MALAYSIA

TRADE SUMMARY

The U.S. goods trade deficit with Malaysia was $24.0 billion in 2006, an increase of $758 million from $23.2 billion in 2005. U.S. goods exports in 2006 were $12.6 billion, up 20.0 percent from the previous year. Corresponding U.S. imports from Malaysia were $36.5 billion, up 8.5 percent. Malaysia is currently the 18th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Malaysia were $1.4 billion in 2005 (latest data available), and U.S. imports were $708 million. Sales of services in Malaysia by majority U.S.-owned affiliates were $1.3 billion in 2004 (latest data available), while sales of services in the United States by majority Malaysia-owned firms were not available in 2004 ($292 million in 1998).

The stock of U.S. foreign direct investment (FDI) in Malaysia in 2005 was $10.0 billion (latest data available), up from $8.1 billion in 2004. U.S. FDI in Malaysia is concentrated largely in the manufacturing, and mining sectors.

FREE TRADE AGREEMENT NEGOTIATIONS

The United States and Malaysia initiated negotiations on a Free Trade Agreement (FTA) in June 2006 with a common commitment to conclude a comprehensive, high-quality FTA. Malaysia is our 10th largest trading partner with more than $49.1 billion in total trade during 2006. Increased access to Malaysia's market that an FTA would provide would boost trade in a wide range of both industrial and agricultural goods and services, enhancing employment opportunities in both countries. An FTA with Malaysia also would advance President Bush's Enterprise for ASEAN Initiative, under which the United States hopes to enhance U.S. trade and economic ties to ASEAN countries, reinforcing a strong U.S.-ASEAN relationship, which is a force for stability and development in the Southeast Asian region. Finally, an FTA with Malaysia would deepen the relationship between the two countries and support our cooperative efforts on key economic, political and security issues.

After the last round of negotiations in February 2007, Malaysia informed us that it needed to seek a political consensus within its Cabinet on how to proceed on these issues. Resolution of that process is a necessary step before the negotiations can continue. The U.S. Government made clear to the Malaysian government the requirements of Trade Promotion Authority (TPA) and, at this point, submission of the FTA under this TPA is improbable. Nonetheless, we continue to believe that reaching a high-quality, comprehensive FTA would benefit both economies and the United States and Malaysia have agreed to continue working toward this goal. When an agreement is within reach, the United States would seek to work with Malaysia to find a mutually acceptable way to conclude and seek legislative approval of such an agreement.

IMPORT POLICIES

Tariffs

Tariffs are the main instrument used to regulate the importation of goods in Malaysia. The simple average applied normal trade relations/most-favored nation tariff rate is approximately 8.1 percent, but duties for tariff lines where there is significant local production are often higher.

The level of tariff protection is generally lower on raw materials than for those goods that have value-added content. In addition to import duties, a sales tax of 10 percent is levied on most goods. Neither import duties nor this sales tax is applied to raw materials or machinery used in export production. Beverage alcohol and wine are subject to an effective tariff of up to 500 percent when import duties and excise taxes are combined. Adjustments to excise taxes made each year as part of the budget process can sharply raise costs (as in FY 2006) and make it difficult for U.S. companies to negotiate long-term supply contracts in this sector or market strategically. Bound tariffs range up to 434 percent on imported spirits, 148 percent on beer and 115 percent on wines and sparkling wines.

Twenty-seven percent of Malaysia's tariff lines (principally in the construction equipment, agricultural, mineral, and motor vehicle sectors) are also subject to non-automatic import licensing designed to protect import-sensitive or strategic industries.

Import Restrictions on Motor Vehicles

Malaysia has long protected its automobile manufacturing industry from foreign competition using high tariffs and non-tariff trade barriers. Malaysian government policies also distinguish between "national" cars (*i.e.,* domestic producers Proton and Perodua) and "non-national" cars, which include most vehicles manufactured in Malaysia by non-Malaysian owned firms. Significant barriers including highway bans also exist to the importation, sale and usage of large foreign motorcycles.

The Malaysian government has slowly started to dismantle some of its protections in order to meet its commitments under the WTO and the ASEAN Free Trade Agreement (AFTA). In January 2004, it eliminated local content requirements that were inconsistent with its obligations under the WTO TRIMS Agreement. In March 2006, the Malaysian government issued a new National Auto Policy (NAP) that paves the way for further sectoral liberalization.

