

## **Moves to drop ethnic policies may draw backlash**

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Malaysia is carefully easing back decades-old policies favouring its ethnic majority Malays to draw foreign investment but may face political dissent over the move, analysts say.

Malaysia since the 1970s has retained affirmative action policies for Malays and indigenous groups known as "bumiputeras" in order to close a wealth gap with the minority Chinese community.

But in a dramatic change, Prime Minister Abdullah Ahmad Badawi last month lifted some of the policies as the country aggressively seeks to attract much-needed foreign investment.

Under the rules, bumiputeras must hold at least 30 percent of equity in any company, and they should be the majority of workers.

But Abdullah dropped the rules to lure foreign firms in healthcare, tourism and four other service sectors in the Iskandar Development Region (IDR), a massive development in southern Johor state that Malaysia aims to turn into a gleaming commercial hub across from booming Singapore.

In a further relaxation last week, he agreed to allow 100-percent foreign equity ownership in Islamic financial institutions conducting business in foreign currencies.

Analysts say Abdullah and his government are treading softly for fear of a political backlash from the ruling Umno which has built a rock-solid support base as a champion of Malay rights.

"They are trying to tone down the reality that they need to find ways to basically go around 30 years of affirmative action," said Wan Suhaimi Saidi, an economist with Kenanga Investment Bank.

### **Fast track incentives**

The government had already exempted some companies, including those in manufacturing and in a high-tech hub south of the capital.

But in terms of stock market capitalisation and as an investment destination, Malaysia remains a "pale shadow of itself compared to 10 years ago," Citigroup said in October, citing the slow pace of economic liberalisation.

Malaysia is Southeast Asia's third-largest economy but in 2005 foreign direct investment fell to RM15 billion from RM17.6 billion in 2004.

The country faces strong competition from regional economies including China and Vietnam in the hunt for foreign funds, analysts say.

"Malaysia realised that it needed to fast track on giving more incentives to investors," said Wan Suhaimi.

"They have to do this or else they're going to lose out to other countries like Thailand, Indonesia, the Philippines and Vietnam," he said.

Jeff Hurst, executive director of the American Malaysian Chamber of Commerce, said Malaysia's equity controls were disincentives to investors.

"Control is key," said Hurst. "If companies have more control, they are more apt to make larger-sized investments and are more apt to put in higher-value operations like research and development."

Despite concerns the affirmative action policies have bred an over-reliance on concessions and favoured an elite, they have been fiercely guarded by the government and Umno, which has ruled Malaysia since independence in 1957.

"Politically, it requires Malaysians to accept competition as a fact of life," Shahrir Abdul Samad, a prominent lawmaker, said of the changes.

### **Party backlash**

Head of research for CLSA Securities Malaysia, Niklas Olausson, said the government knew it had to start liberalising.

"They are taking a big-picture view of this, and whatever political ramifications there are will be limited, because these are measured efforts," Olausson said.

"Umno leaders themselves can understand it's the start of the transformation of the Malaysian economy," from one based on manufacturing exports, to a more service-based economy, Shahrir said.

He denied there would be any party backlash, although the IDR project has already reportedly attracted criticism from ex-prime minister Dr Mahathir Mohamad, who said last week Malays would not be able to compete with foreigners.

As a measure of the sensitivities involved, differences over the affirmative action policies helped bog down free-trade talks between Malaysia and the United States this year.

Malaysia repeatedly stated that the policies were "no-go" areas.

On one hand, the government knows the right policy is to dismantle the affirmative action rules, said independent political analyst Khoo Kay Peng.

"On the other hand, they cannot do it because they have to play to their constituents," Khoo said. "That is a problem."

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