are sporadically able to mobilize large masses of the population. At the end of August 2015, the Coalition for Clean and Fair Elections (Bersih) organized a rally in Kuala Lumpur in which more than 100,000 people participated. The organization is actively involved in activities that aim to raise awareness among the Malaysian population of the implications of the sixth redelineation of parliamentary and state boundaries. If the current redelineation proposal passes, the incumbent government, or at least UMNO, will grow even more advantaged. The protests were not only related to redelineation but protesters also called on the prime minister to resign over the 1MDB scandal. In general, two different civil society cultures have emerged within the growing circle of NGOs. On the one hand, liberal organizations have strengthened monitoring activities in such areas as human rights, the government's reform agenda and, especially, environmental issues. On the other hand, a more welfare-oriented culture has emerged in rural areas, with a particular focus on informal community assistance to the poor at the local level. However, only 20% of the Malaysians are members of any form of societal association, according to data provided by the World Value Survey. The data further shows that involvement in associations largely fails to foster trust in fellow citizens in Malaysia. Stores of social capital are markedly low in Malaysian society: 91.5% of the Malaysians think that people cannot be trusted.

There have been few outbreaks of serious violence in Malaysia in recent times. However, society is increasingly polarized along ethnic and religious lines. Since independence, the political elite has managed ethnic and religious cleavages by forming a multiracial ruling coalition that has included the three largest race-based parties. Though this bargain led to a political spectrum split along religious and ethnic lines, it helped stabilize a divided Malaysian society and inhibited the outbreak of major violent conflict for three decades. However, the divide between Muslims and Non-Muslims increased significantly during the period under review. The rift between the Malay population, and the ethnic Chinese and Indian population was mirrored by the government's decision to submit to parliament a bill that had been proposed by the opposition PAS and consisted of stricter forms of Shariah law introduced in the state of Kelantan. The bill proposes to amend the Shariah Courts (Criminal Jurisdiction) Act 1965. Although the amendment only applies to the Muslim population in the state of Kelantan, non-Malay parties within the ruling coalition and secular opposition parties strongly opposed the bill. The decision by the governing UMNO to submit the bill was widely seen as a strategic decision to forge stronger ties with the PAS in order to gain support among the Malay population. Since

Civil society traditions



Conflict intensity



the MIC and the MCA, the two BN coalition parties that represent the ethnic Indian and Chinese population, do not have the support of their respective ethnic groups anymore and therefore do not deliver enough votes for the coalition, UMNO strengthened ties to religious scholars and the PAS in order to form a united Malay community. This UMNO's decision must be viewed as a tactical move in order to win the votes of the Malay majority population in the next general elections. However, the decision deepened tensions between the ethnic groups and marked a departure from the traditional approach of forming a multiracial ruling coalition that includes the three largest race-based parties. In addition, the polarization of Malaysian society with regard to the question of how far religious norms should define daily public life for all Malaysians became evident in a series of incidents over the course of 2016, when the Malaysian Islamic Development Department (Jakim) - which is the only institution allowed to distribute halal certificates to restaurants - criticized several food chains for not serving halal food. Jakim's campaigns, which even targeted global food giants, can be seen as evidence of the continued influence of religious institutions in daily life in Malaysia. These developments contradict Prime Minister Najib's 1Malaysia program, which stresses national unity and ethnic tolerance. So far, 1Malaysia has not fostered unity among Malaysians, and it is questionable whether the program can become anything more than a slogan, particularly as UMNO leaders adopt increasingly communal positions.

II. Governance Performance

14 | Steering Capability

The Malaysian government claims to be setting strategic priorities. Nonetheless, the political leadership has often shown inconsistency between its everyday decisions and its long-term policy aims. Furthermore, the government's long-term developmental goals do not include a further democratization of the public sphere or any serious deepening of democratic norms. During the period under review, the government's strategic priorities were unveiled in the 11th Malaysia Plan (2016-2020) which was tabled in parliament in May 2015. Every four years the incumbent government presents a plan specifying its economic development policies. In the 11th Malaysia Plan, the government identified six key points, which include: enhancing inclusiveness in order to establish an equitable society, improving well-being for all citizens, accelerating human capital development in order to achieve "fully developed" country status, pursuing green growth for sustainability and resilience, strengthening infrastructure, and re-engineering economic growth for greater prosperity. By 2020, the government aims to have reached its goal of becoming a high-income country. Some government targets are supported with concrete policies,

