SUMMARY

Economic Environment

1. Malaysia is a middle-income country with a diverse economy. Trade is very important, with exports and imports of goods and services equivalent to about 130% of GDP. For the past four years, real GDP growth has averaged nearly 5% despite a number of external and domestic shocks, including global commodity price and financial market volatility, weak external demand, and domestic political controversy. Growth has been based on domestic demand and helped by the diversified production and export base, a flexible exchange rate, responsive macroeconomic policies, and strong financial markets.

2. From 2013 to 2016, there were some changes to the structure of trade in goods. In US dollar terms, exports and imports declined, mainly due to lower commodity prices. On the export side, the value of exports of fuels and palm oil declined while exports of office machines and telecommunications equipment increased. Other Asian countries, and other ASEAN in particular, are the main source of imports and destination for exports.

3. Long-term economic policy is set out in Vision 2020 which includes the objective of achieving high-income country status by 2020, by, *inter alia*, sharply accelerating the growth of labour productivity. In addition, the Eleventh Malaysia Plan and sectoral plans, such as the National Agrofood Policy 2011-20 and the National Commodity Policy 2011-20, emphasize the importance of productivity, innovation, and trade in achieving economic growth.

Trade Policy Framework

4. There have been no major changes to the institutions responsible for trade policy formulation since 2014. Among the new trade and investment-related laws that entered into force during the review period were: the Companies Act, which introduced provisions to simplify the procedures to start a company, to reduce the cost of doing business, as well as to reform corporate insolvency mechanisms; the introduction of the goods and services tax to replace the sales tax; the Malaysian Aviation Commission Act, pursuant to which the Malaysian Aviation Commission was established; and various amendments to the Food Regulations.

5. As an active Member of the WTO, Malaysia has submitted notifications to the WTO in a number of areas. However, at end-October 2017, several notifications were outstanding, including on: agriculture (domestic support); quantitative restrictions; and customs valuation. During the review period, Malaysia was not involved in any new WTO dispute settlement cases either as complainant or respondent. It participated as a third party in four cases.

6. As a member of ASEAN, Malaysia is a party to trade agreements with Australia and New Zealand; China; India; Japan; and the Republic of Korea. During the review period, the ASEAN-India Agreement was expanded to cover trade in services. Malaysia also has bilateral RTAs with: Australia; Chile; India; Japan; New Zealand; Pakistan; and Turkey. The Malaysia-Turkey FTA (MTFTA) entered into force in 2015. On 31 December 2015, the first phase of the ASEAN Economic Community (AEC) Blueprint 2015 was completed and ASEAN leaders then adopted the AEC Blueprint 2025.

7. Restrictions on foreign investment remain in fisheries, energy, telecommunications, finance, and transport services, and foreign participation in public-private-partnership projects is limited to a ceiling of 25% of share capital. Some policies supporting the ethnic Malay community (*bumiputera*), including minimum equity participation in some sectors, may affect FDI. However, the Government has continued to relax foreign investment restrictions. Currently there is no foreign equity restriction in the capital market except for a 70% cap on investment banks.

8. The Government has been making efforts to modernize Malaysia's business licensing system, by reviewing licences and making them accessible online. The Malaysia Productivity Corporation (MPC) conducted sectoral regulatory reviews to reduce unnecessary regulatory burdens on business.

Trade Policy Developments

9. There has been no major change to customs procedures during the review period. Malaysia ratified the WTO Trade Facilitation Agreement (TFA) in May 2015, and notified that it designated all provisions under Category A with some exceptions. Malaysia's ease of trading across borders remains highly ranked in international comparisons.