Nonetheless, certain government policies continue to block open trade in the automotive and motorcycle sectors. The Ministry of International Trade and Industry oversees a system of approved permits (APs) that allows the holder to import cars and motorcycles and distribute them locally. The AP system was designed to provide *bumiputera* (ethnic Malay) companies easy entry into the automobile and motorcycle distribution and service sector. The AP system acts as a quota by restricting the total number of vehicles that can be imported in a given year. APs continue to be capped at an estimated 10 percent of the domestic market. Under the National Automotive Policy (NAP), no new APs will be issued to any existing or new company until the AP system is eliminated. In addition to restricting market access for imports, many of the permits are sold for profit, with the associated costs passed on to consumers, further raising the cost of imported vehicles. The 2006 NAP proposes the elimination of the AP system by 2010.

The Malaysian government has amended the automotive tax regime several times from 2004 to 2006 to meet its commitments under AFTA. The import duty rate for vehicles with at least 40 percent ASEAN content was set at 20 percent in October 2005 but was lowered to 5 percent in 2006 with the NAP launch. To compensate for the revenue lost by cutting import tariffs, the Malaysian government, since 2004, has imposed steep automobile excise taxes. The high tax rates continue to excessively burden automakers; however, a 50-percent rebate on excise taxes that was available to domestic car manufacturers Proton and Perodua, plus two locally incorporated joint ventures assembling imported kits, was eliminated by the NAP.

The NAP implemented a support mechanism for locally assembled vehicles. Components sourced from locally-registered components manufacturing companies are eligible to be deducted from the taxable base of locally assembled vehicles for the purpose of calculating excise and sales taxes. Foreign automakers have complained that the new mechanism essentially revives the local content program that had been abolished in 2004.

The import duty/excise tax schedule is complex. In general, the current applied import tariffs and excise tax rates for completely built-up (CBU) and completely knocked-down (CKD) vehicles are as follows:

	ASEAN Tariff (%)	**NonASEAN Tariff (%)**	**Excise (%)**
Automobiles (CBU)	5	30	75-125
Automobile (CKD)	0	10	75-125
Multipurpose Vehicles (CBU)	5	30	60-125
Multipurpose Vehicles (CKD)	0	0-10	60-125
4WD (CBU)	5	30	65-125
4WD (CKD)	0	10	65-125
Motorcycles (CBU)	5	30	20-50
Motorcycles (CKD)	0	0-10	20-50

Textiles

Import duties on textiles and apparel range between zero percent and 30 percent. Malaysia does not require import licenses or impose burdensome labeling requirements on the import of textiles.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Nutritional labeling

Malaysia requires that certain processed, packaged food products commonly consumed by Malaysians are labeled with nutritional information. These items include cereals, breads, milk, canned meat, canned fish, canned fruits and canned vegetables, fruit juices, soft drinks and salad dressings. Regulations on Nutrition Labeling and Claims issued in March 2003 outline what type of nutritional information is required and the format in which the information is to appear on the package. The regulations limit the kinds of nutritional claims, such as "reduced sodium," "low cholesterol," or "high fiber," that can appear on food packaging. Effective July 1, 2005, more than 50 food products must meet these labeling requirements. To comply with these regulations, U.S. food product importers must affix separate labels at ports of entry, a labor intensive and costly task.

Meat Import Licenses and Halal Certification

Malaysia requires that all meat, processed meat products, poultry, eggs and egg products originate from plants inspected and approved by the Ministry of Agriculture's Department of Veterinary Services (DVS). The U.S. Food Safety and Inspection Service (FSIS) made a formal request to DVS for equivalence, which, if approved, would obviate the need for plant-by-plant food safety approval. However, *halal* (produced in accordance with Islamic practices) approval is required on a plant-by-plant basis.

All meat (except pork), processed meat, poultry, egg, and egg product imports require import licenses issued by DVS. DVS often restricts imports of chicken parts through this import licensing requirement, especially when local producers believe they are facing low prices. Similarly, the State of Sarawak has put in place package-size restrictions that have effectively banned imports. (The States of Sarawak and Sabah on the island of Borneo maintain separate quarantine restrictions from those of Peninsular Malaysia.)