Question
Score

Prioritization

5

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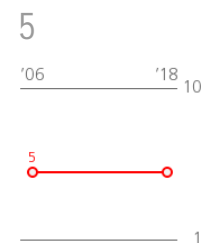
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especially the proposed several infrastructure programs, such as the extension of highways and the development of public transport in the Klang Valley. However, it remains unclear how the government expects to achieve several other policy goals. For instance, it is unclear how increasing inclusion should be realized since concrete policy recommendations are left out in the report. In addition, these efforts by the Malaysian government are overshadowed by the negligent handling of government resources as demonstrated by the misuse of taxpayers' money in the 1MDB scandal, which increased public debt by more than \$11.73 billion. Furthermore, women are still under-represented in the labor market, and the bureaucracy remains dogged by inefficiency.

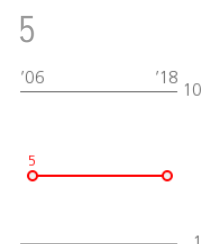
The government has failed to implement policies which would help democratize the political system. Indeed, democratic norms and procedures were further eroded during the period under review, marking a setback in this area. As noted above, under the current prime minister, the government has frequently made use of repressive laws such as the Sedition Act and the Communications and Multimedia Act (CMA) to silence activists who criticized the government's role in the 1MDB scandal. New laws such as the Prevention of Terrorism Act 2015 further undermined democratic norms in the country. Policies helping to democratize the political system are not on the government's agenda. The government's record has been much stronger with respect to implementing policies in pursuit of economic reform and instituting a more market-based economy. Again, as noted above, during the period under review the government eased budgetary pressures by scaling back subsidies on food products such as cooking oil and wheat flour. And it implemented the goods and services tax (GST) in April 2015. These measures were necessary in order to contain deficits, and they help support attainment of a true market economy. For the first nine months in 2016, the GST brought more than MYR 54.86 billion in government revenue. However, populist measures, such as increasing the minimum wage and public-sector salaries in 2016, made it more difficult to achieve fiscal consolidation. Subsequently, a World Bank report urged the Malaysian government to implement additional structural reforms that address human capital development and economic liberalization. Neither of the goals are realized through the Bumiputera quotas that continue to hinder foreign investment across many economic sectors.

The Najib administration has demonstrated a desire to respond to mistakes and failures with change. The government shows to some extent flexibility and learning capability with reference to market reforms. However, the political leadership continues to refrain from the implementation of democratic reforms. Moreover, it shows a low degree of political will to learn from past mistakes so as to facilitate democratic changes. A populist style of politics on the part of the Najib administration flourished during the period under review. The 2017 budget featured some programs which can be seen as highly redistributive to those segments of the population, effectively re-energizing their loyalties. The budget contained bonuses to civil servants such as special cash payments, and bigger loans for homes,

Implementation



Policy learning

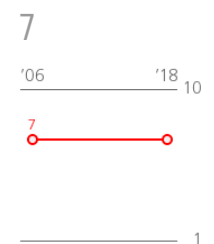


motorcycles, computers and smartphones. Around 79% of civil servants are ethnic Malays, a cohort which forms large parts of the UMNO-led government's support base. In addition, farmers affected by bad weather will get government support, and teachers and Muslim clerics benefited from special handouts such as tablets or money. These payments were seen as "election goodies," with the government expected to call early elections in 2017. Prime Minister Najib, who often presents himself as a reformer, did not show any sustained willingness to scale back authoritarian controls. On the contrary, repressive laws such as the Security Offences (Special Measures) Act 2012 and the newly passed Prevention of Terrorism Act 2015 confirmed doubts that the BN government will commit to democratic norms.

