

AFTER MAHATHIR

Sometime late next month, a low-key ceremony will take place on the fourth floor of a pastel-pink palace in the new Malaysian capital of Putrajaya. In the privacy of his inner chambers, Prime Minister Mahathir Mohamad is to hand over his so-called job manual—a largely symbolic binder of documents—to Abdullah Badawi, his deputy prime minister. Sporting the drab, long-sleeved safari suits the two wear around the building on any weekday, they will shake hands and say their goodbyes. Then Mahathir will stroll across the marble floor, place his thumb on the biomechanical security lock on the front door, and leave Malaysia in the care of its first new Prime Minister in 22 years. “I will be nothing,” Mahathir has told the Malaysian press. “I will be Dr. Mahathir Mohamad.”

Can a man who has ruled with an authoritarian hand for more than two decades truly be expected to walk away from the corridors of power? Some find it hard to believe that a leader as forceful as the 77-year-old “Dr. M” would step down so quietly, but many in Kuala Lumpur say the transition has already effectively happened. Since Mahathir, a former physician, tearfully announced in June, 2002, that he wanted to quit, he has been slowly handing his duties to Badawi. Indeed, last spring Mahathir took a two-month vacation, leaving his deputy in charge as the SARS outbreak pummeled tourism and the war in Iraq brought angry Malays into the streets. Badawi’s diplomatically phrased formal objection to the Iraq war offended no one in

Economics

the international community while appeasing protesters and showing that the heir apparent possessed a deft touch. “They are as much my people as they are Dr. Mahathir’s,” Badawi told a U.S. official in late August.

In his long tenure, Mahathir clearly healed much of what ailed Malaysia. When he rose to power in 1981, the country still bore scars from violent race riots and a long fight against a stubborn communist insurgency. Since then, it has become a model of prosperity, civil order, and economic growth for Asia. Mahathir encouraged export-oriented manufacturing to wean Malaysia from its dependence on crude oil, rubber, and palm oil. His finance ministers and central bankers have kept the fiscal deficit reasonably low. He built high-quality roads, a world-class phone system, and the region’s best railroads. In 1980, Malaysia’s gross domestic product was \$12 billion. Last year, it was \$210 billion, and per capita income stood at \$3,540, the third-highest in Southeast Asia after Brunei and Singapore. “Mahathir created a nation,” says Robert Broadfoot, managing director of Political & Economic Risk Consultancy in Hong Kong. “There’s real pride in the country.”

Along the way, though, Malaysia developed a cozy, inbred business and political culture that critics hope the new Prime Minister will change. Badawi is

The leader who built modern Malaysia is stepping down. Now, a new economic model is needed. Can Abdullah Badawi provide it?



MAHATHIR (RIGHT) AND BADAWI IN JUNE

showing signs that he may want to initiate those reforms. But he's a card-carrying member of the Establishment, too. "To consolidate his power base, he needs to play the game," says Bridget Welsh, a Malaysia expert at the Paul H. Nitze School of Advanced International Studies in Washington. "But he needs to tackle the rules of the game. That's the dilemma."

There's little doubt that Badawi will present a far different public face to the world. Mahathir has earned a reputation both as a fierce defender of Asia against the West and as a tough political infighter at home. His successful prosecution

Economics

of his deputy prime minister and rival, Anwar Ibrahim, on charges of sodomy and corruption—despite Anwar's pleas of innocence—was the most glaring example. And he may be best remembered by many Westerners for his fierce anti-American outbursts and anti-Semitic statements. By contrast, the 63-year-old Badawi is known as a consensus-builder, a skill he learned in eight years as Foreign Minister. He is also the son and grandson of Islamic scholars and a student of Islam himself, earning him the respect of Malaysia's new breed of fundamentalist Muslims, a growing political force. "Badawi will have stronger Islamic credentials than Mahathir, so he'll be able to tone down his rhetoric," says a U.S. defense official who met Badawi recently.

Badawi declined to be interviewed for this story. Mahathir, after receiving a letter from *BusinessWeek* asking for comment on charges by critics that his regime had been tainted by cronyism and corruption, told reporters in Kuala Lumpur that any such allegations were "nonsense." The daily *New Straits Times* quoted Mahathir: "Is that the freedom of the press, to tell lies and to damage other people's country and reputation?"

