Can M'sia reform and still discriminate?
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Dr Mahathir Mohamad sits at a vast desk cluttered with work, hands clasped before him and looking at his visitors with a slight smile.

Dr M, as he is popularly known, was prime minister of Malaysia from 1981 to 2003, the first commoner to ever hold the post in a land with nine sultans. His demeanor suggests the country physician he once was, ready with a frank diagnosis - and in his first interview with the foreign media in five years, he doles out prescriptions for what ails his nation.

The man who made Malaysia part of the 'East Asia Miracle' with a massive inflow of foreign direct investment doesn't think much of it today. The former miracle economy, now a muddle, needs a new policy direction, he says in his office in Putrajaya, the administrative capital he built on old plantation land in the 1990s.

"We should not be too dependent on FDI anymore," says Mahathir. "We've come to the stage when locals can invest. They have now the capital. They have the technology. They know the market. And I think they can manage big industries."

His thinking is at odds with government policy. But it gets to the heart of a debate over the future of Malaysia, a former emerging market star now in danger of becoming an also-ran, stuck in the dreaded "middle income trap."

Foreign investment has been dwindling since the onset of the 1997-1998 Asian financial crisis. Capital outflows have even exceeded inflows in four of the past five years. This has been accompanied by an alarming 'brain drain' of emigres voting with their feet against Malaysia's prospects.

Malaysia is counting on foreign investment to provide a quarter of the investments needed to fund projects under its 'Economic Transformation Programme', which aims to turn the country of 28 million into a fully developed nation by 2020.

That comes to an average of more than US$11 billion a year, compared with an average of US$3.1 billion since 1997 - by any measure an ambitious target.

The challenge is vastly more complicated by the exodus of talent that hits directly at Malaysia's aspiration to become a high-income nation focused on knowledge-based industries.

"For Malaysia to stand success in its journey to high income, it will need to develop, attract and retain talent," the World Bank said in a March report. "Brain drain does not appear to square with this objective: Malaysia needs talent, but talent seems to be leaving."

The rise of China and India in the region has overshadowed the export-dependent 'Tiger Cub' economies of Southeast Asia, all struggling with their own reforms. Thailand has been at a dangerous political impasse for six years. Indonesia is consistently ranked as among the world's most corrupt countries. The Philippines is battling long-running insurgencies.

Yet Malaysia does not compare well with its peers in the eyes of investors. A March report by Bank of America Merrill Lynch ranked Malaysia the second least popular market after Colombia among global emerging market fund managers and tied with India for least favourite among Asia-Pacific managers.

A chief difficulty is the nation's balky affirmative action programme.

Ethnic Chinese account for most of the brain drain. The reason 60 percent of them gave for why they moved out of the motherland was 'social injustice', a World Bank survey says.

They are referring to the bumiputera policy that discriminates against Chinese and Indians, who account for a third of the population, in favour of majority Malays for all kinds of things - places in universities, jobs, shares in companies, home mortgages, government contracts.

The government acknowledges the policy has been widely abused, with Malay front men offering their names to Chinese businesses to obtain government contracts, an arrangement known as 'Ali Baba', after the character in Arabian Nights who gains entrance to the treasure cave of the 40 thieves with the magic words 'Open Sesame'.

Prime Minister Najib Razak has launched a new edition of the policy called the New Economic Model that is meant to correct the inequities, mainly by making preferences need-based and not race-based. But as the World Bank report noted, "limited headway has been made on this front."

It is certainly not popular with the rank and file Malays in Najib's Umno party.

Making significant reforms to the system is crucial to Malaysia's aspirations, but any rollback of privileges for the majority is a big political risk for any government that tries it.

It is the Malaysian dilemma.

The impossible game

Idris Jala, the minister in charge of greatly boosting investment and wooing back emigres under the Economic Transformation Programme (ETP), calls it the impossible game.

He is an unlikely character in the Malaysian cabinet, a Christian from the Kelabit tribe in Sarawak who spent most of his career running companies, including the Malaysian unit of Royal Dutch Shell and Malaysia Airlines.

"I am a true believer that real transformation goes hand in hand with the game of the impossible," Idris says in an e-mail interview. He sets impossible targets, is "very directive" and pushes his team constantly "to do the right things, but differently" until they are finally "one step ahead of you".

“When you do transformation, you cannot achieve big results by democracy," he notes.

The ETP aims to attract RM1.4 trillion (US$466 billion) by 2020 in a dozen broad industries. Only 8 percent of that will come from the government, which has long dominated the economy, either directly or through government-linked firms. Idris disclosed to Reuters that foreign investment will account for 27 percent of the total.