15 | Resource Efficiency

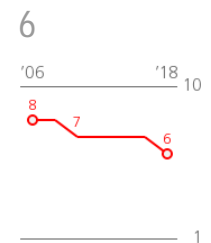
The Malaysian government makes efficient use of most available human, financial and organizational resources. The government's administrative personnel are generally seen as professional. However, the reach of competitive recruiting systems is limited due to the Bumiputera quota system. This negatively impacts the functioning of the administrative system at all levels of the Malaysian bureaucracy. The ousting of high-ranking and well-respected government officials (such as the deputy prime minister and the attorney general) who were critical of the government's handling of the 1MDB scandal also had a negative impact on available human resources. Further, as noted repeatedly throughout this assessment exercise, the government's affirmative action policy, which establishes a Bumiputera quota for virtually all of its economic activities, remains worrisome. The Auditor General explicitly urged the Malaysian government to review the criteria for appointing directors to GLCs and state-owned enterprises (SOEs) since problems of cronyism and patronage still undermined company operations during the period under review. Separately, the high level of federal debt is equally worrisome. With a budget deficit of 3.2% of GDP in 2015 and a public debt which was the equivalent of 54.5% of GDP in 2015, the government is still far from achieving its aim of having a balanced budget by 2020. Without the implementation of major fiscal reforms, it is unlikely that the government will significantly reduce its budget deficit in the coming years. The country's debts remain higher than that of comparable countries and budget discipline has so far not been a trademark of the Najib administration since federal government debt has nearly doubled since the current prime minister took power in 2009. In addition, the National Audit Department of Malaysia monitors the use of tax revenues for efficiency and transparency, although their recommendations are often ignored by the government. In sum, the budget deficit, the Bumiputera quota system and the government's unwillingness to be more transparent restrict the government's efficient use of assets.

Efficient use of assets



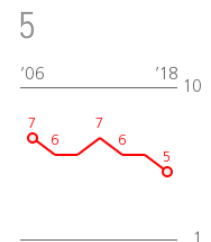
The government coordinates conflicting interests and objectives under the leadership of Prime Minister Najib. Under his hierarchical leadership, the cabinet effectively handled major conflicts over economic or social policies in such a way as to achieve policy coherence. One gray area concerns coordination across federal, state and local levels of government. This has been especially acute since 2008, when several state governments fell to parties which are in opposition at the federal level. Tensions have emerged in such areas of shared authority as infrastructure development and provision of basic services such as water and waste management. In addition, the federal government shows little policy coherence when it comes to managing the tense ethnic relations in the country. Although Prime Minister Najib is heading a multi-ethnic ruling coalition, UMNO's advances to the PAS in order to solidify the support of the majority Malay population, irked the other BN coalition parties and must be seen as a departure from the approach of fostering unity among the country's ethnic groups. UMNO's decision to sharpen Shariah law in the state of Kelantan mirrors the deep frictions within the ruling coalition. In addition, tensions within the highest ranks of the government over the role of the prime minister and political consequences in the wake of the 1MDB scandal were revealed during the period under review. As a result, the ruling UMNO lost several high-ranking party officials such as the deputy prime minister and the menteri besar of Kedah. Compared to other countries, however, the government's ability to coordinate conflicting objectives and interests remains relatively effective.

Policy coordination



The government is only partly willing to contain corruption, while the few integrity mechanisms implemented are mostly ineffective, although levels of corruption in the civil service are probably the lowest in the region after Singapore. During the period under review, it became evident that there are basically two different rules in place for the “big fish” and the “small fish” when it comes to the prosecution of corruption. Every attempt by the Malaysian government to hold officeholders accountable when it comes to corruption practices must be seen in the light of the 1MDB scandal (1MDB is a government investment fund that lost more than \$11.73 billion) in which the government interfered with the investigations and cracked down hard on any individual that reported or discussed the role of the prime minister in the scandal. The Attorney General Gani Patail was sacked when he allegedly drafted a charge sheet against the prime minister. Furthermore, the chief of the Malaysian Anti-Corruption Commission (MACC) was replaced, while two of his senior officials also left the commission and are now facing criminal charges. In addition, the deputy prime minister and several high-ranking government officials who criticized the prime minister's role - nearly \$700 million from the fund was allegedly wired directly to the prime minister's private bank account - in the scandal were also sacked. Summing it up, the various institutions that were supposed to hold the government accountable were marginalized by the government. The government's credibility among investors worldwide took a significant hit while the political consequences are still unclear. In addition to these developments, the Auditor General revealed in its annual report that