All meat, processed meat products, poultry, eggs, and egg products must receive *halal* certification from an approved Islamic Center. Slaughterhouses, meat processors and egg processors must also be inspected and approved by the Department of Islamic Development (JAKIM) for *halal* beef, lamb, poultry and egg exports. Officials from DVS and JAKIM travel together on the inspection visits. U.S. *halal* product suppliers must be under the supervision of an approved U.S. Islamic Center. Each individual product, rather than the plant, must receive *halal* certification. U.S. producers have expressed concern that the *halal* certification process is confusing and non-transparent. Malaysia's *halal* requirements are considered relatively strict compared to other countries.

The plant/product approval is issued on the joint recommendation of DVS and JAKIM following an on-site inspection. The government of Malaysia has the right to re-inspect approved plants after one year. In practice, three or more years may elapse between visits to the United States by a Malaysian inspection team, which limits the opportunities for new products to obtain certification as well as for companies to reapply or correct problems if they fail the first inspection.

On February 16, 2006, Malaysia announced it would resume U.S. boneless beef imports from cattle under 30 months of age, lifting a ban which had been imposed since the December 2003 announcement of a case of Bovine Spongiform Encephalophathy (BSE) in the United States. U.S. officials are working with DVS to widen the range of beef and beef products eligible for export to Malaysia.

Pork imports are also controlled by licensing and by restrictions on the types of cuts that can be imported. Import levels of chicken meat generally exceed the minimum access commitments of 6,552.5 tons established during the Uruguay Round of Multilateral Trade Negotiations. In the Uruguay Round, Malaysia negotiated for a number of tariff-rate quotas (TRQs), but has never implemented them. Ministry of Agriculture officials have indicated that TRQs will be implemented in 2007.

Biotechnology

Malaysia is currently in the process of drafting a biosafety law which would require mandatory labeling for products developed through biotechnology. The United States and Malaysia have been working together to ensure that any approach taken does not mislead consumers or result in unjustified trade restrictions.

EXPORT TAXES

Malaysia is the second-largest producer and largest exporter of palm oil and products made from palm oil, accounting for approximately 15 percent of world production and 30 percent of world trade in vegetable oils. Malaysia uses export taxes to discourage the export of crude palm oil, taxing it at 10 percent to 30 percent *ad valorem*, and to encourage development of the local refinery sector. Refined palm oil and products are currently not subject to export taxes. The Malaysian government waives export taxes on exports of crude palm oil to Malaysia-invested foreign vegetable oil refineries that include investment by Malaysian persons, giving Malaysia-invested plants a decided competitive advantage in foreign markets, including the United States.

GOVERNMENT PROCUREMENT

Malaysia is not a party to the WTO Government Procurement Agreement. Malaysia's official policy calls for procurement to be used to support national public policy objectives. These objectives include encouraging greater participation of *bumiputera* (ethnic Malays) in the economy, transferring technology to local industries, reducing the outflow of foreign exchange, creating opportunities for local companies in the services sector, and enhancing Malaysia's export capabilities. Generally, international tenders are invited only where domestic goods and services are not available. In domestic tenders, preferences are provided for *bumiputera* suppliers and other domestic suppliers. In most procurements, foreign companies are required to take on a local partner before their bids will be considered.

Malaysia's government procurement system lacks transparency and competitive bidding. In October 2003, Prime Minister Abdullah Badawi announced that the Malaysian government would introduce open tenders for government procurements and major projects, with direct negotiations limited to special cases. U.S. companies have voiced concerns about the non-transparent nature of the procurement process in Malaysia. The Malaysian government's new central tender website provides links to other ministries' websites, but not all of them provide user-friendly information on government tenders. In September 2005, the Ministry of Finance announced that the purchase of roadway, decorative, and outdoor lighting fittings, together with equipment and accessories for all government projects, must be sourced from one of three local *bumiputera* manufacturers.

U.S. firms have also expressed concern about bias in the Malaysian government's software procurement policy. A 2004 policy established a preference in government procurement for Open Source Software "in situations where the advantages and disadvantages of Open Source Software and proprietary software are equal." In 2006, the Malaysian government modified its software procurement policy to remove this preference.

EXPORT SUBSIDIES

Malaysia offers several export allowances. Under the export credit-refinancing scheme operated by the Central Bank, commercial banks and other lenders provide financing to all exporters at a preferential rate for both pre-shipment and post-shipment. Malaysia also provides tax incentives to exporters, including double deduction of expenses for overseas advertising and travel, supply of free samples abroad, promotion of exports, maintaining sales offices overseas, and research on export markets.

