UOB HONG KONG

23/F, Three Garden Road, Central, Hong Kong SAR

Tel: (852) 2910 8888 | Fax: (852) 2910 8899 | www.uobgroup.com/hk/

HONG KONG UNIVERSITY OF SCIENCE AND TECHNOLOGY
INSTITUTE FOR EMERGING MARKET STUDIES

IAS2018-2020, Lo Ka Chung Building, Lee Shau Kee Campus
Hong Kong University of Science and Technology, Clear Water Bay, Kowloon, Hong Kong SAR

Tel: (852) 3469 2215 | Email: iems@ust.hk | iems.ust.hk

The Belt and Road Initiative in ASEAN

Malaysia

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Contents

Research Methodology

The study aims to provide insights into the political, institutional, and environmental factors that affect the design and implementation of Belt and Road Initiative (BRI) projects in Malaysia, the potential for BRI investments to spur private investment and other foreign direct investment (FDI) opportunities, and any potential role for the Hong Kong SAR.

The key research questions that drove the study were:

- What changes has the BRI brought to Malaysia?
- What are the key sectors or areas experiencing growth and what are the key BRI projects?
- What factors seem to be affecting the success of the projects?
- What are the key opportunities and challenges in Malaysia?

The case study employed a mix of quantitative and qualitative data. The primary data were mostly qualitative and included a combination of in-depth interviews, informal interviews, and field notes based on observation. The primary data also included datasets and documentary evidence exclusively obtained from informants. Other quantitative data consisted of datasets describing Malaysia's economic, environmental, and social dimensions which were used to support the analysis as well as the selection of specific projects or sectors.

Interviewees included a wide range of stakeholders such as government officials, representatives of business associations, entrepreneurs, members of civil society groups, academics and consultants both in Malaysia and in the Hong Kong SAR.

The research process involved three phases: 1) preparation, 2) fieldwork and data gathering, and then 3) data analysis and write-up. In the preparation phase researchers examined the background of the case through desktop research and identified key issues and projects. Afterwards, key topics to be explored were selected in consultation with UOB staff in the Hong Kong SAR and Malaysia. Before the fieldwork, both UOB and the researchers contacted potential interviewees to brief them on the research and inquire about their availability and willingness to partake in the project as informants. Subsequently, phase 2 consisted of two 2-3 week visits to Malaysia during which the researchers carried out interviews and site visits. The last stage focused on gathering the data into themes, analysing it and writing up this case report.

Highlights

- The new Malaysian government of the Perikatan Nasional (PN), led by Prime Minister Muhyiddin Yassin that supplanted the Pakatan Harapan led by PM Dr. Mahathir remains supportive of China's BRI and Malaysia – China relations remain strong.

- Malaysia welcomes investments that contribute to its Industry 4.0 plan, which aims to transform its agricultural and manufacturing sectors through automation and bring new environmental technologies.
- With the second-highest ranking in the region for Ease of Doing Business (after Singapore), good quality of life and reliable infrastructure and connectivity, Malaysia is a promising base for investments in ASEAN.
- The Hong Kong SAR with its thriving Malaysian community associations and strong financial services institutions plays a major role in brokering deals with Malaysia.
- Rather than "going solo" and engaging in "incentive shopping", successful mainland Chinese companies in Malaysia forge strategic alliances with local stakeholders for long-term gain.
- Malaysia has successfully contained the first wave of COVID-19 cases by implementing strict movement control orders, but a second wave has hit the country in September. The stringent measures have reduced the number of new cases but have also significantly damaged economic activity. The outlook remains positive for next year, however, and the key BRI projects are still moving ahead.

Background

Situated on the Straits of Malacca between the Pacific and Indian Oceans, Malaysia has a young and growing multi-ethnic population of 32.73 million. The main ethnic groups are the Malays (said to be 62%, though no census has been conducted for many years), Chinese (21%), and Indians (6%). The population is 88% urban, and only 6.9% are aged above 65.

In February 2020, Malaysia entered a different political landscape while at the same time having to tackle the COVID-19 pandemic. The new Perikatan Nasional government led by Prime Minister Muhyddin Yassin supplanted the Pakatan Harapan government, but support for the Belt and Road Initiative remains stable. The former government had established a new paradigm for China-Malaysia relations, described by one of its high-ranking politicians as a doctrinal shift away from a transactional mode of foreign policy making into one marked by international credibility and domestic legitimacy.[1]

The former government sought to stimulate inclusive and regionally-balanced development involving sustainable and "meaningful" growth and enhancing local human resources. Faced with the pandemic, the new government says it aims to

> **"Strengthen exchanges and cooperation between Malaysia and China to contain the COVID-19 outbreak.[2]"**

Malaysia's economy was performing well before the COVID-19 crisis. In 2019, its nominal GDP was US$364.7 billion, and it had grown between 4.3% and 4.8% in the previous two years.[3] The GDP forecasts for 2020 now range between -5% (The World Bank) and -3.5% (Bank Negara), with improvement expected in 2021, but with substantial uncertainty. In 2019 the driving sector of the economy was services (57.7%), followed by manufacturing (22.3%) and agriculture (7.1%). The services sector includes mostly wholesale and retail trade, ICT, and financial services.

[1] *Malay Mail. The Mahathir Doctrine: A new deal between Malaysia and China — Liew Chin Tong https://www.malaymail.com/ news/what-you-think/2018/07/13/the-mahathir-doctrine-a-new-deal-between-malaysia-and-china-liew-chin-tong/1652103*

[2] *Mu, X. 2020. Malaysia, China should strengthen joint efforts against COVID-19 outbreak: Malaysian PM. Xinhua Net. http://www.xinhuanet.com/english/asiapacific/2020-03/19/c_138892644.htm*

[3] *World Bank, East Asian and Pacific Economic Update. October 2018. p.25.*

Malaysia's major industries consist electronic equipment (E&E) manufacturing, petroleum, chemicals, rubber and plastics, and transportation equipment. Economic growth is supported by robust private consumption, which has grown annually at about 8% over the past couple of years, sustained mainly by food and beverage, retail trade, communications, and hotel services. But the service sector is projected to contract by 0.7% in 2020 according to the latest estimates by the Ministry of Finance.

Malaysia is rich in natural resources, including forestry, agriculture, oil, and minerals. The country's oil and gas reserves are among the largest in the Asia Pacific region. Key resource-based commodity exports include palm oil, oil and gas, rubber, aluminium and copper. However, E&E manufactured goods, ICT, and travel and tourism products constitute the majority of total exports by value.