Anti-corruption policy



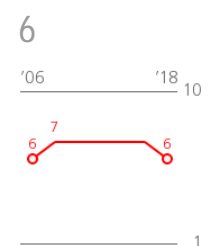
public funds were repeatedly mismanaged. The Auditor General urged the government to look into cases when government bodies bought wall clocks and scanners for prices that were up to 40 times higher than the retail price. In addition, the Federal Land Development Authority (FELDA) lost millions due to poor planning and execution raising suspicions that the money was intentionally mishandled. Party financing regulations are still insufficient. Although the National Consultative Committee on Political Financing tabled recommendations to regulate party finances, the recommendations are yet to be implemented and have been criticized as favoring the government. Opposition parties complained about the recommendation to prohibit political parties from accepting foreign donations since opposition parties especially depend on foreign assistance. At present, the Election Commission has no authority to inspect party financing or to prosecute legal violations. Parties are not required by law to file a statement of their income or expenditures during elections, although they spend exorbitant sums to muster support.

16 | Consensus-Building

There is no consensus on liberal democracy shared by political and social actors. The ruling coalition has tried to present itself as reformist and open to democratic practices. These announcements are little more than lip service, as the Malaysian government has repeatedly cracked down on opposition politicians and activists, using the Sedition Act and other legislation. With the implementation of the National Security Council Act 2016 in August 2016, and the frequent use of the Sedition Act and the Communications and Multimedia Act (CMA) to silence opposition activists, the government demonstrated that there is no consensus on liberal democracy. However, secular opposition parties and segments of civil society adhere to democracy.

In principle, all major political and social actors agree on the goal of a market-based economy. The exceptions to this include some environmental groups, who criticize the subordination of environmental considerations to growth efforts, as well as right-wing Malay groups such as Perkasa, who argue for economic opportunities to be structured on ethnic lines. Right-wing Malay groups, which dominate certain segments of the public discourse, pose a growing challenge to the government's reform policies. Opposition parties and labor activists have also expressed concern with the impact of several free trade agreements. Nevertheless, there is no politically or economically relevant actor with the power to derail either the reform process or the expansion of the market economy.

Consensus on goals

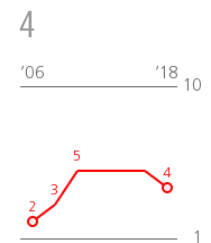


With the Barisan Nasional (BN) coalition maintaining a parliamentary majority at the federal level and soundly winning the state elections in Sarawak in May 2016, non-state reformers have had little power to bring forward either democratic or anti-democratic reforms. The government has shown no intention of enabling democratic transformation, nor has it allowed significant leeway to radical activists' intent on creating a theocratic Islamic state (the primary anti-democratic model proposed in the period under review). However, the federal BN government tabled a bill which would sharpen Shariah law in Kelantan state in 2015. Although the law only applies to Muslims and does not influence the daily lives of non-Muslims, this development was widely seen as increasing the influence of theocratic activists. The military poses no threat to potential democratic transformation, as the armed forces are effectively subordinated to civilian rulers.

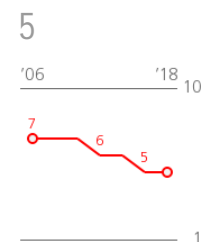
Given the ethnic and religious heterogeneity of Malaysian society, with its significant ethno-religious cleavages, the government has been more or less successful in managing social differences in the past. However, while cleavage-based conflicts have not boiled over into large-scaled violence, ethnic and religious tensions remained high during the period under review. On several occasions, ethnic Malay protesters, wearing red shirts, demonstrated against ethnic minorities in the capital Kuala Lumpur and voiced their anger especially against Chinese businessmen. Because some of the red-shirt protesters have close ties with the governing UMNO (e.g., the leader of the red shirts is UMNO's head of the Sungai Besar division) and organized protests against independent media outlets that are critical of the government (e.g., Malaysiakini), the government seems to be complicit in cleavage-based conflicts, which have been escalating since the government's setback in the 2008 general election. Although government officials are not directly involved in the protests, the protesters can be viewed as proxies used to attack opposition activists and media outlets which call for the democratic inclusion of all ethnic groups.