As Malaysia prepares for the handover to Badawi, on many levels the nation appears to be in good shape. The stock exchange is up nearly 20% since January, and the economy is expected to hit 4.5% growth this year. Foreign investors have long liked the political stability, good infrastructure, and relatively cheap skilled labor Malaysia offers. In exchange, foreigners have agreed to honor laws that require them to offer equity stakes in their enterprises to Bumiputras—a local term that generally means ethnic Malay Muslims—often members of Mahathir's party, the United Malays National Organization, or UMNO. While exceptions were made for exporters in some industries and the party's involvement was rarely overt, the rules were understood and obeyed.

This arrangement frequently drew charges from critics



SHIFT Badawi has said that some government building projects have "become too embarrassing to mention"

ONE OF THE PETRONAS TOWERS IS ONE-THIRD EMPTY, SAY REAL ESTATE AGENTS

itself as affordable office space for low-tech call centers and back-office data processing. Malaysia's investment in education, meanwhile, will take at least a generation to bear fruit. Badawi can get faster results by offering more incentives to foreign investors and opening the economy and financial system further, says Bertrand Bidaud, vice-president of Gartner Research in Singapore: "The world has changed, and Malaysia has been a bit complacent."

Nowhere are the problems more evident than in Penang. Once the pillar of Malaysia's electronics industry, the steamy island in the Malacca Strait is hollowing out, with Seagate Technology, Motorola, Solectron Technology, and other multinationals shifting production elsewhere in Asia. Solectron, which

Badawi may have to be patient when it comes to pushing Malaysia up that ladder. During the boom years, Mahathir promoted a program called Vision 2020—a plan to transform Malaysia into a developed nation by 2020. It was based on the assumption that heavy spending on education, information technology, and other modern industries would do for Malaysia's 24 million people what similar programs have done for Japan and Korea. Part of the business plan was the \$4 billion "Multimedia Super Corridor," centered around Cyberjaya, an office park tailored to high-tech companies.

That was before China became a competing industrial power. The government hails Cyberjaya as a success, but lately tech investors have stayed away, forcing it to market

makes equipment for Cisco Systems, Hewlett-Packard, and others, has already transferred assembly of PCs, cell phones, and routers for 10 of its clients to China. The company has kept some more sophisticated operations, such as design work, in Penang, but it expects to move that to China within two years. "All of us are quite concerned about the change in leadership in the country, whether it's going to lead to positive or negative impact on this industry," says Joe Tang, a corporate vice-president at Solectron in Penang. Tang wants Malaysia to follow the lead of China, which has fostered the growth of local tech companies by wooing foreign investors while also building up the local supply base.

Malaysia's leading ethnic Chinese and Indian tycoons are

nervous, too. Over the years, Mahathir has relied on their support, both politically and financially. Many have expanded their businesses with construction contracts for government-sponsored infrastructure projects. But Badawi's stronger Islamic credentials will likely increase UMNO's support among Muslims, so the tycoons are starting to wonder what their role will be. They're jockeying for meetings with Badawi and keeping an even lower profile than usual. "Everyone wants to be in the inner circle," says Lim Kit Siang, former leader of the opposition Democratic Action Party.

Business leaders with ties to UMNO may have even bigger wor-

that Malaysia Inc. benefited from state largesse and tolerated corruption. Until recent years, as long as the factories kept humming, few were concerned. Today, though, investors can avoid Malaysia's intricate corporate dance by building their factories in other countries—China first and foremost—that offer cheaper skilled labor and good infrastructure, too. Average factory wages in Malaysia are \$159 per month, compared with \$125 in China, \$38 in Indonesia, and just \$18 in Vietnam. "Malaysia is being sandwiched by lower-cost producers such as China, India, and Vietnam," says Rajeev Malik, senior economist at J.P. Morgan Chase & Co. in Singapore. "But it's unable to move up the value chain and compete with Korea, Taiwan, or Singapore."