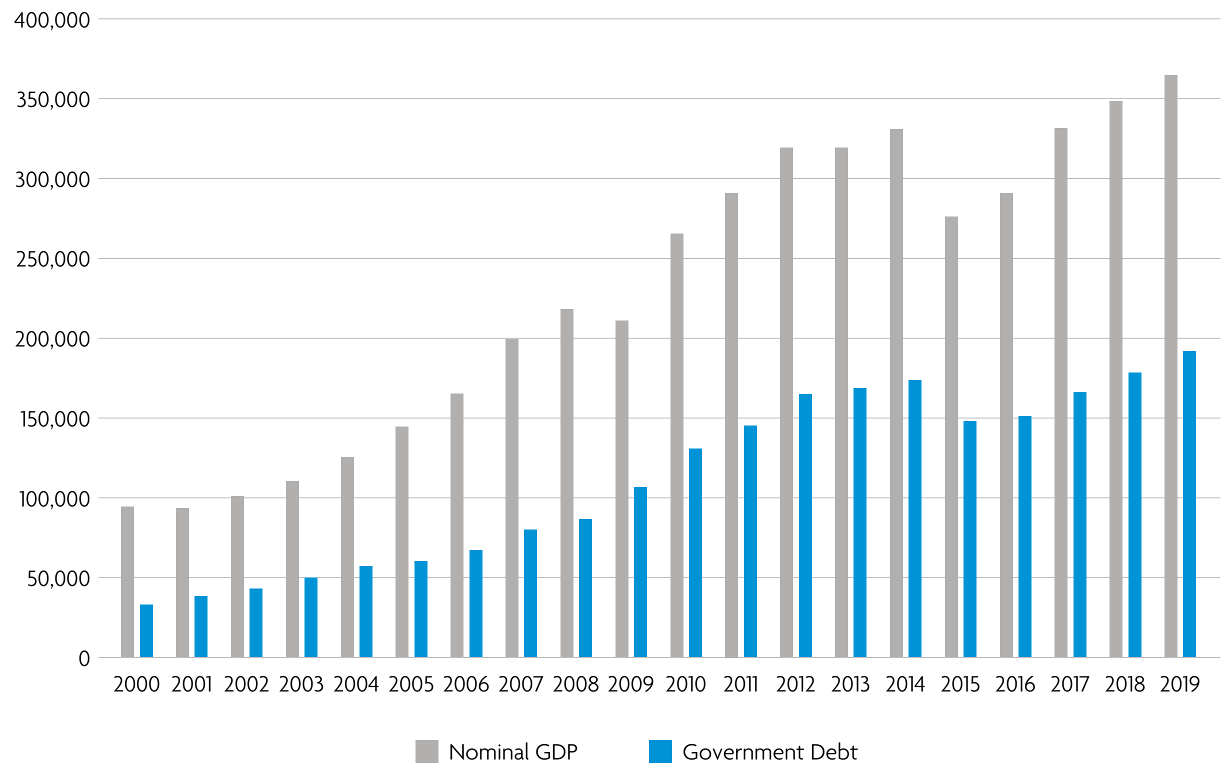

Figure 1. Malaysia GDP (Nominal Value) and National Debt (US$ million). Source: CEIC.

China Trade and FDI in Malaysia

Malaysia has maintained its historically flourishing trade in goods across the Asia Pacific region, and has developed an export-oriented economy that has been significantly affected by COVID-19. In 2019, total exports were worth US$238 billion and imports were worth US$204 billion. Its main trading partners were mainland China, Singapore, the United States, Japan, and the Hong Kong SAR.

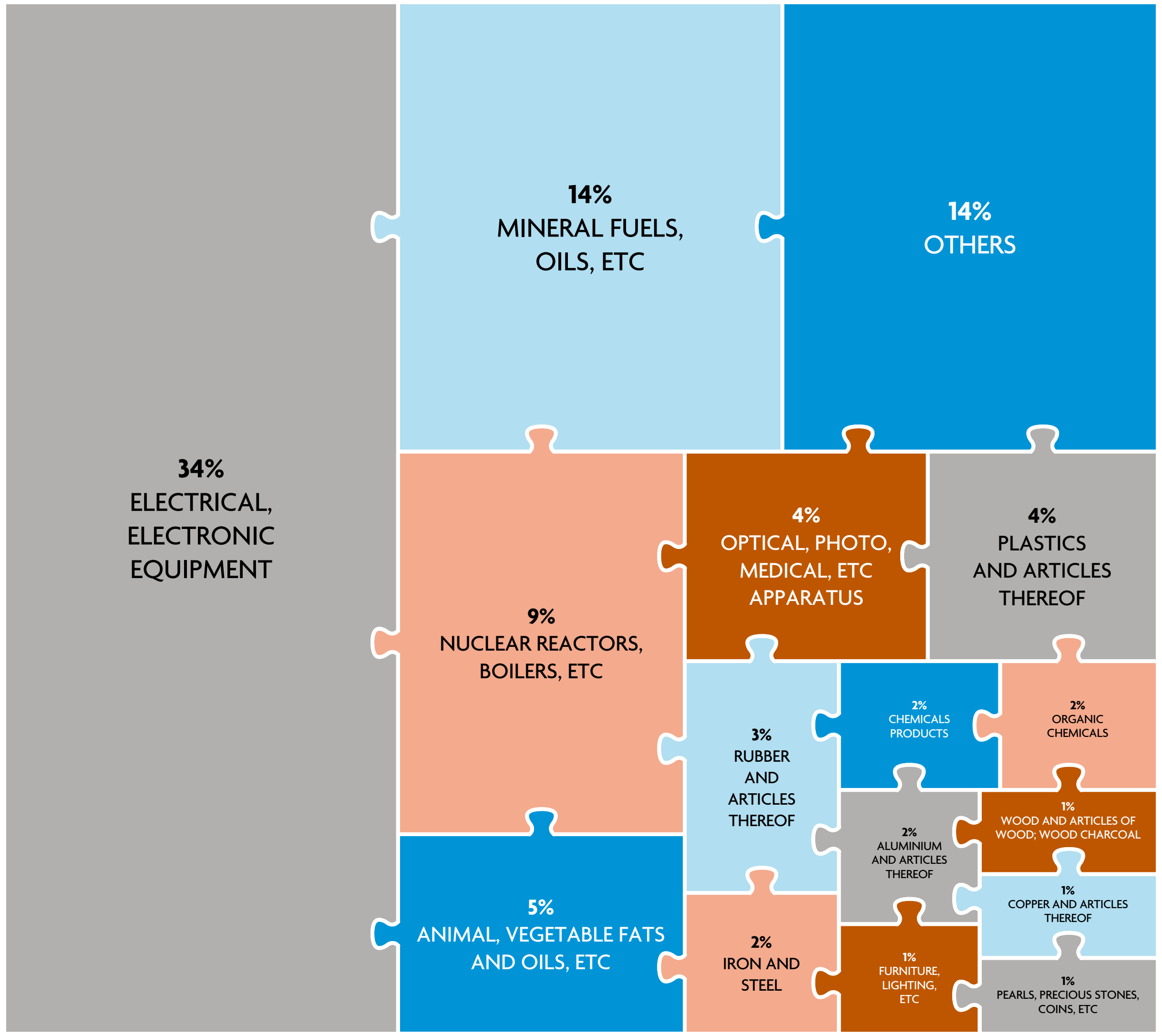

Figure 2. Malaysia's Exports to the World in 2019. Source: UN COMTRADE.

" Malaysia and China have been trading for thousands of years. Over the past 11 years, mainland China has been our number one trading partner, and we foresee the same trend happening in the years to come. "

Interview with Mr. Unny Sankar, Director of China Section, Ministry of International Trade and Industry (MITI)

Since 2008 Malaysia has been China's number one trading partner in ASEAN, and in 2019 trade with mainland China was 17.2% of Malaysia's total trade and was valued at US$73.94 billion (RM315.9 billion).