The political leadership recognizes and accommodates the interests of civil society actors only as long as they are not perceived to interfere with government policies. Laws pertaining to NGOs and other civil society groups continue to limit the space within which civic activity can take place. For instance, demonstrations organized by civil society groups which called for the prime minister's resignation amid the 1MDB scandal went unheard. In addition, recommendations formulated by civil society actors during the sixth redelineation of parliamentary and state boundaries had no impact on the Election Commission's decision to revise electoral boundaries. As a result, Malaysian civil society has little input into agenda setting, policy formulation, policy implementation and performance monitoring. The government does however partner with certain civil society organizations, for welfare service delivery, for instance and Islamist groups in order to re-energize its social support base.

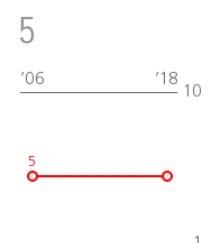
Anti-democratic actors



Cleavage / conflict management



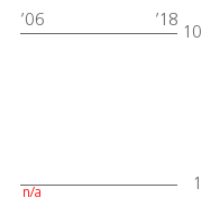
Civil society participation



The effects of the May 13, 1969, race riots remain visible in Malaysian society today, as the Bumiputera affirmative action policies implemented at the time are partially still in place. Discontent with these policies is clearly visible among the ethnic Indian and Chinese minorities. This is true even within the ruling coalition, largely due to the fact that the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC) have both lost significant support within their own ethnic communities. Since the UMNO reached out to the PAS in order to form a united Malay community, fears among the ethnic minorities of being neglected intensified during the period under review. The government's 1Malaysia campaign, aimed at creating unity among Malaysian citizens, cannot be seen as an effective tool to overcome the country's ethnic and religious divisions, and political leaders periodically invoke "May 13" when they feel that non-Malay communities are overstepping the mark. As a result, tensions between the Malay-Muslim majority and the non-Malay, non-Muslim minorities remained on a high level during the period under review.

Reconciliation

n/a

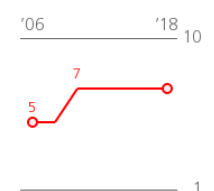


17 | International Cooperation

The political leadership tries to use international assistance to further its own development agenda, but has demonstrated difficulties in devising a consistent long-term strategy able to integrate this support effectively. The Najib government works with bilateral and multilateral international donors such as the World Bank, the IMF and the Asian Development Bank (ADB). Nevertheless, the government limits the influence of international aid by approving only those policies that suit the government's own ideological preferences. It has maintained rules on ethnic preference and castigated officials from foreign governments and international organizations for criticizing government decisions, including controversial court judgments and internal security policies. It is worth recalling that, early in the current prime minister's tenure, extensive advice was sought from foreign consultants and planners over development and governance frameworks involving, for example, the new economic model, economic transformation program, the government transformation program, and key indicators and goals. But amid rising Malay nativism and Islamism, fall out over the 1MDB scandal, and the UMNO-led government's perceived need to re-energize its social base of support, these new frameworks have been largely abandoned.

Effective use of support

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The Malaysian government is considered by the international community to be a reliable and credible partner. The political leadership remains fully engaged with the World Bank, the IMF, the ADB and other international institutions such as the WTO. Malaysia is also an active member of ASEAN, serving as chair for 2015. However, the impact of the 1MDB scandal and the allegations against Prime Minister Najib had a serious influence on Malaysia's standing in the world community and led to a change in Malaysia's foreign policy. With countries such as Switzerland, Singapore

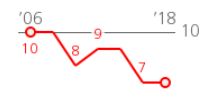
Credibility

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and the United States investigating the money laundering allegedly involved in the 1MDB fund corruption case, the prime minister has come under greater pressure. Especially U.S. authorities kept a close eye on Najib allies and investigated the role of his step-son in the scandal. The U.S. Department of Justice has filed a suit in an effort to recover more than \$1 billion from people close to Najib and 1MDB. The U.S. investigations are in deep contrast to the relationship between the two countries before the scandal when then U.S. President Obama invited Najib to play golf on a state visit to the United States by the Malaysian prime minister in December 2014. As a reaction to the investigations, the Malaysian government tightened relationships with the Chinese government. While Malaysia intensified efforts to de-escalate the conflict over territories in the South China Sea and did not openly criticize the Chinese government for building artificial airstrips in the disputed waters, China decided to invest more than \$33 billion in Malaysia as revealed during a state visit by the Malaysian prime minister to China in November 2016. Malaysia is also poorly evaluated by international organizations over its efforts to combat human trafficking. In addition, the U.S. State Department heavily criticized the Malaysian government for human rights violations with regard to freedom of speech, media, assembly and press in April 2016.