Meet the New Boss

Badawi's style is far different from the authoritarian Mahathir's

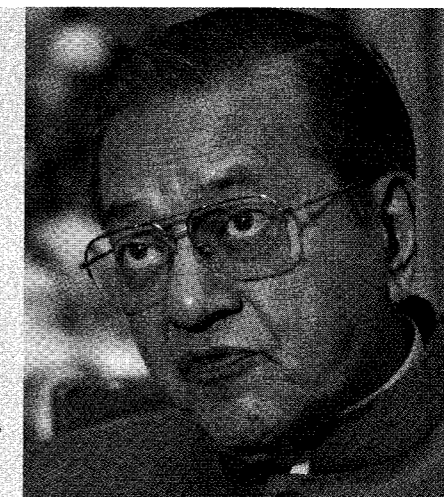


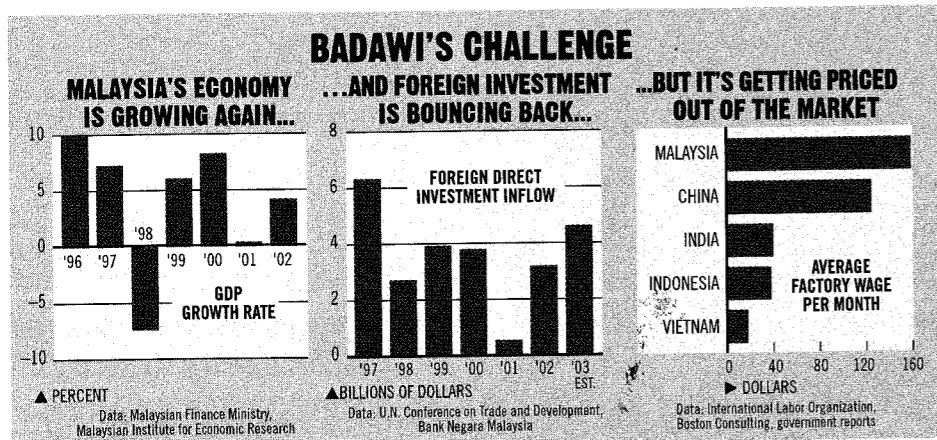
BADAWI

- Advocates better corporate governance and is speaking out against graft
- Is an Islamic scholar and has good relations with Muslim clerics
- Has shown diplomatic tact in handling explosive issues such as the war in Iraq
- Is known as a patient, nonconfrontational negotiator with few enemies
- Is expected to slow the pace of infrastructure development

MAHATHIR

- Transformed Malaysia into a prosperous nation, but one that has tolerated corruption
- Defused ethnic tensions with an affirmative-action program promoting Malays
- Has offended the West with anti-American and anti-Semitic rhetoric
- Is known for fighting political battles to the bitter end, even if it alienates voters
- Has spent billions on infrastructure projects such as a new capital city, Putrajaya





the New Economic Policy, an affirmative action program for Bumiputras that Mahathir has started to sour on. Last year, the language of instruction in math and science courses at government schools was switched from Malay to English. Then a quota system in university entrance exams that gave Bumiputra students an advantage was adjusted to give academic merit more weight. Finally, on June 17, the law requiring foreign investors to have Bumiputra partners was repealed. Foreigners may now own 100% of a Malaysian company in most sectors.

The Bumiputra regulations aren't the only restrictions Badawi wants to remove. In March he vowed to "rectify" the "excruciating" level of red tape at government agencies that regulate hotel management and land transactions. The government is also preparing to issue new licenses in the once closed-to-outsiders financial-services industry, says Zeti Akhtar Aziz, governor of Bank Negara Malaysia, the central bank. "A lot of deregulation is taking place," says Mohamad Ariff, executive director of the independent Malaysian Institute of Economic Research.

Investors are delighted with the new rules. "As outsiders, we know it isn't going to be in our favor if an industry is distorted through the industrial policy of a government," says Nicholas R.H. Bloy, director of private equity fund Navis Management. In 2001, Navis acquired a disposable-diaper factory in Malaysia from Houston-based Drypers Corp. after Drypers sought bankruptcy protection. Now, Bloy is negotiating to acquire two more Malaysian companies.

Badawi will take office at a time when Malaysia, like the rest of Asia, is benefiting from a global economic recovery. Gross domestic product grew at an annual rate of 4.5% in the first half, up from 2.6% during the same period last year. Manufacturing was the largest contributor, growing 6.2%, mainly from exports of semiconductors and household appliances. Some manufacturers have started exporting partially assembled products to China, where they are completed at less well equipped, more labor-intensive plants.