Observers have pointed out that this could have been an effect of US-China trade tensions, as Malaysia was one of the prime beneficiaries of

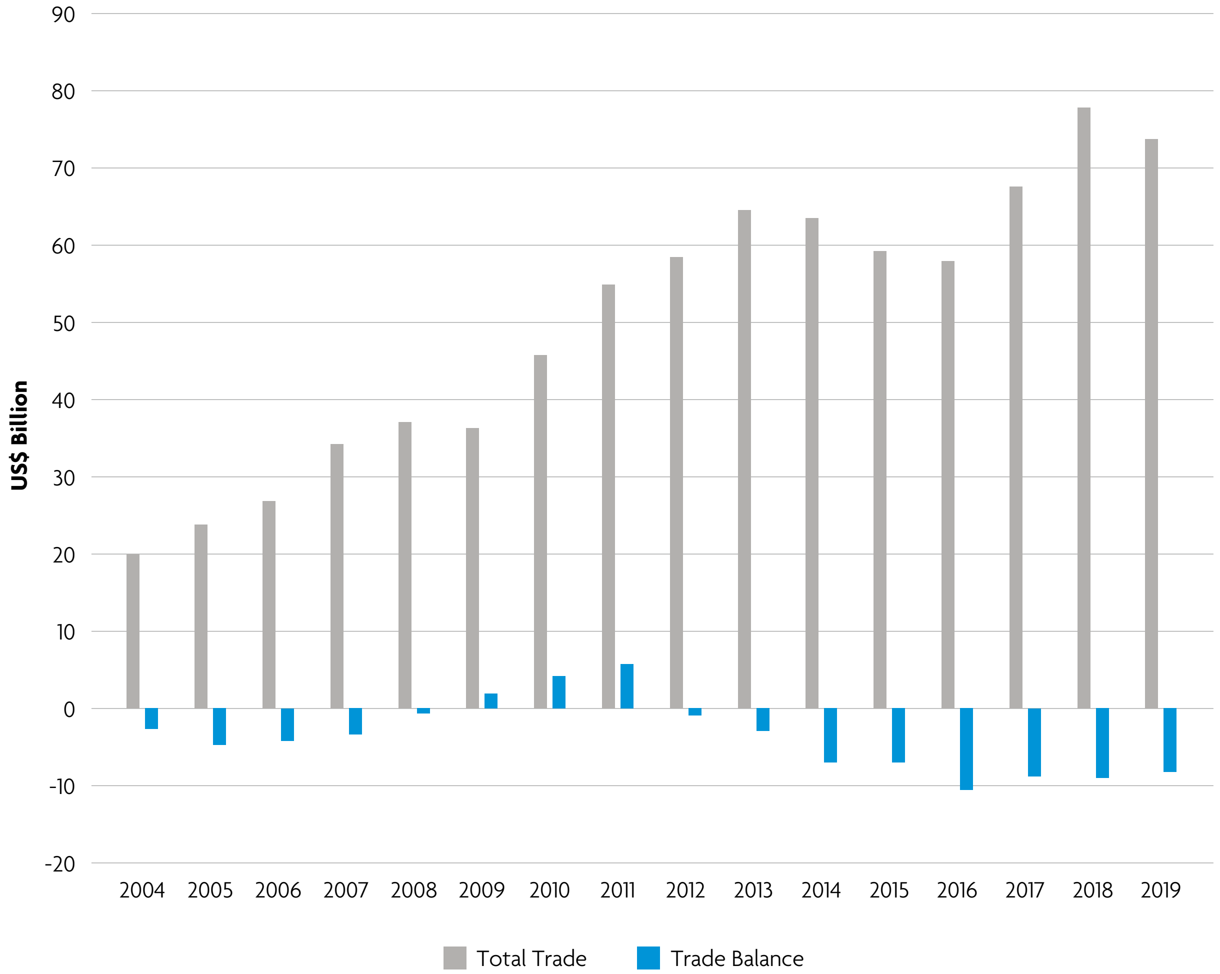

Figure 3. Malaysia - Mainland China Trade Flow. Source: Statista.

import substitution because of its well-established networks of production for E&E, liquefied natural gas, and communication equipment among others. However, it is also true that close Sino-Malaysia ties support the growing trade and investment flows between the two countries.

“ We invest in relatively stable markets. We look at factors such as foreign exchange, political risks, and GDP growth. When compared to other countries in Southeast Asia, Malaysia has a relatively good legal structure to protect foreign investors. It also has the second largest banking system after Singapore, as well as a large ethnic Chinese community. This community makes it relatively easy to use local talents for localization, and the culture factors make it easy to collaborate. ”

Interview with a mainland Chinese investor in Malaysia

Malaysia has also been a key destination for mainland Chinese FDI and a good source of construction contracts.

Data from Malaysia's Investment Development Authority (MIDA) shows that in 2019 the largest foreign investments approvals in the manufacturing sector came from mainland China and totalled US$3.74 billion (RM15.30 billion), followed the United States (US$3.4 billion, up four-fold from 2018), Singapore, Japan, and the United Kingdom. Mainland Chinese investments currently span a variety of industries. They include high technology robotics and E&E in Penang, Selangor, Kuala Lumpur, and Johor, solar panels and solar technology in Penang, glass manufacturing in Kota Kinabalu, steel plants in Kuching, Kuala Lumpur, and Kuantan, and recycling and textiles in Johor.

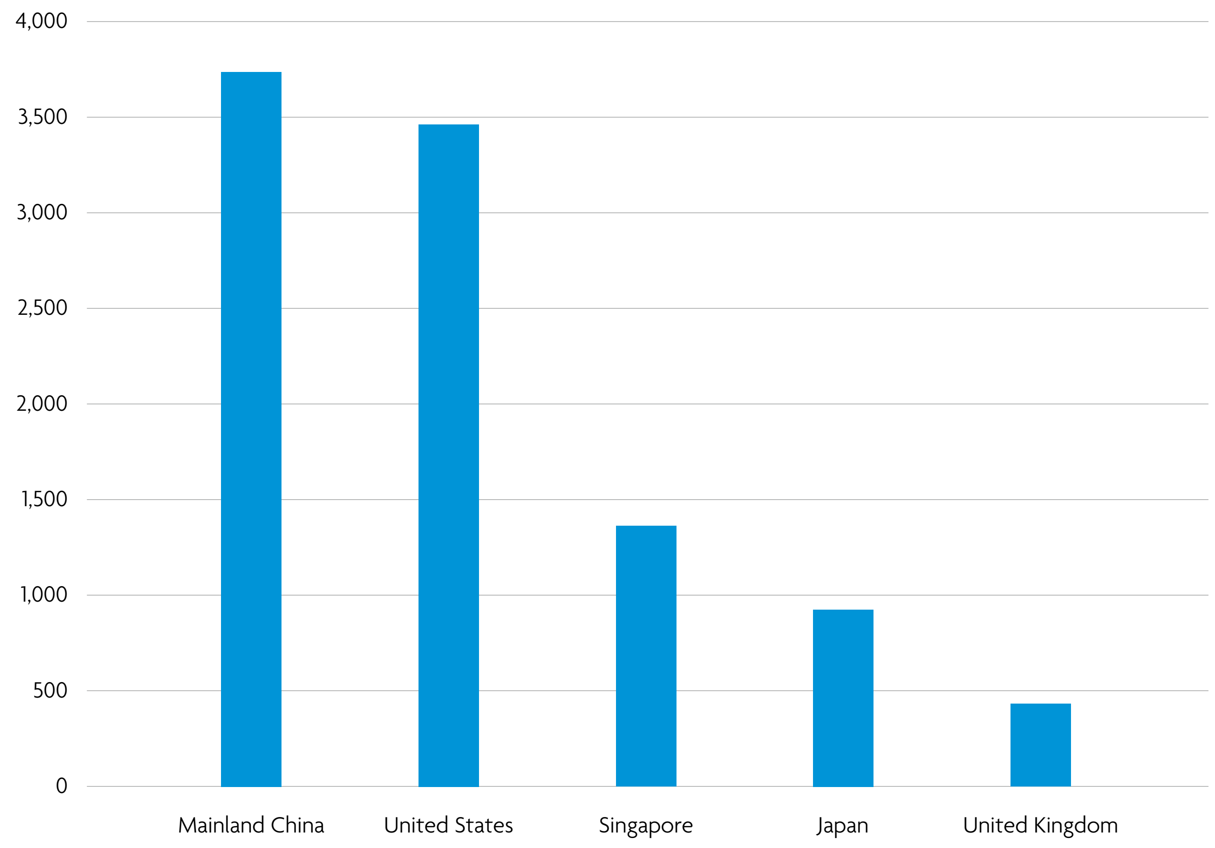

Figure 4. Malaysia Manufacturing FDI Approved by Country in 2019 (US$ million). Source: MIDA.