In addition, Malaysia provides investment incentives through the Pioneer States and Investment Tax Allowance programs. Malaysia has not submitted a notification of its subsidies to the WTO Committee on Subsidies and Countervailing Measures since 1995. As a consequence, the United States recently submitted questions to Malaysia, pursuant to Article 25.8 of the WTO Subsidies Agreement, requesting that Malaysia provide further information regarding these programs.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Malaysia is a member of the World Intellectual Property Organization (WIPO) and is a party to the Berne Convention for the Protection of Literary and Artistic Works and the Paris Convention for the Protection of Industrial Property. In 2006 Malaysia acceded to the Patent Cooperation Treaty. Malaysia has not ratified the WIPO Copyright Treaty or the WIPO Performance and Phonograms Treaty, which extend traditional copyright principles to the digital environment.

In 2000, Malaysia's parliament amended the Copyright Act, the Patents Act, and the Trademarks Act, as well as legislation on layout designs of integrated circuits and geographical indications, in order to bring Malaysia into compliance with its obligations under the WTO TRIPS Agreement. In 2004, Malaysia passed the "Protection of New Plant Varieties Act 2004" in line with the requirements of Article 27.3 (b) of the TRIPS Agreement. Enabling regulations for this law are expected to be implemented in early 2007. Malaysia does not prohibit other companies from relying on test and other undisclosed information submitted by another company to the government to obtain marketing approval of pharmaceuticals and agricultural chemicals, as called for under TRIPS Article 39.3.

Optical Media Piracy

The piracy of copyrighted materials, particularly those stored on optical media are a serious concern in Malaysia. Malaysia's production capacity for CDs and DVDs significantly exceeds local demand plus legitimate exports. U.S. industry estimates Malaysia's excess capacity is between ten to twenty times that needed for the legitimate market. The resulting surplus is exported globally. Pirated products believed to have originated in Malaysia have been identified throughout the Asia-Pacific region, North America, South America, Europe, and Africa.

The International Intellectual Property Association estimates 2006 industry losses in Malaysia due to piracy at $59 million. IIPA estimates 2006 piracy rates at 61 percent for business software and 45 percent for music. Malaysia has remained on the Special 301 Watch List since October 2001, specifically because of its failure to substantially reduce pirated optical disc production and export.

Malaysia sought to strengthen its intellectual property regime over the past several years and has tightened its laws. The Optical Disc Act of 2000 established a licensing and regulatory framework to control the manufacture of optical discs and to fight piracy. Under the Act, manufacturers are required to obtain licenses from both the Ministry of International Trade and Industry and the Ministry of Domestic Trade and Consumer Affairs (MDTCA), to place source identification (SID) codes on each disc and to allow regular inspections of their operations. U.S. industry is seeking changes in the law to ensure inspection authority covers all locations where optical media production may occur and also include as offenses acts such as ”gouging” or tampering with the SID codes and “burning” of recordable discs.

In 2006, the Malaysian government continued to make progress in IPR enforcement The MDTCA reported in 2005 that it had revoked the licenses of six CD factories found to have been involved in piracy activities. It also reported that in the first half of 2006 MDTCA enforcement officials had conducted 179,195 raids throughout Malaysia; initiated 39,346 prosecutions; and had arrested 1,948 vendors for selling pirated discs worth 475 million ringgit (approximately $130 million). Prosecution continues to be an ongoing challenge, but the Malaysian government made some headway in tackling the judicial backlog for infringement cases. Malaysia’s courts have imposed sentences of imprisonment and/or fines for the offenders. The MDTCA continues to pledge the creation of a specialized IP court, but it is not expected to be in place before mid-2007.

The Malaysian government is making further efforts to reduce trade in pirated goods. A special task force, chaired by the Minister of Domestic Trade and Consumer Affairs and including representatives from all ministries and agencies with responsibility for IPR, has overseen the expansion of enforcement staff and a more vigorous program of raids on sellers of pirated products. The Ministry added over 700 more enforcement officers in 2006 to complement the existing 1400 officers.

Malaysia continues to impose a hologram-labeling requirement for optical discs containing copyrighted material.

