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EXPLORING NICHES FOR EXPORTING: THE CASE OF MALAYSIA

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The technological revolution has changed the way services can be provided from one end of the world to the other. Service provision no longer requires the customer and provider to interact in a shared environment through physical presence. The ability to provide services from a distance has facilitated the globalization of services, making knowledge-based and technology-intensive intermediate services the new sources of growth. Furthermore, progressive deregulation of the service sector through either formal trade liberalization agreements or unilateral liberalization measures has contributed to the increasing importance of the service sector by enhancing the potential of service exports (Behuria and Khullar 1994). Thus, service exports present a promising way to push economic growth. The United Nations Conference on Trade and Development found service exports to be a significant factor in explaining the growth performances of developed countries in the 1990s, though this nexus is somewhat weaker in developing countries (Gabriele 2004, 20).

Malaysia's gross domestic product (GDP) has enjoyed a high growth rate (about 5 percent) since 2000, which increased the demand for several consumer and producer services and hence the contribution of the service sector. The Malaysian government believes that the service sector is potentially an engine of economic growth and aims to increase its contribution to GDP from 56 percent in 2009 to 67 percent—the contribution observed in developed countries—by 2020 (NEAC 2010, 103). To achieve this target, the government has been proactive in introducing policies and strategies to grow the service sector and its exports. Examples can be seen in the Second and Third Industrial Master Plans as well as the New Economic Model (NEM) (MITI 1996, 2006; NEAC 2010). In the Second Industrial Master Plan, the service sector was intended to enhance manufacturing development; in the Third Industrial Master Plan and the NEM, selected services such as health and education were targeted as new sources of export revenues.

This chapter characterizes the nature of service exports in Malaysia and analyzes the factors that have contributed to the success (or otherwise) of specific services relative to others. Factors that could influence the success or failure of the service exports are grouped into three categories: (a) endowments such as availability of human capital and telecommunication infrastructure; (b) government policies such as promotion initiatives and unilateral, bilateral, or regional liberalization; and (c) access to service export markets.

The chapter is organized as follows. An overall picture of the service sector and service exports in the Malaysian economy is followed by a detailed analysis of the characteristics of service exports from Malaysia. The next section details the fundamental factors that have contributed to the success of these exports. The subsequent section explores some specific factors that also may have constrained service exports. Finally, the chapter concludes with policy lessons.

The Service Sector in Malaysia

Since its independence in 1957, Malaysia has traditionally been a net importer of services. After a long period of persistent deficit, a positive balance in service trade started to emerge in 2007 and 2008. Nevertheless, the sector is an important one for the Malaysian economy in terms of its share in GDP, employment, and inter- and intrasectoral links. The service sector has been the largest sector in the Malaysian economy from 1978 to 2009. In 2009, this sector contributed 56 percent of GDP and 59 percent of total employment, including employment in government services (Tham and Loke 2010, 3).

The service sector has the second highest multiplier effect on the economy, after the manufacturing sector. An increase in demand in every service subsector by RM 1.00 (US$0.26) is expected to increase the output in the whole economy by RM 40.04 (US$10.53) while it increases the output in the manufacturing sector by RM 3.73 (US$0.97) (table 5.1). Conversely, an increase in demand by RM 1.00 (US$0.26) in every manufacturing subsector will increase service output by RM 9.80 (US$2.58).

For input requirements, the service sector depends more heavily on its own industries (linkage index of 6.00) than on other sectors in the economy.[1] The

Table 5.1. Multiplier Effect of Increased Demand of RM 1 (US$0.26) in Every Subsector in Each of the Sectors Shown on Other Sectors and the Economy

	Sector (RM)				
Sector	Services	Agriculture, fishery, and forestry	Mining and quarrying	Manufacturing	Construction
Services	35.231	0.752	0.577	9.778	0.212
Agriculture, fishery, and forestry	0.464	8.736	0.011	5.139	0.014
Mining and quarrying	0.291	0.161	3.111	1.526	0.054
Manufacturing	3.734	1.614	0.340	72.553	0.390
Construction	0.321	0.031	0.146	0.496	1.008
Total economy	40.040	11.294	4.185	89.492	1.678

Source: Authors' computation based on Department of Statistics 2005, table 15.

manufacturing sector seems to depend more on the service sector (linkage index of 1.67), relative to the service sector's dependence on the manufacturing sector.