Chinese companies have also become prominent in Malaysia's construction sector, and have become contractors for public and private residential and commercial real estate projects, as well as infrastructure development. Statistics from the Construction Industry Development Board show that in 2015 foreign contractors secured 18.7% of the construction projects awarded in Malaysia (worth US$6,467 million or RM26,588 million). Chinese contractors led the way with RM8 billion worth of projects. The value of construction contracts awarded to foreign firms increased sharply in 2017, reaching 37% of the total (US$20,754 million; RM85,285 million), but that was followed by a considerable decline in 2018.

In recent years the number of commercial and real estate projects awarded to mainland Chinese companies has grown strongly. Some examples include the redevelopment of Plaza Rakyat by a subsidiary of Debao Property, the construction of the Elite Pavilion Serviced Apartment Project, the Banyan Tree Hotel by the Beijing Urban Construction Group, and Princess Cove by the Guangzhou R&F group. Country Garden is perhaps the largest among mainland Chinese investors in real estate, with projects in Selangor (Diamond City), and Johor (Danga Bay, Central Park, Forest City).

A key infrastructure project with Chinese involvement is the 197km Gemas-Johor Baru rail line, the last link to be upgraded from single to double tracks. In October 2016, the RM8.9 billion project was awarded to a consortium of three China-based companies: China Railway Construction Corporation, China Railway Engineering Corporation, and China Communications Construction Company (CCCC). Construction officially started in 2018, and the project should be operational in 2021.

In 2015, the Beijing Entreprises Water Group carried out the design and construction of an upgrade the water treatment and distribution facilities in Kemaman for the Terengganu government. In 2018, they also completed the construction of the Pantai 2 sewage treatment plant that will treat the sewage from Bandar Baru Sentul, Kuala Lumpur's central business district, Bangsar, Bukit Kiara Recreational Area, Seputeh, Kerinchi, and Old Klang Road. The plant now exploits several green technologies, such as rainwater harvesting, solar power for street lighting, biogas as a source of renewable energy, and treated effluent reuse for air-conditioning.

Another key construction contract is the expansion of the Mengkuang Dam in Penang, which was awarded to China International Water & Electric for US$200 million. The project is necessary to meet the expected demand for potable water in the State of Penang by 2026.

The Role of Hong Kong

Hong Kong is an important trading partner and FDI source for Malaysia. As of 2020, Malaysia is the SAR's seventh largest trading partner, second only to Singapore in ASEAN. In 2019 the total merchandise trade between Hong Kong and Malaysia totalled US$25.1 billion. FDI from (or channelled through) Hong Kong to Malaysia surpassed that from mainland China at more than US$3.79 billion (MR16.173 billion). Much of that presumably originated in mainland China.

The relationship works both ways.

> **“For Malaysia, we see Hong Kong SAR as an important gateway to mainland China.”**

“Doing business with China is not always easy. Hence, Malaysia sees Hong Kong SAR as a midway stop for Malaysian companies to introduce their products or to access the mainland Chinese market. We estimate that 80% of our export to Hong Kong is re-exported to China” (Interview with a MATRADE official in Hong Kong).

The FDI from Hong Kong is largely in the E&E, chemicals, textiles, and food & beverage sectors.

> **“Our Hong Kong SAR team was instrumental in the first two overseas projects, as they are more familiar with overseas markets, have greater knowledge and expertise compared with senior managers in China. Hong Kong SAR has practices and systems that are more international, making it easier for Hong Kongers to work in Southeast Asia.”**
>
> *Interview with a Chinese investor in Malaysia*

Belt and Road Flagship Projects in Malaysia

> **“The Belt and Road Initiative has definitely changed the investment trend, not just in Malaysia but also in this region. When President Xi Jinping announced the BRI, most provinces in China have urged their SOEs to invest abroad.”**
>
> *Interview with Mr. Unny Sankar, MITI*

Malaysia's strong diplomatic and economic ties with the mainland have led to a variety of joint projects that were facilitated by government talks and high-level meetings. There is not yet, however, an official list of Belt and Road Initiative projects. The Malaysian government has successfully renegotiated some of these investments and construction contracts, improving their terms or postponing them.

The Malaysia – China Kuantan Industrial Park & Kuantan Port Expansion

The Malaysia-China Kuantan Industrial Park (MCKIP), together with its twin park, the China-Malaysia Qinzhou Industrial Park is a leading government-to-government project that was facilitated through the BRI. The MCKIP is a 51:49 joint venture between a Malaysian consortium (40% IJM Land; 30% Kuantan Pahang Holding Sdn. Bhd. & Sime Darby; 30% Pahang state government) and a Chinese consortium (95% Guangxi Beibu Gulf International Port Group; 5% Qinzhou Investment Company).

Figure 5. Kuantan Port Expansion. Source: kuantanport.com.my

The industrial parks' activities have created a demand for expanding and improving the port at Kuantan to include a new deep-water terminal to accommodate larger vessels. The Kuantan Port Consortium Sdn. Bhd. (KPC), jointly owned by IJM (60%) and Beibu Gulf Holding (40%), manages the port on a 60-year concession. The consortium has invested US$730 million in dredging and reclamation work to create new berths, buildings, facilities, equipment, and machinery as well as land for development with its infrastructure. The Government of Malaysia has also invested US$267 million (RM1.1 billion) to build a new 4.7 km breakwater as well as road infrastructure. The port's handling capacity will increase from 26 million to 52 million tonnes annually and its annual container volume will rise from 150,000 to 1.5 million TEU.

No.	Industry	Investment Value (RM)	Job Creation	Land Area (acres)
1	Modern Integrated Steel Mill	5.6 billion	3500 (2700 Malaysian)	710
2	Processed Kaolin, Porcelain Tableware and Tiles	533 million	1000	24.95
3	Spun Concrete Tiles Manufacturing	92 million	100	16
4	Battery manufacturing (Lead-acid/Lithium-ion for EEV)	609 million	600	41
5	Tyre Manufacturing	2.1 billion	1300	244.12

Table 1. Potential and Confirmed Investors in the MCKIP. Source: MCKIP.

Figure 6. MALAYSIA: The New Proposed Route of the East Coast Rail Link.

The MCKIP extends for a total of 3,500 acres divided into MCKIP 1 (1200 acres), MCKIP 2 (1000 acres), and MCKIP 3 (1500 acres). MCKIP 1 and 2 will host medium and heavy industries. Since 2019, Alliance Steel's integrated steel mill has occupied 710 acres of MCKIP 1 producing wire, rod, bars, and H-beams. Potential and confirmed investors in other industries include porcelain, tyres, and battery manufacturing.

MCKIP3 plans to host light manufacturing as well as commercial, residential, and leisure facilities. The aim is to instil new economic life into this area of Malaysia's east coast.