In the long run, that strategy may not hold as more companies shift production to China. But it's working now: The inflow of foreign investment reached \$1.46 billion from January to June, up from \$928 million during the same period last year. But Malaysia needs to do more to prepare for the challenge ahead. The economy has long been buoyed by oil-and-gas production, which contributes

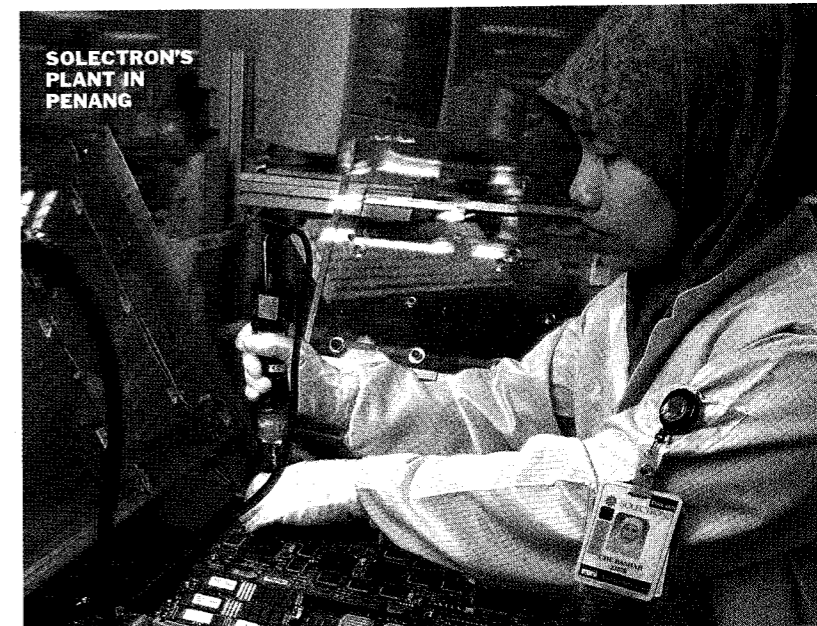
7% of GDP. "You want to be investing in R&D and education and skills for the time when oil exports run out," says Hal Hill, a Southeast Asia expert at Australian National University in Canberra.

At street level, Malaysia is bouncingly optimistic, particularly after dark in Kuala Lumpur. The city's nightlife betrays no hint of greater Islamicization under Badawi. Thousands of teens and twentysomethings pay as much as \$10—more than a day's wage in many factories—for cocktails at trendy nightclubs that stay packed into the wee hours. And it's not just Malay men and Chinese and Indian couples anymore, but also Malay Muslim women, who leave at home the scarves that cover their hair during the day. Dancing to the Red Hot Chili Peppers on the wood-plank dance floor of the Beach Club, the crowd literally shakes the thatch roof, while across the street at the Nouvo Club, customers dance on the bar to hip-hop and rap while between their feet bartenders serve frozen margaritas.

Even the country's troubled financial system is getting its health back. Loans at Malaysia's 10 full-service banks—the product of a massive government-enforced consolidation of 54 financial institutions—grew 4% in the second quarter over the year-earlier period. Foreign reserves have risen to \$38.6 billion, enough to cover more than seven months of imports, up from five months in June, 2000. With the stock market up sharply this year, fund managers from Asia, Europe, and the U.S. are waking up. "They're calling, they're coming to visit, they're buying," says Uday Jayaram, head of research at ING Financial Markets in Kuala Lumpur. Two of the issues they're interested in: PLUS Highway, a remnant of the Renong conglomerate that ran aground in 1997, and Astro, a satellite-TV broadcaster that's planning an initial public offering this fall.

Part of the attraction may be that a new, more professional breed of manager is ready to take the helm at Malaysia Inc. The old generation of UMNO-linked CEOs often owned controlling stakes in their companies and gave short shrift to the needs of minority shareholders, say Malaysian economists and Western diplomats. But new CEOs run many restructured UMNO-linked corporations. The companies compensate their managers with stock options, while before the crisis they received loans and substantial equity stakes. And they advertise themselves as managed by professionals without the interference of controlling shareholders. "These are quite early days, but I call it Malaysia Inc. II," says Nazir Razak, CEO of Commerce International Merchant Bankers, one of Malaysia's biggest financial institutions.