Among service subsectors, government services (public administration and other government services) in general have higher dependency on the manufacturing sector than do nongovernmental services. Among the nongovernmental services, hotel and restaurant services depend relatively highly on the manufacturing sector for inputs, particularly from the food processing subsector (linkage index of 15.17). Other examples are transport and storage services, which depend relatively highly on the petroleum products subsector (linkage index of 6.64); communication services, which have high dependency on the electrical machinery subsector (6.18); education services, which depend on the food processing subsector (3.99); and health services, which depend on the industrial chemicals subsector (2.49).

In terms of the degree of importance of service subsectors as inputs to the manufacturing subsectors, the wholesale and retail trade service subsector is an important input to all manufacturing subsectors particularly to the food processing subsector (linkage index of 22.60), because its forward linkage index values are all greater than 1.00. Other services that are relatively more important to the manufacturing sector are transport and storage services (particularly to food processing, with an index of 6.23) and business services (particularly to food processing, with an index of 6.59).

In short, the linkage analysis shows that the service and manufacturing sectors are interdependent. Growth in the service sector (in terms of size or quality) is likely to promote the manufacturing sector and vice versa.

Hence, the service sector is an important sector in the domestic economy in terms of its contribution to GDP, employment, and inter- and intrasectoral links in the country. However, its contribution to total exports is much smaller than the contribution of manufacturing. Overall, Malaysia is not a big exporter of services in the global arena. Because of the dominance of multinational corporations in the manufacturing sector, Malaysia's export of manufactured goods is facilitated through the import of transport services.

Significance of service exports

Malaysia's exports comprise mainly manufactured goods. The share of service exports in total exports stagnated between 12 and 14 percent from 1998 to 2008, while its share in GDP remained within 12 to 16 percent. The share of service exports in service value added stood at 36 percent in 2007 before falling to 25 percent in 2008. This finding indicates that a larger share of service output in the country is directed toward the domestic economy.

Table 5.2 shows the revealed comparative advantage for Malaysia for four broad categories of services. The results suggest that Malaysia has a strong and growing comparative advantage in travel services. Transport services indicated a comparative advantage for one year (2007). The comparative advantage that Malaysia held in computer, communication, and other services in 1999 to 2000 has deteriorated over time. These revealed comparative advantages should be interpreted with caution because these indicators are calculated for a fairly aggregated group of services; further disaggregation is not possible owing to the unavailability of data.

Table 5.2. Revealed Comparative Advantage of Malaysia, 1999–2008

	Real comparative advantage									
Sector	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Computer, communication, and other services	1.21	1.07	0.77	0.78	0.81	0.75	0.78	0.74	0.64	0.61
Insurance and financial services	0.39	0.36	0.42	0.20	0.35	0.32	0.25	0.21	0.18	0.19
Transport services	0.85	0.82	0.78	0.81	0.87	0.78	0.86	0.80	1.02	0.91
Travel	0.95	1.15	1.55	1.62	1.51	1.68	1.63	1.80	1.82	1.95

Source: Authors' calculation based on Balassa's (1965) formula and balance of payments data from the World Bank's World Development Indicators database.

Composition of cross-border service exports

This section identifies the major service exports of the country through its balance of payments statistics, which are the primary source of data for the country's exports of services. A shift occurred in the share of the three main categories of exports over time. From 1995 to 2000, the largest share in exports accrued to other services, followed by travel and transport. The share of travel in exports increased steadily over time, and it became the largest component in service exports from 2001 onward. Although the share of travel ranged between 21 and 35 percent in the 1990s, it rose to over 40 percent for all years during the 2000s. In 2008, travel constituted 50 percent of total service exports. The largest share of the travel export is business travel. Personal travel exports are less than 1 percent, though that figure is increasing. The share of health- and education-related services was reported for the first time for the years 2004–07.