East Coast Railway Link

The plan to spur investment in the State of Pahang with the MCKIP and the upgrading of Kuantan Port will be supported by the East Coast Railway Link. It will connect the state with the rest of the east coast, Selangor, and Kuala Lumpur. The 688 km line will connect Kota Baru (Kelantan) to Port Klang (Selangor) passing through four Malaysian states. It will reduce travel time for passengers between Selangor and Kelantan from the current eight to twelve hours to under four hours.

Major Chinese Investments and Construction Contracts in Peninsular Malaysia

- Airports
- Ports
- Expressway
- Projects Approved or Underway
- Projects under Renegotiation or Postponed
- Project Cancelled
- Malaysia China Kuantan Industrial Park
- ECRL
- Geely-proton New JV
- Forest City
- The KL – Singapore High Speed Rail

Malaysian Rail Link, a state-owned company under the Ministry of Finance, will own and operate the line. In 2016, the government awarded the engineering, procurement, and construction contract to China Communications Construction Company for US$15.9 billion (RM65.5 billion), financed with a loan from China Exim Bank. That agreement was re-negotiated in April 2019, reducing the price of the project to US$10.57 billion (RM44 billion). The line was shortened from 688 to 640 km and the domestic contribution to the civil works was increased from 30% to 40%. The two countries have agreed to form a 50:50 joint venture between Malaysian Rail Link and CCCC for the operation and maintenance of the new railway. The project is expected to have spillover effects for Malaysia's economy during its construction and while in operation, as it could spur tourism and economic growth in the East Coast region.

Figure 7. The Kuala Lumpur to Singapore High-Speed Rail Project.

KL – Singapore High-Speed Rail

The High-Speed Rail (HSR) link that will connect Kuala Lumpur with Singapore is meant to be another game-changer for Malaysia, and indeed for all of ASEAN if, according to the Master Plan on ASEAN Connectivity, it can be part of a high-speed rail link between Singapore and Kunming. The 350 km line between Kuala Lumpur and Singapore is also part of Kuala Lumpur's Economic Transformation Programme that seeks to improve mass transport and relieve traffic congestion in the busiest region of the country. Many see the HSR link as a vital alternative to reduce the air traffic between KL and Singapore, one of the busiest international air routes globally.[4] The non-stop journey of 90 minutes will considerably reduce the current travel time of approximately six hours.

The project started in 2013, but in 2018 Malaysia postponed construction to May 2020 due to the high cost. In May, Singapore agreed to postpone the project until December 2020, but in November the Malaysian government released its 2021 budget and announced that the project will go ahead, as it is expected to generate a positive multiplier effect for the country's economy. MyHSR Corp, a corporation under the Ministry of Finance, is responsible for the development and implementation of the project together with its Singapore counterpart SG HSR. The companies project the potential spillover impact of the line to be between US$48 billion and 158 billion (RM200-650 billion) by 2069, as the connectivity will enhance business productivity and access to markets and will unlock development opportunities for economic clusters along the HSR corridor.

The Xiamen University: Bringing Old Sino – Malaysian Ties Back Through Education

In 1921, Tan Kah Kee, a famous mainland Chinese entrepreneur and philanthropist who worked in Singapore during the colonial times, founded the Xiamen University. Dr. Lim Boon Keng, an eminent Malaysian physician and social activist from Penang served as the university's first president for sixteen years. During that time the university attracted hundreds of students from Malaysia as well as from the whole of Southeast Asia and established one of the first Southeast Asian research institutes in mainland China.

The agreement to build Xiamen University's overseas campus was signed during a visit to Malaysia by President Xi Jinping in October 2013. In 2015, the campus was formally inaugurated, and Premier Li Keqiang praised it as an example of "the depth of people-to-people exchange between China and Malaysia, but also [of] the openness of the Malaysian government and its people." The university had enrolled nearly 4,000 students as of February 2020. The project's estimated cost is US$290 million (RM1.3 billion) financed by Chinese loans obtained with the support of the government and by donations.

[4] *BBC. Kuala Lumpur – Singapore named busiest international air route. https://www.bbc.com/news/business-44000000*

Opportunities for Mainland Chinese Companies in Malaysia

Malaysia is, according to many official indexes and rankings, one of the most attractive FDI destinations in Southeast Asia, with excellent investor protection and liberal investment policies. The Malaysian government is open to and welcomes investments from mainland China as it seeks to promote itself as a principal hub. Chinese companies are encouraged to use a Malaysian base to conduct regional or global business operations.

Manufacturing

Manufacturing is one of the areas where the government wishes to encourage investments. In particular, it hopes to attract investments in high technology, capital-intensive industries and those which are knowledge-driven. The intention is to build on a base of existing industries and labour skills. Malaysia is one of the leading centres for E&E manufacturing, and that contributed 37.8% of its total exports and 22.3% of its manufacturing GDP in 2019. The production clusters already established can support further investments in advanced electronics, optics and photonics, medical devices, aerospace, biotechnology, advanced materials, and in services such as tourism, ICT, offshoring and outsourcing, and education and training.

Pharmaceutical products manufacturing is also growing. Malaysia is a member of the Pharmaceutical Inspection Convention and its pharmaceutical products Inspection Cooperation/Scheme (PIC/S). Hence, locally manufactured pharmaceutical products are accepted globally, particularly in other convention countries. As of June 2020 the Ministry of Health's Drug Control Authority had licensed 260 manufacturing facilities producing traditional medicine (53%), poisonous and non-poisonous over-the-counter remedies (28%), traditional and standard health supplements (15%), and veterinary products (5%).

There are also investment opportunities in the manufacture of machinery and equipment, components and spare parts, and moulds and dies. One of the most exciting joint ventures between a mainland Chinese and a Malaysian company is the Proton-Geely one. The collaboration is set to dramatically transform Proton, injecting innovative technology into new car models, but also restructuring the firm's management and marketing.

“Several business matching opportunities between mainland Chinese and Malaysian companies are already lined up along the supply chain, and we plan to integrate the Malaysian plant into our global supply chain,”

said a mainland Chinese executive during an interview.

Malaysia has over 200 industrial estates and parks, with 18 free industrial zones (FIZs). The five most popular zones are the Pasir Gudang free zone (Johor Baru), Port Klang free zone (Selangor), Kulim Hi-Tech Park (Kedah), Port of Tanjung Pelepas free zone (Johor Baru), and Bayan Lepas free zone (Penang). FIZs have more efficient and relaxed customs controls and can enjoy duty-free imports of raw materials, packaging materials, machinery, and equipment as well as exemption from sales tax, excise duty, and services tax. Companies located in FIZs must export at least 80% of their output, but approval can be obtained from the Ministry of International Trade and Industry to reduce this export condition to 60%.

INDUSTRY 4.0

The digitalisation of the economy is a top priority for Malaysia, and since 2009 the government has been very forthcoming in seeking the help of China's top companies to be part of the Digital Silk Road. In 2016, Jack Ma was appointed an advisor to the Malaysian government to help design its digital economy strategy. 2017, a new Digital Free Trade Zone (DFTZ) was launched in collaboration with Alibaba to digitise trade and promote e-commerce for SMEs by “connecting them to eMarketplaces, government agencies, cross border logistics providers, and cross border payment providers.”[5] The connections will use Alibaba-inspired electronic world trade platforms, which will facilitate trade with other Belt and Road countries. Another noteworthy project is the KL City Brain, which uses Alibaba's cloud computing and artificial intelligence to collect traffic data to improve congestion in the city. The project began in January 2018, and it is the first Alibaba smart city solution outside of mainland China. It was implemented in collaboration with the Malaysia Digital Economy Corporation, Kuala Lumpur City Hall, and Grab. In September 2018 it was announced that the platform would expand to other cities in Malaysia.