Skeptics scoff at the notion and say that just as Mahathir's friends have benefited from his years in power, Badawi has his own crowd. Among them is his son, Kamaluddin Abdullah. Kamaluddin controls Scomi Group, an oil-services company whose stock price has risen more than fivefold since its IPO on May 12. Kamaluddin says neither he nor his company benefits from his pedigree. "The stock price of [Scomi] is a reflection of its sound fundamentals and its good performance," he explains. Critics don't believe it's that simple. "It's just one set of cronies replacing another set of cronies," grumbles Steven Gan, editor-in-chief of *Malaysiakini*, an independent news Web site that has frequently crossed swords with the government.



SKITTISH Solectron has moved the bulk of its operations to China—and could well move the rest within two years

Regardless of how well the economy does, Badawi will have to confront the rising tide of terrorism in Southeast Asia. And for that, he has already earned relatively high marks from Western diplomats, who praise Malaysia for providing a more secure environment for American and Australian interests than Thailand or Indonesia. In his role as Home Minister, Badawi signs "detention

orders" to hold people indefinitely—about 100 were under arrest at last count—without trial or formal charges under Malaysia's Internal Security Act. Leaders of the opposition Parti Islam Semalaysia accuse the government of detaining figures such as Nik Adli, the 35-year-old son of Nik Aziz, the party's supreme spiritual leader. (The government declined to say whether Nik Adli is being held.) In a sign that Badawi isn't about to let down his guard, Malaysian police recently released a report accusing Nik Adli of having attended meetings with alleged terrorists Hambali, who was captured in Thailand on Aug. 12, and Abu Bakar Basyir, who was sentenced to prison in Jakarta on Sept. 3.

There's little doubt that the handover of power will be smooth at first. But Badawi will come under enormous pressure to prove himself quickly in the political arena. One of his first challenges will be to ensure victory for UMNO in elections expected next spring. "If he does well, he can come up with his own policies, programs, and agenda," says a prominent Malaysian economist. "Only after the elections can he prove he's not living under Mahathir's shadow." When that happens, though, the answers to Badawi's real challenges—remaking the business culture, reorienting the economy—surely won't be found in the ceremonial job manual that Mahathir will leave in his hands. Only then will Malaysia—and the world—know whether Badawi is truly up to the task of taking over where the good doctor left off.

By Michael Shari in Kuala Lumpur

BusinessWeek online

For a Q&A on Malaysia's economy with Australia National University's Hal Hill, go to www.businessweek.com/magazine/extra.htm

ries if Badawi reins in outlays for the public-works programs that have been Mahathir's signature. Since 1991, Malaysia has spent well over \$15 billion on infrastructure projects such as the Kuala Lumpur International Airport. The \$2.4 billion facility, which was built to resemble a cluster of Arabian tents, is designed to handle 25 million passengers a year but will see just 16 million this year. Although the city's old airport at Subang was clearly overburdened, the new facility won't likely reach full capacity until 2011, estimates brokerage ING Financial Markets. The \$2.9 billion Petronas Twin Towers in Kuala Lumpur, which marry Islamic motifs with the soaring lines of New York's Chrysler Building, are the world's tallest skyscrapers. But one tower remains one-third empty, say real estate agents. And in the new capital, Putrajaya, built at a cost of \$5.3 billion some 30 kilometers from central Kuala Lumpur, parking lots are landscaped like golf courses, and domed government office buildings are modeled after mosques. The city was built to relieve overcrowding in Kuala Lumpur, but foreign embassies have mostly stayed in the old capital, and the web of new highways around Putrajaya is empty much of the time. Badawi has criticized the government construction boom, telling Malay grads of elite British universities in a speech on Mar. 6 that some projects have "become too embarrassing to mention."

Economics

Badawi isn't just a critic of government infrastructure projects. For months now, he has been breaking protocol by railing against corruption at otherwise polite, white-tablecloth luncheons with Malaysia's upper crust. "We cannot dismiss the problem by saying that this is just the way things are done in Malaysia and offer to pay a bribe," he said in the Mar. 6 speech. And he's continuing to dial back on