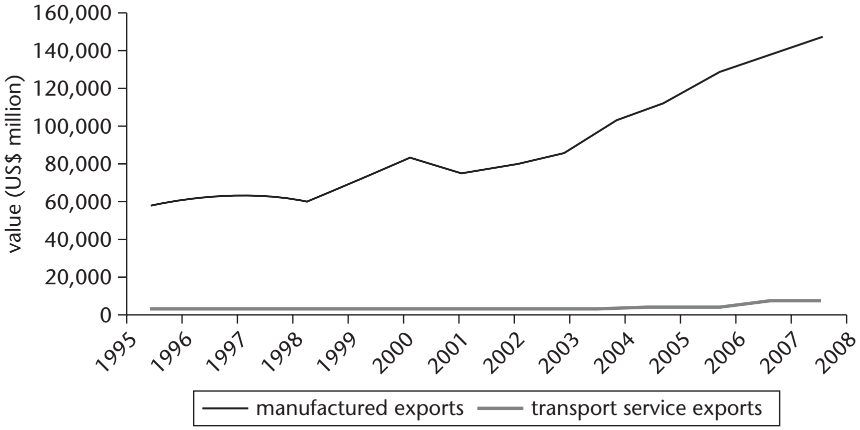
Although other services constituted the second-largest component in service exports from 2001 onward, their share has decreased over time, falling from 34 percent in 2001 to 27 percent in 2008. This decrease does not imply that the absolute value of other service exports has fallen but rather that the value of exports in this category has not increased as fast as the value of service exports in transport and travel.

Nevertheless, within other services, the shares of some services are increasing, including computer and information services. The share of information and communication technology (ICT) service exports in aggregate service exports grew from 1.2 percent to 3.4 percent from 1993 to 2008. Total cumulative ICT service exports from the Multimedia Super Corridor (MSC), a government-designated zone for the development of multimedia technology, amounted to RM 7.2 billion (US$2.0 billion) in 2009. Annual ICT service exports from the MSC as a percentage of total computer and information service exports grew from 66 percent in 2005 to 70 percent in 2006 but slowed to 43 percent in 2008.

Transport service exports are the third major group of service exports, with a share of about 20 percent of total service exports throughout the period 1995–2006. However, the share of passenger transport in aggregate service exports increased significantly from 5.3 percent in 2001 to 10.8 percent in 2008. The increase in passenger transport was facilitated by the emergence of low-cost carriers in Malaysia and subsequently in other countries in the region. These carriers further enhanced tourism within the region as well as business travel. Tourism in Malaysia is also boosted by the presence of an increasing number of middle-income consumers in Asia, thanks to overall economic growth in the region.

The slow growth of transport service exports can be attributed to the fact that Malaysia has not been able to capitalize on its manufacturing exports to deepen its

Figure 5.1. Value of Manufactured Exports and Transport Service Exports, 1995–2008



Sources: International Monetary Fund balance of payment statistics; Bank Negara Malaysia 2010.

service exports. Figure 5.1 plots the value of manufactured exports and transport service exports over time (1995–2008). Both have clearly increased over time; however, they do not seem to have high correlation with each other. Manufactured exports increased at a faster rate than transport service exports, leading to a widening gap between manufactured exports and transport service exports over time. This finding indicates that Malaysia still very much depends on the import of transport services to facilitate its exports of manufactured goods.

The heavy dependence on foreign transport services, particularly foreign shipping lines, was noted in a study by Sieh Lee, Abidin, and Loke (2000, 132), which found that only 15 percent of Malaysia's total trade was carried by Malaysian ships. This phenomenon has continued in recent years as an estimated 85 percent of total trade is carried by foreign ships (Baird Maritime 2010). Data from the Ministry of Transport show that, in 2005, Maersk Line handled approximately 78 percent of the total cargo in Port Klang and Tanjung Pelepas, two of the major ports in the country. Maersk's share increased to 82 percent in 2009. The dominance of multinational corporations in manufacturing exports and their preference for using transport services from other multinational corporations in their home countries has contributed to this dependence.

In 2007, for the first time since independence, the services account shifted from negative to positive in Malaysia's balance of payments (WTO 2009, 8). Increasing exports of travel services and passenger transportation contributed to this shift. This surplus was retained in 2008, although there was a slight decrease compared to 2007.

Mode 2: Key service exports not fully reflected in balance of payments data

The balance of payments data do not describe the full extent of service exports because they capture only cross-border financial transactions made through the banking system. An important omission is the domestic expenditure involved in mode 2 service exports. Even for financial services, there are some restrictions in the use of balance of payments data. First, it is not possible to identify the types of financial services that are exported, because there are no domestic data on this topic. Second, financial services in the balance of payments data do not completely capture the export of some financial instruments and bonds.[2] For example, no published data are available on the extent to which Islamic financial instruments and bonds in Malaysia have been subscribed in the global market. Malaysian and non-Malaysian corporations and multinationals have issued *Sukuk* (Islamic bonds), which were subscribed by both domestic and international investors. In 2002, Kumpulan Guthrie Berhad issued the US$150 million Global Sukuk (*Sukuk Ijarah*), the first global corporate Islamic bond issue that was launched in Malaysia (Laldin 2008, 12). The Malaysian government also launched the Malaysian Sukuk Ijarah, worth US$600 million, in 2002. To date, Malaysia captures about 40 percent of the global Sukuk issuance, but there is no apparent indicator to show the expansion of the related service activities.