Pharmaceuticals

Sales of counterfeit pharmaceuticals are a continuing concern in Malaysia. Counterfeit medicines that have been identified include drugs with the wrong ingredients, insufficient active ingredients, and those with fake packaging. Most of the copied drugs are believed to originate in China. Unregistered generic copies of patented products, primarily imported from India, also are available in Malaysia. Both street vendors and health professionals sell the counterfeit products. The counterfeit medicines may create risks for consumers’ health, reduce sales by legitimate manufacturers, and leave legitimate companies vulnerable to lawsuits from patients who may have adverse reactions to the counterfeit products. The Ministry of Health and the MDTCA have sought to improve their enforcement efforts, sharing information and collaborating with industry in their efforts. Legal prosecution of counterfeit pharmaceuticals remains weak, however, with an inefficient court system plagued by delay and by lenient penalties for convictions.

Malaysia continues to consider the implementation of data exclusivity provisions and is working with industry as it formulates a position. The Malaysian government does not have an effective patent linkage mechanism to prevent the regulatory approval of copied versions of pharmaceuticals that are still patented; U.S. industry has reported several cases of the registration of generic versions of pharmaceuticals which are still under patent protection.

Trademarked Consumer Products

A number of U.S. consumer product companies have also suffered significant losses due to the manufacture and sale of counterfeit trademarked products. The volume is difficult to determine because of the broad scope of products involved. Counterfeiting in Malaysia goes beyond the counterfeiting of luxury branded products to include printer cartridges, plastic container systems, motor oil, household cleaning agents, shampoo and skin care items, herbicides, and penlight batteries. Counterfeiters have improved the quality of packaging and marketing so that consumers are misled into purchasing the products. The products have caused harm to individuals and damage to automobiles and household goods. Some of the counterfeit goods are produced in Malaysia, while many are brought into the country from China, Thailand, and India.

Enforcement by the local government is hampered by the lack of training and scarcity of information about ongoing counterfeit activities. Complicating enforcement of trademark-related violations is a Malaysian Court of Appeals interpretation of the trademark law that requires enforcement officials to have a “Trade Description Order” to conduct criminal raids when the counterfeit product seized is not identical to the trademarked original. High specificity requirements necessary to seize a shipment suspected of containing pirated or counterfeit products also represent an enforcement obstacle to U.S. industry.

SERVICES BARRIERS

Malaysia’s services sector constitutes about 58.1 percent of the national economy and remains highly protected.

Telecommunications

Under the WTO Agreement, Malaysia made limited commitments on most basic telecommunications services and partially adopted the reference paper on regulatory commitments. Foreign companies are entitled to acquire only up to a 30 percent equity stake in existing licensed public telecommunications operators, and is limited to facilities-based suppliers.

In December 2005, Malaysia issued its revised WTO services offer, which contains marginal improvements to its existing commitments by allowing foreign shareholdings up to 49 percent in "application service providers." On the other hand, foreign ownership of "network facilities providers" and "network service providers" (NSP) would be limited to 30 percent under the revised offer. This NSP ownership limitation is actually more restrictive than the limitation currently in existence under Malaysian regulations. Those regulations allow individual foreign licensees to own up to 61 percent of a network service provider, subject to a requirement that the foreign equity holding be reduced to 49 percent over a 5 year period commencing on the date of incorporation.

Distribution Services, including Direct Selling

Malaysia’s requirements for the licensing and operation of direct selling companies include a provision that a locally incorporated direct selling company must allow for 30 percent *bumiputera* equity. The MDTCA also “recommends” local content targets. Local companies that seek direct selling licenses require paid-in capital of RM1.5 million (approximately $397,000), while companies with foreign shareholders must have paid-in capital of RM5 million (approximately $1.3 million).

The Malaysian government also included local content requirements in new "Guidelines on Foreign

Participation in the Distributive Trade Services" that came into effect in December 2004. Among other provisions, department stores, supermarkets and hypermarkets must reserve at least 30 percent of shelf space in their premises for goods and products manufactured by *bumiputera*-owned small and medium size industries. The guidelines also require that at least 30 percent of a store's sales consist of *bumiputera* products. The Malaysian government continues to consider changes to these guidelines, in large part due to complaints from both domestic and foreign business interests.