10. The tariff is the main trade policy instrument, despite its low share in total tax revenue (1.7%). Due to changes in nomenclature (HS12 to HS17) and for other technical reasons, the average applied MFN tariff increased from 5.6% in 2013 to 7.5% in 2017, although tariffs increased on only a single tariff line (at 10-digit level). Almost all rates (99% of tariff lines) are *ad valorem,* while duty-free lines accounted for 56.2% of all tariff lines. The number of different tariff rates increased from 19 in 2013 to 25 in 2017. *Ad valorem* tariff rates range from zero to 60% for industrial products and zero to 90% for agricultural products. Among different product groups, average tariffs are highest for transport equipment (the simple average tariff rate was 21.5% in 2017). These averages do not include the 1% of lines subject to non-*ad valorem* tariffs which are mostly applied to tobacco and alcohol products, with *ad valorem* equivalents that range from 0.2% to 465% for certain manufactured tobacco. Simple average rates under all preferential arrangements are lower than the simple average MFN rate, although the averages among arrangements are different, ranging from 0.1% to 7.4%.

11. Malaysia applies nine tariff quotas affecting 27 tariff lines at the HS 10-digit level. According to the authorities, this is to meet the requests of domestic small producers. Import duty exemptions are applied to local and foreign manufacturing companies on raw materials and components used in the manufacture of goods for export, and for machinery and equipment not available in Malaysia but used directly in the manufacturing process. In addition, imports of 16 product categories required import licences.

12. During the review period, the number of antidumping investigation initiations reached its peak in 2015, and the number of definitive anti-dumping measures reached its peak in 2016. Imports from nine Members were affected, and antidumping duties were applied mostly on biaxially oriented polypropylene film, and steel wire rod. Between 2014 and 2017, four safeguard investigations were initiated, all concerning steel products.

13. Export duties range from 5%-30% and apply to 217 tariff lines (mainly crude oil, palm oil, and wood) in 2017. The number of tariff lines with export duties declined from 482 in 2014, partly reflecting the merging of tariff lines during the transposition exercise.

14. A significant change to Malaysia's tax structure was the replacement of the sales tax with a 6% goods and services tax (GST) (from 1 April 2015), which is essentially a value added tax-type system. In 2016, revenue from GST accounted for 24% of total tax revenue. The share of petroleum income tax to total tax revenue declined, from 19% in 2013 to 5% in 2016, reflecting falling oil prices.

15. Malaysian incorporated companies, local or foreign, are eligible for incentives. Tax incentives continued to be implemented mainly through the pioneer status and the investment tax allowance schemes. Direct tax incentives grant partial or total relief from income tax for a specified period, and incentives on indirect taxes are in the form of exemptions from import tariffs and excise duties. In addition, Malaysia provides support in the form of a statutory income tax exemption to manufacturers based on the value of increased exports. Exemption of statutory income tax equivalent to 50% of the value of increased export is available to companies in selected services sectors.

16. Regarding standards, Standards Malaysia, Malaysia's national standardization and accreditation body, is focusing on establishing standards that have a high impact on the public, including industries, rather than on the number of standards. As a result, the number of Malaysian standards dropped from 6,381 in 2012 to 5,284 in 2017. Malaysia continues to align its standards with international ones: in 2017, 60% of Malaysian standards were aligned with international standards, up slightly from 59.8% in 2014, and 54% were identical, down from 57.5% in 2014. In 2017, 510 or 9.7% (6.5% at end-2012) of all Malaysian standards were compulsory.

17. State involvement in the economy is considerable, with government-linked investment companies involved in petroleum, electricity, telecommunications, postal services, air transport, public transport, and financial services. Malaysia notified the WTO that Padiberas Nasional Berhad (BERNAS) acts as a state trading enterprise for rice importation. General purpose flour, cooking oil, and liquefied petroleum gas (LPG) are subject to price controls and subsidies are provided to support ceiling prices.

18. There have been no major changes to the legal and institutional framework governing competition policy since the previous review. The government procurement regime remains a decentralized system, and continues to be used to favour locally owned businesses. Foreign suppliers are not allowed to participate in domestic tenders, while international tenders are invited only if there are no domestically produced supplies or services available. Malaysia is an observer to the plurilateral WTO Agreement on Government Procurement.

19. There has been no significant change to the IPR regime in Malaysia during the review period. Enforcement, despite having improved, remains an area of concern. Malaysia ratified the Protocol Amending the TRIPS Agreement on Public Health in December 2015.