The political leadership actively and successfully builds and expands upon cooperative neighborly and international relationships. The government promotes both regional and international cooperation. In late 2015, Malaysia was among the ASEAN countries which intensified efforts to further enhance economic integration in the region by launching the ASEAN Economic Community (AEC). In August 2016, Malaysia assumed the presidency of the U.N. Security Council while serving its two-year term in the U.N. Security Council. The term ended in December 2016.

On the other hand, Malaysia's territorial disputes with China, the Philippines, Brunei, Vietnam and Taiwan in the South China Sea took a significant turn during the period under review. Malaysia claims those Spratly Islands that fall within its Exclusive Economic Zone (EEZ), which stretches 200 miles out from Malaysian shores. Tensions between the dispute parties rose in April 2015, when satellite images revealed that China had built an airfield on Fiery Cross Reef within the Spratly Islands. In contrast to other dispute parties such as Vietnam, Malaysia decided not to openly criticize the Chinese government for their actions and urged all conflict parties to respect international law. In July 2016, the Permanent Court of Arbitration in The Hague ruled that China's claims to the majority of the South China Sea were invalid. While China rejected the court's decision, Malaysia underlined that security issues in the South China Sea should be resolved by diplomatic and legal means, and urged China to honor international law. In line with their defensive approach with regard to the dispute over the islands and its refusal to openly criticize China's actions, the Malaysian government signed an agreement with China in November 2016, in which both parties declared that their navies would increasingly cooperate in the South



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Regional cooperation
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China Sea. However, Chinese patrol vessels and fishing boats continue to make incursions into the EEZ claimed by Malaysia.

To improve border security and neighborly ties with Thailand, Malaysian and Thai officials discussed the possibility of building a wall along the border in order to minimize the illegal flow of weapons, insurgents, goods and labor in September 2016.

Strategic Outlook

Malaysia faces a challenging political landscape for reform. The weakness of the Barisan Nasional coalition parties representing Malaysia's ethnic Chinese and Indian population (the MCA and the MIC) indicates that the formula of a "multiracial" ruling coalition, which includes the three largest ethnic-based parties and which helped to stabilize communal relations after the riots in 1969, has broken down. After many Chinese voters changed their political allegiance and began supporting the opposition DAP in 2013, UMNO began to forge stronger ties with the PAS in order to galvanize its Malay-Muslim base. This has far-reaching implications. On several occasions during the period under review, radical Malay activists wearing red shirts protested, agitating for a distinctly Malay nativist agenda. Consequently, the ruling coalition under UMNO's leadership will have to undertake several measures to avoid any further deepening of religious and ethnic cleavages within the Malaysian population. A necessary first step would be for the dominant UMNO to cut all personal and organizational ties to the red-shirt protesters, and their anti-minority political agenda. Second, the ruling coalition should refrain from any further strengthening of Shariah law as happened in the state of Kelantan, as such measures alienate ethnic minorities as well as foreign investors. Third, the government has to return to guaranteeing the rule of law, avoiding legislation that oppresses opposition activists and independent media outlets. The polarization of Malaysian society and the deterioration of ethnic relations can only be stopped if the government follows a political agenda which includes the entire Malaysian population. In addition, the potential of Malaysian society can only be fully realized if freedom of speech and the articulation of divergent opinions are guaranteed. To stem ethnic tensions and to promote a more competitive economy, the government could reduce preferential policies and special rights favoring the Bumiputera, while also reaffirming non-Muslims' constitutional freedom to worship as they choose. While the government's decision to cut subsidies on several goods was a major step to promote a more competitive market economy, the ruling coalition has to focus on investing more in the education and training of Malaysia's citizens. Enhancement of technological capabilities among the Malaysian population is essential to readying the Malaysian economy to participate more effectively in the global economy. At the same time, this measure would reduce the country's dependency on export of commodities. As a final step, the government should rethink its stance on the 1MDB scandal. Confidence in the government among the Malaysian population and foreign investors can only be restored if the government decides to appoint an independent commission to review the scandal. As long as the 1MDB scandal is not fully and independently processed, the polarization of political actors and the Malaysian population will continue to negatively impact the country's democratic and economic transformation.