Legal Services

Foreign lawyers may not practice Malaysian law, nor may they affiliate with local firms or use the name of an international firm. Foreign law firms may not operate in Malaysia except as minority partners with local law firms and their stake in any partnership is limited to 30 percent. Under the Legal Profession Act of 1976, the practice of Malaysian law is normally restricted to Malaysian citizens or permanent residents who have apprenticed with a Malaysian lawyer, are competent in *Bahasa* Malaysia (the official language), and have a local law degree or are accredited British Barristers at Law. The Attorney General has authority to grant limited exceptions on a case-by-case basis, provided the applicant has seven years of legal experience. Malaysian law does not allow for foreign legal consultancy except on a limited basis in the Labuan International Offshore Financial Center (see "Banking" below). Malaysia limits such foreign attorneys' scope of services to advice concerning home country and international law. Persons not licensed as lawyers are subject to criminal penalties if they directly or indirectly undertake activities relating to the Malaysian legal system, including drafting documents.

Architectural Services

A foreign architectural firm may operate in Malaysia only as a joint-venture participant in a specific project with the approval of the Board of Architects. Malaysian architectural firms may not have foreign architectural firms as registered partners. Foreign architects may not be licensed in Malaysia but are allowed to be managers, shareholders, or employees of Malaysian firms. Only licensed architects may submit architectural plans.

Engineering Services

Foreign engineers may be licensed by the Board of Engineers only for specific projects and must be sponsored by the Malaysian company carrying out the project. The license is only valid for the duration of a specific project. In general, a foreign engineer must be registered as a professional engineer in his or her home country, have a minimum of 10 years experience and have a physical presence in Malaysia of at least 180 days in one calendar year. To obtain temporary licensing for a foreign engineer, a Malaysian company often must demonstrate to the Board that they cannot find a Malaysian engineer for the job. Foreign engineers are not allowed to operate independently of Malaysian partners or serve as directors or shareholders of an engineering consulting company. A foreign engineering firm may establish a non-temporary commercial presence if all directors and shareholders are Malaysian. Foreign engineering companies may collaborate with a Malaysian firm but only the Malaysian company may submit the plans for domestic approval.

Accounting and Taxation Services

Foreign accounting firms may provide accounting and taxation services in Malaysia only through affiliates. All accountants who wish to provide auditing and taxation services in Malaysia must register with the Malaysian Institute of Accountants (MIA) before they may apply for a license from the Ministry of Finance. Citizenship or permanent residency is required for registration with MIA. Malaysian citizens or permanent residents who received degrees from local universities or are members of at least one of the 11 overseas professional bodies recognized by Commonwealth countries may apply for registration. The American Institute of Certified Public Accountants is not recognized by Commonwealth countries.

Banking

The Malaysian government limits foreign participation in financial services to encourage the development of domestic financial services providers. Its policies are guided by the Banking and Financial Institutions Act of 1989 and the ten-year Financial Sector Master plan, unveiled in 2001, which sets out a three-phase strategy for developing the Malaysian banking sector. Phase I focused on developing a core set of domestic banking institutions, in large part through encouraging consolidation. The Malaysian government encourages the establishment of these institutions through mergers of commercial banks with merchant banks, discount houses and stock brokerage firms. The Plan set out "building blocks" to be implemented within the first two years to four years, with the goal of consolidating the existing financial institutions down to nine. This goal has now been reached. According to the Plan, Phase II would include the gradual removal of some restrictions on incumbent foreign financial institutions, and during Phase III the Malaysian government would "consider" introducing new foreign competition. Malaysia is expected to enter Phase II during 2007.

Foreign institutions are allowed to hold an equity stake in investment banks of up to 49 percent. Currently, foreign participation in commercial banks is still restricted to an aggregate maximum stake of 30 percent. In 1994 Bank Negara revoked authorization of foreign banks to operate in Malaysia unless they incorporated locally. Foreign banks currently operate in Malaysia under a grandfathering provision, albeit with all-Malaysian Boards of Directors. No new licenses are being granted to either local or foreign banks. Bank Negara also announced that it would require all banks, including U.S. banks, to maintain their back office and computer operations in Malaysia, claiming that any operations outside of Malaysia are "outsourcing," even for foreign banks based elsewhere. This decision prevented some foreign banks from keeping up with global trends in Internet banking, but Bank Negara has waived the requirement on a case-by-case basis for foreign banks willing to reinvest sufficiently in Malaysia.

On December 28, 2005, Bank Negara announced that locally incorporated foreign banking institutions currently operating in Malaysia would be allowed to open four additional branches in 2006, with one branch in a market center, two in semi-urban centers, and one in a non-urban center. Each location must be approved by Bank Negara. Some foreign banks have obtained permission to open more than four, particularly if the new branches will be in underserved areas. Standard Chartered, for example announced its intention to open six more.