Similarly, tourism is the largest service industry in Malaysia, employing about 451,000 in 2005. The number of tourist arrivals increased from 10.2 million in 2000 to 16.4 million in 2005 and is expected to reach 24.6 million in 2010 (under the Ninth Malaysia Plan). This average annual rate of increase of 10 percent has surpassed the target of 6.9 percent. A major difficulty is determining the amount of tourist receipts spent domestically on related services such as restaurants, transportation, and entertainment. The government estimated that tourist receipts in 2000 totaled RM 17.3 billion (US$4.6 billion), and this figure rose to RM 31 billion (US$8.2 billion) in 2005. The expected tourist receipts in 2010 were RM 59.4 billion (US$19.2 billion).

Mode 3: Foreign direct investment outflows

Data on outflows of foreign direct investment (FDI) by sectors and by public and private companies were not published in Malaysia at the time of writing of this chapter. According to the 2009 annual report of the Malaysian central bank, Bank Negara Malaysia, cumulative outflows grew from RM 32 billion (US$10.3 billion) for the period 1995–99 to RM 182 billion (US$49.5 billion) for the period 2000–09 (Bank Negara Malaysia 2010, 37). The share accruing to services in the cumulative outflows from 1995 to 1999 grew from 49 percent to 70 percent for the period from 2000 to 2009. Financial services, telecommunication, and utilities are the main subsectors in services that are investing abroad. Government-linked companies play a big role in outward investment, although private companies are also involved. The investment is focused in the region, especially in the Association of Southeast Asian Nations (ASEAN), the Asian newly industrialized economies, China, and West Asia.

Anecdotal evidence, as well as data from annual reports, indicates that government-linked companies that have investment abroad are Telekom Malaysia Berhad and banks, including private banks, as shown in tables 5.3 and 5.4. Tenaga Nasional Berhad, the national electricity company, reported in its 2009 annual report that it has investment holding companies in India, Mauritius, and Pakistan. It also operates a power plant and generates electricity in Pakistan.

AirAsia, the low-cost carrier, has joint ventures in Indonesia and Thailand (Indonesia AirAsia and Thai AirAsia). Private hospitals and higher education institutions have also ventured overseas. For example, KPJ Healthcare has facilities in Bangladesh, Indonesia, and Saudi Arabia. Eight private higher education institutions in the country have reported having branch campuses overseas, mainly in other developing countries such as Bangladesh, China, India, Indonesia, and various countries in Africa. The exception is Limkokwing University, which has reported the establishment of an affiliate in the United Kingdom.

Mode 4: Service exports from Malaysia

Many Malaysians work in Singapore, particularly in health and education services. An estimated 350,000 Malaysians are working in Singapore, with 150,000 commuting from Johor Bahru and the rest residing in Singapore (New Straits Times 2009). The number of Malaysian migrants with tertiary education reported in the countries of the Organisation for Economic Co-operation and Development has increased from 72,649 in 1999 to 102,321 in 2000 (Fong 2010). Fong (2010) also reported that there were 7,955 Malaysian science and technology researchers in the United States in 2003 compared with 10,419 at home.

Destination of service exports

Malaysia has information on the destination markets for selected subsectors, which permits an analysis of bilateral service exports.

In the case of higher education, the top countries in terms of inflows of international students are China, Bangladesh, and the Islamic Republic of Iran,