Sectoral Policy Developments

20. Malaysia has a dichotomous agricultural structure with large plantations dominating palm oil production and small producers dominant in other sectors. Several large corporations with international activities are responsible for a large proportion of production and processing of palm oil. While the area under rubber trees has declined relative to the mid-2000s, rubber remains important in terms of agricultural production and as an input to industry, with both domestic production and imports of natural rubber being used. Although rice production represents a relatively small part of the total value of agricultural production, the Government has continued to prioritize the sector, which is dominated by small-scale producers, through self-sufficiency targets (which also apply to fruits, vegetables, and livestock), minimum prices, input subsidies, and direct payments to producers. In general, small-scale producers tend to be supported by the Government, while large plantations tend to be taxed.

21. Petroleum and gas remain important to the economy, contributing about 10.5% to GDP and about 14% to government revenues in 2016. The sector is dominated by the state-owned company PETRONAS, which has exclusive ownership of all oil and gas deposits and exclusive rights for exploration and production in Malaysia, both on land and offshore, and responsibility for planning and investment. It is also responsible for regulation of upstream activities. Exploration, development and exploitation of petroleum and gas takes place through production sharing or risk service contracts between oil companies and a subsidiary of PETRONAS. Another subsidiary of PETRONAS, MISC Bhd, is a major energy shipping company with a large fleet of tankers and LNG vessels. In addition to producing crude oil, Malaysia also imports crude for refining. Although the value of both exports and imports of petroleum products and natural gas has declined over the past few years, the volumes traded have increased significantly and investment continues, bringing Malaysia towards its objective of being a principal hub for oil and gas in the Asia-Pacific area. At end-2014, subsidies for petrol and diesel were removed although regulated prices continue to be applied. Subsidies remain for LPG and regulated prices of gas to the power sector are being increased.

22. In line with the Eleventh Malaysia Plan, 18 services subsectors were liberalized in 2012 and up to 100% foreign equity participation is now allowed for wholesale and retail trade, healthcare, professional services, environmental services, courier, and education subsectors. Since then, progress has slowed, although foreign equity restrictions in unit trust management companies and in credit rating agencies were removed in 2014 and 2017, respectively. However restrictions remain in several sectors including telecommunications, transport, and investment banks.

23. Under the Malaysian Aviation Commission Act of 2015, the Malaysian Aviation Commission was established, taking over some of the responsibilities of the Ministry of Transport, including economic regulation, allocation and management of air traffic rights, monitoring of slot allocations, and licensing of air services, ground handling, and aerodrome operators. All except two of Malaysia's airports are owned by the State, and the government-linked company, Malaysia Airports Bhd, manages five of the six international airports.

24. Malaysia has a well-integrated and mature financial sector, which has undergone consolidation over a number of years. The financial sector, which is comprised of banks, insurance, and capital markets, contributed 6.4% to GDP in 2016 with increasing levels of cross border activity. Furthermore, Malaysia is at the forefront of the global Islamic finance industry and has a highly developed Islamic finance sector. Islamic financial institutions operate in parallel with conventional financial institutions, both offering a full range of financial products and services and often using the same infrastructure. Islamic banking has grown rapidly over the past ten years with its market share increasing from about 12% in 2007 to 28% at the end of 2016. In addition, Malaysia issued more than 54% of the total global sukuk (Islamic bonds).

25. Malaysia's diverse economic base and general openness to trade helped the economy to continue to grow through a difficult period caused by low commodity prices which affected several sectors, particularly petroleum and gas, and palm oil. Growth was also helped by pragmatic government policies such as the floating exchange rate, which allowed the Malaysian ringgit to fall against other currencies while government revenues were supported by the introduction of the goods and services tax in 2015, despite the decline in oil-based revenues. On the other hand, the State remains very involved in the economy through government-linked enterprises and their subsidiaries, and investment restrictions remain in some sectors. However, trade and investment policies are becoming more liberal as investment restrictions are being relaxed, and Malaysia has expanded its network of trade agreements – both through ASEAN and on its own behalf. Given Malaysia's abundance of natural resources, strategic location, and pragmatic policies, growth should continue towards the goal of becoming a high-income country by 2020.