On October 14, 2004, Bank Negara completed the issuance of three Islamic banking licenses to three Middle Eastern Islamic banks. Bank Negara encourages all commercial banks operating in Malaysia to set up full-fledged Islamic banking subsidiaries in which foreigners may take a 49 percent equity stake. The government of Malaysia continues to offer various tax incentives and other measures to achieve its stated goal of becoming a global hub for Islamic Banking. In June 2005, Bank Negara established the Fund for Shariah Scholars in Islamic Finance to provide funding for research grants and scholarships. In August 2006, Bank Negara announced the launch of its three-pronged Malaysia International Islamic Financial Center Initiative, including special tax and regulatory treatment, scholarships, and efforts to work toward global harmonization of Islamic banking and insurance practices. This was acted upon in part in the Malaysian government's 2007 budget, released September 1, 2006, which proposes a ten-year tax exemption on Islamic financial products in foreign currencies and tax relief for persons engaged in Islamic Finance studies.

On April 1, 2005, the Malaysian government abolished the requirement imposed on foreign-controlled companies for domestic borrowing. It has also allowed foreign-controlled companies to seek any amount of ringgit credit without Bank Negara's approval.

The Federal Territory of Labuan was established as an International Offshore Financial Center in October 1990. Businesses receive preferential tax treatment for offshore banking activities, trust and fund management, offshore insurance and offshore insurance-related businesses, and offshore investment holding businesses. On September 16, Bank Negara lifted the requirement to maintain a physical presence in Labuan for existing and new financial institutions licensed to conduct Islamic financial business in international currencies. Islamic banks and insurance companies will be given greater flexibility to open operation offices anywhere in Malaysia. They will remain subject to regulation by the Labuan Offshore Financial Services Authority and will retain the favored tax treatment extended to offshore businesses in Labuan, 3 percent or RM20,000 (approximately $5,460), whether or not they maintain a physical presence there.

The Malaysia Deposit Insurance Corporation (MDIC) was established in August 2005. Membership is compulsory for commercial banks licensed under the Banking and Financial Institutions Act of 1989 and Islamic banking institutions licensed under the Islamic Banking Act of 1983. Eligible deposits are insured for up to RM60,000 (approximately $16,500). The MDIC maintains and administers two separate deposit insurance funds for conventional and Islamic deposits. Investments held in the Islamic Deposit Insurance Fund are made in accordance with Shariah principles.

Insurance

The 2001 Financial Sector Masterplan recommends phased liberalization of the insurance industry, including increasing caps on foreign equity, fully opening the reinsurance industry to foreign competition, and lifting existing restrictions on employment of expatriate specialists. In August 2006, foreign equity caps for insurance companies were raised from 30 percent to 49 percent. Branches of foreign insurance companies were required to incorporate locally under Malaysian law by June 30, 1998, although a few companies still enjoy extensions granted by Malaysia. Foreign shareholding exceeding 49 percent is permitted only with Malaysian government approval. As part of the 1997 WTO Financial Services Agreement, Malaysia agreed to allow existing foreign shareholders of locally incorporated insurance companies to increase their shareholding to 51 percent. New entry by foreign insurance companies is limited to equity participation in locally incorporated insurance companies and aggregate foreign shareholding in such companies may not exceed 30 percent. However, this limit has been subject to negotiation.

The Malaysian government continues to promote Islamic insurance (*"takaful"*) as part of its strategy to make Malaysia a global hub for Islamic financial services, including through new tax breaks announced in the 2007 budget. On September 16, 2006 Bank Negara announced that international *takaful* operators, both domestic and foreign, would be licensed to conduct business in international currencies as either incorporated entities or branches. Operations would receive a full tax exemption for ten years beginning in 2007. International *takaful* operators will not be subject to foreign equity caps.