He wants to climb the value ladder in the targeted industries.

Take birds' nests, for example. Nests made with the saliva of swifts have been collected for centuries from huge limestone caves in Idris' home state of Sarawak to make the most expensive soup on earth. Processing them would give Malaysia a bigger chunk of a global market worth US$3.3 billion, he said.

Foreign investment will also provide many of the 3.3 million jobs that will be created under the ETP, whose over-arching goal is to raise per capita income to US$15,000 from US$6,700 in 2009.

A challenge will be to upgrade skills in a labour force long geared to basic manufacturing and plantations, attract foreign talent, and try to reverse some of the 'brain drain'. About 700,000 Malaysians work abroad.

A new agency called 'Talent Corporation' has been given this task, offering tax breaks for Malaysians to return home and easing visa restrictions for foreigners.

But the shift from low-cost manufacturing and plantations to more knowledge intensive work needs to take place in an environment where creativity and freedom of inquiry can flourish to draw talent and investment. The Malaysian model of ethnic preferences has not been conducive to that.

Mega-projects

Mahathir remains a towering figure. In public forums and in his blog, he is a scourge to the government of the day, influential, for instance, in forcing the early retirement of his anointed successor, Abdullah Badawi. But while he's a critic of his successors, he is a strong defender of the Malaysian system he built.

Mahathir came to office as the foremost champion of Malay privileges. Under his administration, the 'bumiputera rules' led to a mingling of politics and business that largely benefited a coterie of Malay and Chinese businessmen.

Huge government building projects kept the contracts flowing and the political machine running. Mahathir says as much in the interview, citing the slowdown in big projects as the reason for the steady attrition of Chinese support for his successors in office.

"What is happening is the Chinese feel that in the economic area, the business area, they are not receiving the kind of benefits they got during previous times," he said. "The moment I stepped down, all the projects were stopped ... When you stop big government projects, a lot of people - well, their businesses will go down."

In March, Mahathir published an 809-page autobiography, 'A Doctor in the House'. His main motivation in writing it was "to make corrections of the opinions and the accusations that were leveled at me" - especially that he systematically undermined the judiciary.

It is the biggest stain on his record. He authorised the arrest of his deputy and heir apparent, Anwar Ibrahim, on sodomy and corruption charges after the two men fell out over how to handle the Asian financial crisis. The trial was denounced in and out of Malaysia as a farce that called into question the rule of law.

The financial crisis and Anwar's conviction marked a watershed. Foreign investors became wary about Malaysia, and a country once a haven for foreign investment was shunned.

"Ten-twenty years ago, Malaysia was it," said a regional president of a European-based distribution company. "But then came 1997 and the rule of law was exposed for what it was. We once looked at Malaysia for a regional headquarters but rule of law and the bumi policy made us choose Singapore instead."

Mahathir retired in 2003, but Malaysia has yet to inspire confidence again. Economic growth has fallen along with investment, averaging 4.6 percent in the decade that ended in 2010 from an average 7.2 percent in the 1990s.

Field of cyber dreams

Putrajaya is a monument to Muslim Malay culture. Graceful minarets and gleaming blue domes dominate the skyline and a bridge across an artificial lake was inspired by the famous one in Isfahan, Iran. More than 90 percent of the residents are bumiputeras.

Across Putrajaya lake from Mahathir's office is a curious community of knowledge workers called Cyberjaya. The town is a place where the contentious "bum rules" do not apply.

Cyberjaya is home to about 500 IT companies and two universities. It has a daytime population of 41,000 but only 14,000 full-time residents sleep there overnight. This town is filled with futuristic-looking buildings but has few residential neighbourhoods and little in the way of amenities, not yet anyway.

Cyberjaya was one of Mahathir's last big projects. It was to be Malaysia's answer to California's Silicon Valley, the key difference being this one would be a ready-made town, built on old plantation land, in hopes technology innovators would come.

Cyberjaya offers foreign investors a waiver of the bumiputera rules that require equity stakes and employment for ethnic Malays. It also guaranteed the Internet would not be censored, in a country that kept the media on a tight leash.

Cyberjaya was part of a grand plan to avoid the emerging market middle income trap Malaysia was falling into because it could no longer compete for manufacturing jobs, especially with China.

Then the financial crisis hit and Mahathir's response spooked potential investors. Blaming Jewish conspirators for the crisis, he imposed capital controls to stop short-selling of the ringgit. Anwar was arrested the day after that.