Malaysia's government released its Jalinan Digital Negara (Jendela) for the years 2021–2025. The pandemic has not only accelerated the adoption of digital and e-ecommerce platforms across Malaysia, but has also renewed government efforts to improve 4G network coverage in preparation for the transition to 5G. It has launched the ‘Shop Malaysia Online’ campaign to encourage online shopping, and allocated grants for the digitalisation of SMEs.

HALAL PRODUCTS AND SERVICES

The global market for halal food is expected to grow from US$45.3 billion in 2016 to US$58.3 billion in 2022, and Malaysia has excellent competitive potential. In 2006 the government set up the Halal Industry Development Corporation (HDC) and soon after, launched a halal industry master

[5] *Tham, Siew Yean. The Digital Free Trade Zone (DFTZ): Putting Malaysia's SMEs onto the Digital Silk Road. HKTDC. http://china-trade-research.hktdc.com/business-news/article/The-Belt-and-Road-Initiative/The-Digital-Free-Trade-Zone-DFTZ-Putting-Malaysia-s-SMEs-onto-the-Digital-Silk-Road/obor/en/1/1X000000/1X0AF45J.htm*

plan covering 2008-2020. The blueprint sought to establish Malaysia as the global leader in innovation, production, and trade in several halal-related sectors, including specialty and processed foods, cosmetics and personal care products, pharmaceutical ingredients, livestock, and the services sector (particularly logistics, tourism, and healthcare). Currently, there are 22 halal parks in Malaysia designed to host specific clusters which are at different stages of development. The Techpark@Enstek, for instance, hosts halal pharmaceutical manufacturing and research. The Tanjung Manis Halal Hub is promoted for aquaculture and related halal food processing. And the Prima Halal Food Park specialises in the production of halal processed food.

RENEWABLE ENERGY AND GREEN TECHNOLOGIES

In line with its commitment to become a sustainable advanced nation by 2020, Malaysia is also encouraging investments in renewable energy and green technologies. In 2016, the government introduced a feed-in tariff and net energy metering. There are now schemes to encourage investment in large-scale solar energy generation and in biogas, mini-hydro and biomass generation. There are also incentives for energy efficiency related technology that involve import duty exemptions on qualified machines and components, a tax allowance for the purchase of green technology assets, and income tax exemptions to reward the use of green technology.

The government classifies green technologies into four main categories: energy, water and waste, buildings and townships, and transport.

A new RM5 billion green technology financing scheme became effective on 1 January 2019 which aims to boost the uptake of efficient technologies in these areas by companies which are at least 51% Malaysian-owned. That leaves plenty of opportunities to collaborate with local companies.

Figure 8. Major Industrial Estates in Malaysia.

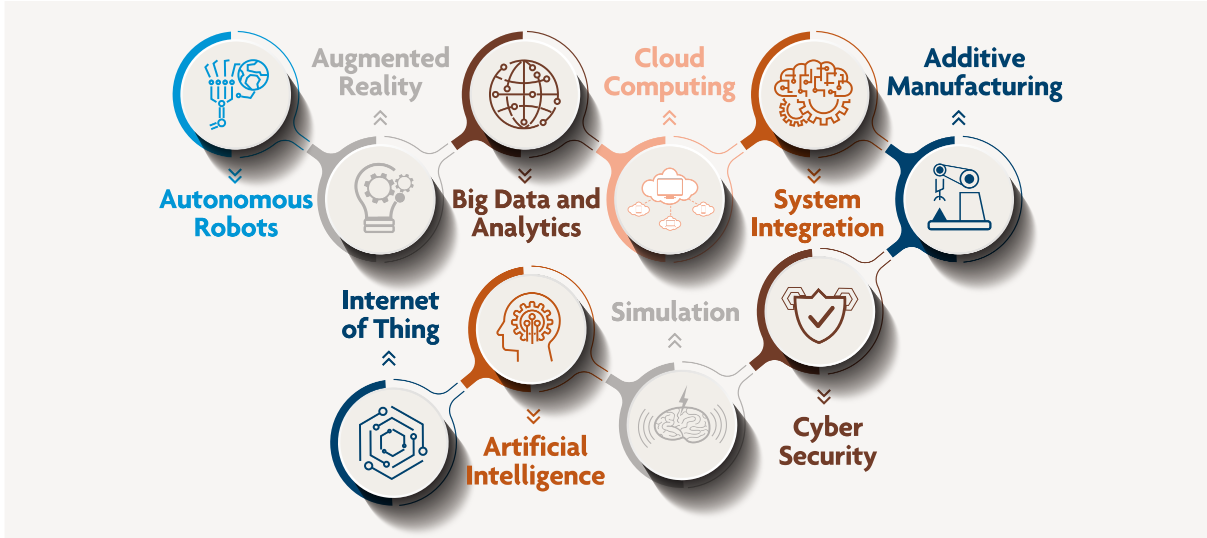

Figure 9. Industry 4.0 - Key Technologies.

Services

Malaysia's services sector is a very significant contributor to the economy. In 2019, it attracted US$27.65 billion (RM118.10 billion) in investment, more than manufacturing (US$19.37 billion) or primary industry (US$1.65 billion). Services grew 3.1% in Q1 of 2020, and this segment presents ample opportunities for potential investors. Sub-sectors include logistics, education and training, hotels and tourism, offshoring and outsourcing activities, ICT services, environmental management, and medical tourism. Huawei provides an example. Government officials regard its investments as successful for bringing new technology, services and opportunities for local SMEs and the workforce. The company entered the Malaysian market over two decades ago, and since 2011 its investment has increased considerably. It has sought to collaborate actively with government-linked corporations such as Malaysia Digital Economy Corporation and SME Corp. In 2012, the company set up the Huawei Malaysia Global Training Centre in Cyberjaya — the firm's first training facility outside of mainland China. The centre has collaborations with ten Malaysian universities to provide training for fresh graduates and professionals in the field of ICT, and it promotes exchange opportunities with the training centre in Beijing. In 2015, Huawei opened its first regional data-hosting centre called the Asia Pacific Digital Cloud Exchange in Bandar Medini, Iskandar Johor, to provide technical solutions in multimedia technology and support the development of the gaming industry. In 2016, Huawei formally located its regional office in Malaysia and by 2017 it had hired more than 2500 employees, of whom 70% are local.

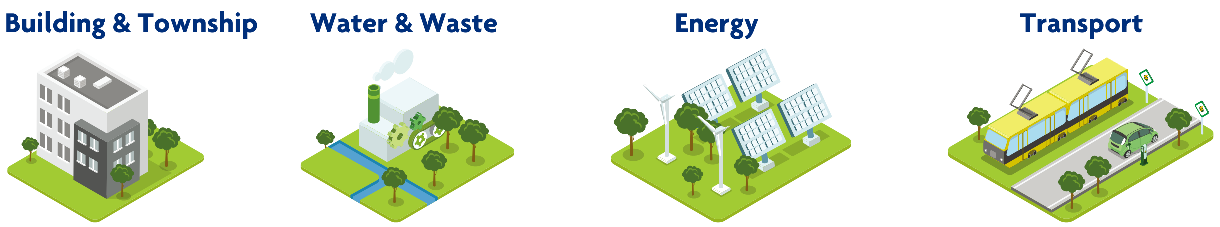

Figure 10. Categories of Green Technology Identified by the Malaysian Government.