Securities

Malaysia currently allows 49 percent foreign ownership in stock brokerage firms and a 30 percent foreign stake in unit trusts. The Securities Commission's ten-year Capital Market Masterplan, released in February 2001, proposed liberalizing foreign participation limits by 2003, at which time foreigners would be permitted to purchase a limited number of existing stock-broking licenses and to take a majority stake in unit trust management companies. Fund management companies may be 100 percent foreign-owned if they provide services only to foreigners, but they are limited to 70 percent foreign ownership if they provide services to both foreign and local investors. On March 22, 2005, the Malaysian government allowed five foreign stock brokerages and a foreign fund management company to set up operations in Malaysia. More foreign fund management companies are expected to utilize four of the remaining licenses. In September 2003, the Securities Commission began allowing foreign firms operating in Malaysia to seek listing on the Kuala Lumpur stock exchange (Bursa Malaysia). Futures brokerage firms may now be 100 percent foreign-owned.

Advertising

Only 20 percent of commercials in Malaysia can include foreign content. The Malaysian government recently relaxed enforcement of regulations governing the appearance of foreign actors in commercials shown in Malaysia. The government of Malaysia has an informal and vague guideline that commercials cannot "promote a foreign lifestyle."

Audio-Visual and Broadcasting

The Malaysian government maintains broadcast content quotas on both radio and television programming. Eighty percent of television programming is required to originate from local production companies owned by ethnic Malays. However, in practice, local stations have been granted substantial latitude in programming due to a lack of local programming. Sixty percent of radio programming must be of local origin. Foreign investment in terrestrial broadcast networks is prohibited. As a condition for obtaining a license to operate, video rental establishments are required to have 30 percent local content in their inventories. Malaysia regularly censors movies and television shows deemed offensive on religious or sexual grounds.

INVESTMENT BARRIERS

Malaysia encourages foreign direct investment (FDI) in export-oriented manufacturing and high-technology industries, but retains considerable discretionary authority over individual investments and restricts foreign investment in other sectors. Especially in the case of investments focused on producing goods or services for the domestic market, the Malaysian government has used its authority to restrict foreign equity (normally to 30 percent) and to require foreign firms to enter into joint ventures with local partners. As noted above, foreign investment in the financial services industry is restricted; foreign investment in terrestrial broadcasting is prohibited. To alleviate the effects of the regional economic crisis, Malaysia in 1998 temporarily relaxed foreign ownership and export requirements in the manufacturing sector for those companies that did not directly compete with local producers. In June 2003, the government permitted 100 percent foreign ownership of new investments aimed at expanding existing investments in manufacturing concerns. In September 2004, the government announced that venture capital firms could be 100 percent foreign owned.

Malaysia's announced goal with regard to attracting and retaining FDI is to "move up the value chain." It is renewing tax abatements primarily for manufacturers of higher-technology products and other targeted industries, but not for manufacturers of more labor intensive products, some of which have moved to China or elsewhere. FDI in Malaysia continues to decline. While the Malaysian government has been successful in attracting lower-wage, labor intensive manufacturing, improvements in the business climate needed to attract higher value manufacturers have not kept pace. According to UNCTAD's World Investment Report, FDI inflows to Malaysia in 2005 declined 14 percent, while inflows to Southeast Asia as a whole increased 45 percent.

Shortages of skilled and technical employees remain, particularly in the electronics sector. Most foreign firms face restrictions in the number of expatriate workers they are allowed to employ. In June 2003, the Malaysian government released new guidelines liberalizing the policy on employment of expatriates in the manufacturing sector. In its proposed 2007 budget released September 1, 2006 it announced that it will establish four additional immigration units intended to expedite visa approvals for expatriates, and it will allow professional spouses of expatriates to work. Manufacturing companies with foreign paid-up capital of at least $2 million receive automatic approval for up to 10 expatriate posts.

ELECTRONIC COMMERCE

Malaysia applies no onerous restrictions on products or services traded via electronic commerce. Products that are ordered via the Internet and physically delivered are subject to applicable import duties. Engineering services may not be provided via the Internet unless the engineer is properly licensed.

OTHER BARRIERS

Transparency

U.S. companies have raised concerns regarding transparency in government decision-making and procedures, and anticompetitive practices in Malaysia. The Malaysian government has taken steps to fight corruption, including through the Anti-Corruption Agency (ACA) which is part of the Office of the Prime Minister. The ACA has the independent power to conduct investigations and is able to prosecute cases with the approval of the Attorney General. However, relatively few senior officials or politicians have been prosecuted for corruption, despite the fact that Malaysia has slipped in its ranking on Transparency International's corruption perceptions index from 33 in 2002 to 44 in 2006. Malaysia has signed but not yet ratified the UN Convention Against Bribery and Corruption.