Some US$30 billion in portfolio investment fled Malaysia in 1997; most of it has yet to return. Key foreign investors scrapped plans for Cyberjaya and for years Malaysia struggled to woo them back. The effort now appears to be bearing fruit.

Last October, Hewlett Packard launched a multi-purpose client servicing center in Cyberjaya, the single biggest investment by a technology multinational in Malaysia. HP said it would provide 4,000 jobs. It joins Dell, DHL, IBM, Fujitsu, Nokia and DoCoMo among others in the 29-square-kilometre town.

Since 2009, Cyberjaya has attracted RM7.12 billion (US$2.37 billion) in investment, compared with a total of RM4.62 billion in the previous 11 years.

Success has given Hafidz Hashim, managing director of Cyberview Sdn Bhd, the town's developer, a new problem.

“Entertainment," Hafiz said when asked what his "citizens" want the most. He is known as "the mayor of Cyberjaya because his company acts as both builder and city manager.

More than half the projected investment over the next three years will be for residential property, Hafidz said in an interview. Cyberview has already built a community center and clubhouse and plans to build a huge entertainment complex, along with more shops and restaurants.

It is far from Malaysia's answer to Silicon Valley, though. Cyberjaya is home to server farms, data storage facilities and client service centers, the low end of the Internet economy. There is little in the way of R&D underway.

Arvin Singh, 22, has just quit his job at the HP plant because he was "constantly doing the same thing over and over again" and not growing on the job. Most of his co-workers were content to remain in this "comfort zone," he said.

"But one must constantly work to expand one's knowledge," Singh says, adding he plans to study overseas to get further qualified.

Hafidz said one of his biggest challenges is meeting the skills companies in Cyberjaya need, and which Malaysia's education system is not providing. He has set up a 'Knowledge Workers Development Institute' where companies can send workers for training, and on-the-job training programmes. Cyberjaya's success after a sputtering start has inspired similar projects in the country.

The most ambitious is one emerging just north of Singapore called Iskandar Malaysia. It will eventually be a metropolis three times the size of Singapore with theme parks, international schools and colleges, hotels and hospitals, a movie studio, a financial centre and luxury homes. It has attracted US$23 billion in promised investments, nearly half from overseas.

Iskandar is one of five "economic growth corridors" Malaysia is developing with incentives to foreign investors. They are, in effect, investment zones ring-fenced from the mainstream economy where business and politics have long entwined.

Fear for future

Months after Mahathir took power in 1981, a Malaysian Chinese banker packed up his family in the southern city of Johor Bahru and moved to Singapore. He had grown uneasy about the future as Mahathir took an increasingly interventionist approach to the economy and ramped up the affirmative action policy.

Those uncertainties have only increased for a Chinese community that abandoned the ruling BN coalition in the 2008 general election and are now deserting the country in ever mounting numbers. The World Bank said the Malaysian diaspora has quadrupled over the past three decades.

"People are unhappy about the way the (policy) has been exploited, the way it has degenerated into some kind of apartheid policy," said the banker, who requested only his surname, Lee, be used.

"They say come back, we'll give you tax breaks. But when you move back, you're not talking just about your career, but your children's future. And it's this perception of uncertainty that holds them back. They feel the society they have moved to is more assuring that the one they came from."

Lee's son, a medical doctor, said the overseas Chinese Malaysian community has now become anxious about the growing force of political Islam. Last year, 10 churches and two mosques were desecrated after a high court ruled Christians could use the word Allah for God in their literature.

"A lot of people are now worried about a hyper-religious government taking power, and then all that they worked so hard for goes up in smoke."

Kalimullah Hassan, former group editor of pro-government New Straits Times publications, understands their anxiety.

A bumiputera himself, Kalimullah worries about the emergence of right-wing politicians trying to win back Malays, nearly half of whom voted for a multi-ethnic opposition coalition headed by Anwar Ibrahim in 2008.

"To unite the Malays, they raise the bogeyman - other races, specifically the Chinese and foreigners who are supposedly out to displace the Malays in their own homeland - and in doing so, they've upped the ante in race relations," Kalimullah says.

The politics of patronage is no longer working because there isn't enough largesse to spread around in a country whose population has nearly tripled since 1970 and with capital inflows and growth slowing, Kalimullah says.

What Malaysia needs now more than ever is the meritocracy Prime Minister Najib has proposed in his New Economic Model. Otherwise its human capital will be stunted, he says.

"In the mid-to-long term, Malaysia is going to be left further behind by a world which has already realised that human capital is its greatest asset."

- Reuters