Some Barriers to Mainland Chinese FDI

There have been cancellations and re-negotiations of some projects with Chinese involvement, but government sources remain clear that they continue to welcome Chinese investments. On the company level, however, some skepticism remains. It is important for current and potential investors to develop strong networks and collaborations with local companies and to design them for mutual benefit. As one investor noted, “We need to use local networks, local banks, local services and professionals like consulting firms, architects. We need to get more familiar with the local partners and the local context, as China’s market is very unique.” The government has pledged to foster transparency and accountability, but our interviewees insisted that, “Mechanisms will be implemented to prevent companies from going ‘incentive shopping’ across different Malaysian states.” The government announced the China Special Channel (CSC), which sought to attract US$1.1 billion (RM 4.5 billion) of high-value, high-tech and high-impact investments by the end of 2020. The CSC has now been renamed as Project Acceleration and Coordination Unit (PACU), and has the aim of facilitating all investments projects regardless of the country of origin.

The US-China trade tension is also having an effect on FDI from mainland China. A local expert explains that, “Nowadays, the common question that Chinese companies ask is whether they can obtain a certificate of origin from Malaysia.” As the Malaysian government is trying to attract investments that benefit the country’s economy and bring new technology and skills, companies should make sure they bring value-added processes to Malaysia.

Investment Climate

Malaysia is, along with Singapore, one of the most convenient places in Southeast Asia to do business, due to the standard of its infrastructure as well as its business environment. As of 2019, Malaysia had seven bilateral free trade agreements with Japan, Pakistan, India, New Zealand, Chile, Australia, and Turkey supplementing the six implemented through ASEAN with China, Korea, Japan, Australia, New Zealand and India. Malaysia has signed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership but has not yet ratified it.

Companies can now apply for manufacturing licenses, incentives, expatriate posts and duty exemptions online. Foreign companies can hold 100% equity ownership in manufacturing and in selected services sectors. There are several incentives for foreign investors, among which Pioneer Status and the Investment Tax Allowance are the most popular. They apply to companies in the manufacturing, agricultural, hotel, and tourism sectors, but also to companies that engage in designated activities or produce certain products. When a company is eligible for Pioneer status, it will enjoy an exemption from 70 to 100% of corporate income tax for a period of five years. The Investment Tax Allowance can also apply to up to 60% of the qualifying capital expenditure incurred for a period of five years. Malaysia also has good policies in place to allow smooth repatriation of capital, and more lenient regulations of foreign labour than most other countries in the region. On the other hand, labour costs are high for Southeast Asia, and Malaysia’s relatively mature market has greater competition.

When investing in Malaysia, it is essential to know the right place to do so, as every area or state has its advantages and priorities. Penang, for instance, has only limited and comparatively expensive land available, but investors there can count on the availability of skilled labour. Penang’s priorities are to attract investment in hi-tech, capital intensive, and creative industries. Port Klang and the Selangor region are an interconnected regional distribution hub as well as a trade and logistics centre, which can benefit from its proximity to Kuala Lumpur for a variety of resources. Hence, they are suitable areas for most export-oriented and high-tech manufacturing facilities. Johor Baru is also well connected with nearby Singapore, and land prices are lower. That can make Johor a good option for resource-based and traditional manufacturing, but also petrochemicals, due to the presence of well-established clusters.

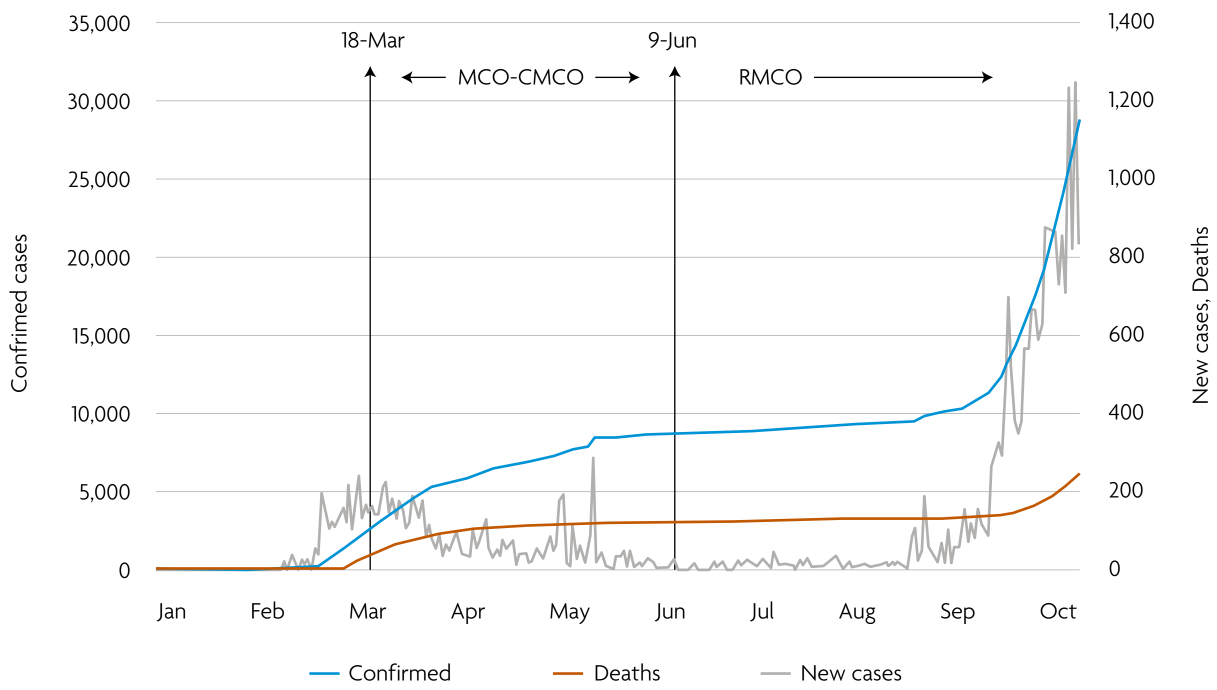

Figure 11. Malaysia COVID-19 Cases. Source: Johns Hopkins University Center for Systems Science and Engineering.

Thanks to a series of movement control orders, Malaysia has successfully contained the COVID-19 pandemic. The stringent lockdown and targeted testing measures implemented between March and June 2020 have greatly reduced the number of new cases, but a new wave allegedly triggered by the state elections in Sabah led to new deaths and more than 1,000 newly-confirmed cases every day. While this has negatively affected Malaysia' economy, which shrank by 17.1% year-on-year in the second quarter of 2020, five economic stimulus packages mean that the outlook for next year remains positive and key BRI projects are still moving ahead. As of 5 November 2020, Malaysia had 35,425 confirmed COVID-19 cases with a recovery rate of 70%.

Preventive Measures

As the number of confirmed cases started to rise in March 2020, the Malaysian government swiftly implemented a series of seven different policies, starting from restricting the movement of people within and out of the country and suspending unnecessary commercial activities.

	Phase	Effective Time
Movement Control Order (MCO)	Phase1	2020/3/18 - 2020/3/31
	Phase2	2020/4/1 - 2020/4/14
	Phase3	2020/4/15 - 2020/4/28
	Phase4	2020/4/29 - 2020/5/12
Conditional Movement Control Order (CMCO)	Phase5	2020/5/4 - 2020/5/12
	Phase6	2020/5/13 - 2020/6/9
Recovery Movement Control Order (RMCO)	Phase7	2020/6/10-2020/8/31
	Phase8	2020/8/31-2020/12/31

Table 2. Malaysia's COVID-19 Response Measures.

On 9 June, the Recovery Movement Control Order allowed activities in most economic sectors to resume under strict operating procedures. Religious and educational activities resumed in phases. Interstate travel bans were also lifted.

On 28 August, the Prime Minister announced that the RMCO was to be extended to 31 December 2020.

Economic Impacts

According to the World Bank's Malaysia Economic Monitor report, the COVID-19 crisis has severely impacted Malaysia's economy, with growth dramatically declining during the second quarter of 2020. All key economic sectors contracted with the exception of agriculture, water and sewerage, information and communications, insurance, and government services.

The pandemic's effect on Malaysia's economy includes external and internal impacts. Malaysia's strong integration with global supply chains and its export orientation exposed it to external shocks. In April 2020, Malaysian exports fell 23.8% compared to 2019, the largest drop since September 2009. However, they experienced a strong rebound in June and July, falling again in August, but rebounding once again in September. The exports that sustained the rebounds were manufactured goods (4.7-16.3%) and agricultural produce (26.6-30.4%), while mined commodities experienced a sharp decline (45.6-25.9%). Malaysia's strong links with China's supply chains also meant that economic fluctuations in the mainland had a significant impact on Malaysia. China locked down in late January 2020, halting many factories and services with a resulting sharp drop in demand and capacity. Over a quarter of Malaysia-China trade (about US$20 billion in 2018) is in intermediate components, which were badly affected by the supply chain disruptions.[6] However, after China resumed normal economic activity, exports from Malaysia to increased between 13.9 and 46.8% for 4 consecutive months from June to September. Trade with the US and other ASEAN countries also grew.

[6] *New Straits Times. 2020. New Normal May Be Permanent, Says Tengku Zafrul https://www.nst.com.my/business/2020/05/594891/new-normal-may-be-permanent-says-tengku-zafrul.*

“ Malaysia is a trading nation and as such, the global economic fluctuation has direct ramifications towards our domestic economy. However, amid global economic uncertainties, the Malaysian government maintains our stance to advocate pro-business policies and is determined to attract quality investments. With this stability in approach, we remain hopeful that we will generally continue to welcome and benefit from trade and investment opportunities with our trading partners. ”

Mr. Unny Sankar, MITI

Moreover, some sectors such as medical supplies and equipment benefited from the pandemic. Malaysia, the world's largest supplier of rubber gloves, has seen a rapid surge in demand which will probably continue into next year. World consumption of personal protective equipment is expected to record a compound annual growth of 7.8% between 2020 and 2025.[7]

Internal shocks have included changes in consumer behaviour. Affected by the pandemic and the movement control orders, Malaysians have become more cautious about spending, and online shopping has become more popular.

Package	Announced	Target	Key measures	Amount
First economic stimulus package	27/02	Tourism and specific industries	Tax reduction/ exemption / deferral, easing cashflow	US$486.5 million (RM20 billion)
PRIHATIN Rakyat Economic Stimulus Package	27/03	Vulnerable groups	Food and healthcare assistance, deferment of loan and tax payments, cash assistance, discount of utilities, loan funds for SMEs, loan guarantees, allowing EPF withdrawals	US$55.9 billion (RM230 billion)
PRIHATIN SME Economic Stimulus Package	6/04	SMEs	Wage subsidies, special grant for qualifying firms	US$243 million (RM10 billion)
National Economic Recovery Plan	5/05	Rebuilding the economy	Employment subsidies, incentives for technology adoption and digitalization, revive strategic sectors, support for private firms, promotion of FDI	RM35 billion
PENJANA	5/6	Bottom 40% of earners (B40), single mothers, disabled, gig economy workers	One-off cash handouts, social security and Employee Provident Fund contributions, healthcare support, free internet, childcare services vouchers	US$364 million (RM35 billion)
Kita Prihatin	26/9	B40, middle 40% income groups, local workers, SMEs	Cash handouts, wage subsidy programme, special grants for SMEs	US$243 million (RM10 billion)

Table 3. Key Economic Stimulus Packages in Malaysia. Source: Compiled by IEMS.

[7] *Research and Markets, 2020. Global Personal Protective Equipment Market Study (2020 to 2025) - Growth, Trends and Forecasts.https://www.globenewswire.com/news-release/2020/06/08/2044788/0/en/Global-Personal-Protective-Equipment-Market-Study-2020-to-2025-Growth-Trends-and-Forecasts.html*

The Finance Minister reports that online sales of fast-moving consumer goods were up 40% because of the pandemic, and he believes this trend will consolidate in the future.[8] Sectors such as tourism have been only slowly rebounding after restrictions were lifted.

Policy Interventions for Economic Stimulus

By October 2020, the government had implemented the six different economic stimulus packages summarised in the table. The budget released in early November also included a number of similar provisions.

BRI Projects Update

“ In the short run, the BRI has slowed down a bit as the Chinese government focused on tackling COVID-19 domestically to safeguard the health of the people. In the long run, China will move aggressively to make early completion of projects associated with [the] BRI in Pakistan, Sri Lanka, and Malaysia where things are moving faster. ”

Shan Saeed, Chief Economist, Juwai IQI

The COVID-19 crisis inevitably affected foreign investments and the progress of most BRI projects. The government suspended all construction projects, including the ECRL when the MCO was imposed in March. Construction resumed only at the end of April, introducing new programs to prioritize local recruitment and subcontracting.[9] Work on the Kuala Lumpur–Singapore high-speed rail line was initially deferred, but the government later announced that the project will move ahead. Progress on the MCKIP was partially affected, but an interview with the Head of Operations revealed things are resuming and post-crisis improvements are underway:

“ The ripple effects [of the COVID-19 crisis] are still unfolding on a global scale, and uncertainties in the market has brought existing and potential investors of MCKIP to a standstill. The closure of international borders has detained or disrupted foreign investments. However, we are taking proactive steps in MCKIP to mitigate these expectations from the crisis. Remote working, digitalised processes, and many other uses of technology have been adopted throughout the pandemic. [Investments are resuming]. This is remarked with the signing of a memorandum of understanding between MCKIP and an investor in the midst of the MCO in April 2020 for their investment funding application in Hong Kong. Currently, our operations have resumed as before and several enquiries from investors, especially from mainland China, have been received as they opt to diversify their operation risks due to the COVID-19 lockdown there. ”

[8] *Cheng, C., 2020. COVID-19 In Malaysia: Economic Impacts & Fiscal Responses - ISIS. https://www.isis.org.my/2020/03/26/covid-19-in-malaysia-economic-impacts-fiscal-responses/.*

[9] *Hassan,H. 2020. Malaysia gives green light for construction to resume on East Coast Rail Link. The Straits Times. https://www.straitstimes.com/asia/se-asia/malaysia-gives-green-light-for-construction-to-resume-on-east-coast-rail-link*

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About the Authors and HKUST IEMS

Angela Tritto is an Adjunct Assistant Professor at the Division of Public Policy and a Postdoctoral Fellow jointly appointed by the Institute of Emerging Market Studies and by the Division of Social Science at Hong Kong University of Science and Technology.

Albert Park is the Head and Chair Professor of the Department of Economics, Chair Professor of Social Science, and Professor of Public Policy, HKUST. He is also the Founding Director and currently Special Advisor to the Director at HKUST IEMS.

HKUST Institute for Emerging Market Studies (IEMS) provides thought leadership on issues facing businesses and policymakers in emerging markets. Building on the research strengths of the faculty at the Hong Kong University of Science and Technology, the Institute focuses its research and activities on the themes of human capital, employment, and structural change; innovation and entrepreneurship; global economic integration; financial development; strategy, firms, and markets; and organisational and consumer behaviour. Find out more at *http://iems.ust.hk*

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