Table 5.3. Investment Abroad of Telekom Malaysia Berhad, 2009

Country	Subsidiaries, associates, and affiliates	Shareholding (%)	Nature of business	Number of subscribers
Bangladesh	TM International (Bangladesh) Limited	70.0	Cellular	8,700,000
Cambodia	Telekom Malaysia International (Cambodia) Company Limited	100.0	Cellular	591,515
India	Idea Cellular Limited	15.0	Cellular	34,200,000
	Spice Communications Limited	49.0	Cellular	3,800,000
Indonesia	PT Excelcomindo Pratama Tbk	83.8	Cellular	26,000,000
Iran, Islamic Rep.	Mobile Telecommunication Company of Esfahan	49.0	Cellular	13,696
Pakistan	Multinet Pakistan (Private) Limited	89.0	Broadband, long-distance, and international services	—
Singapore	Mobileone Ltd	29.7	Cellular and broadband	1,600,000
Sri Lanka	Dialog Telekom PLC	85.0	Mobile, Internet, international data and backbone, fixed wireless, transmission infrastructure, and media-related services	5,500,000
Thailand	Samart Corporation Public Company Limited	19.0	Mobile services, multimedia services, ICT solutions and services, and technology-related businesses	—
	Samart I-Mobile Public Company Limited	24.4	Mobile, multimedia, and international business services	—

Source: Telekom Malaysia Berhad 2009.
Note: — = not available.

Table 5.4. Operations Abroad of Malaysian Banks, 2009

Bank	Number of subsidiaries	Location of subsidiaries	Number of branches[a]
AmBank Group	3	Brunei Darussalam, Indonesia, Singapore	3
CIMB	17	Bahrain; Brunei Darussalam; China; Hong Kong SAR, China; Indonesia; Myanmar; Singapore; Thailand; United Kingdom; United States	212
Hong Leong Bank	2	Hong Kong SAR, China; Singapore	2
Maybank	14	Bahrain; Brunei Darussalam; Cambodia; China; Hong Kong SAR, China; Indonesia; Papua New Guinea; Philippines; Singapore; United States; Uzbekistan; Vietnam	342
Public Bank	5	Cambodia; Hong Kong SAR, China; Lao PDR; Sri Lanka; Vietnam	51
RHB Bank	4	Brunei Darussalam, Singapore, Thailand, Vietnam	10

Sources: Annual reports of banks for 2009.
a. Includes representative offices and offshore banking units.

respectively, followed by countries in ASEAN (table 5.5). The most popular undergraduate programs for international students are the transnational programs that are conducted locally in English. International students, including students from China, aspire to obtain the foreign degrees that are awarded by the parent institutions of these transnational programs. The lower cost of living in Malaysia is an added attraction. Because Malaysia has multiethnic groups, including a substantial Chinese population, cultural diversity is another comparative advantage. Over time, the share of students from Bangladesh and China has been declining. The share of Chinese students coming to Malaysia for higher education declined from 34 percent in 2003 to less than 14 percent in 2007 while the share of Bangladeshi students declined from 7 percent to 5 percent in the same period. By contrast, more students from the Islamic Republic of Iran were attracted to Malaysia for higher education. Their share increased from barely 1 percent to 8 percent.

An Observatory on Borderless Higher Education (OBHE) analysis of the market share of the major and minor players for international students in higher education from 2007 to 2009 reveals some interesting shifts (Lasanowski 2009, appendix C; Verbik and Lasanowski 2007). According to OBHE, the market share of the major players (namely, Australia, the United Kingdom, and the United States) dropped slightly from 45 percent to 44 percent of the world's

Table 5.5. Top Source Countries for International Students, 2003–07

	Number of students (% of total)					
Country	**2003**	**2004**	**2005**	**2006**	**2007**	**2003–07**
Total	30,397	31,674	40,525	44,390	47,928	194,914
Bangladesh	2,136 (7.03)	1,635 (5.16)	5,712 (14.10)	6,517 (14.68)	2,506 (5.23)	18,506 (9.49)
China	10,349 (34.05)	9,250 (29.20)	9,317 (22.99)	7,310 (16.47)	6,468 (13.50)	42,694 (21.90)
Iran, Islamic Rep.	374 (1.23)	703 (2.22)	1,181 (2.91)	1,784 (3.72)	3,678 (7.67)	7,720 (3.96)
ASEAN	8,350 (27.47)	9,312 (29.40)	10,150 (25.05)	11,099 (25.00)	12,317 (25.70)	51,228 (25.80)
Brunei Darussalam	241 (0.79)	234 (0.74)	218 (0.54)	241 (0.54)	325 (0.68)	1,259 (0.65)
Cambodia	95 (0.31)	85 (0.27)	130 (0.32)	213 (0.48)	218 (0.45)	741 (0.38)
Indonesia	5,634 (18.53)	6,520 (20.58)	6,866 (16.94)	7,541 (16.99)	8,454 (17.64)	35,015 (17.96)
Lao PDR	29 (0.10)	14 (0.04)	19 (0.05)	27 (0.06)	27 (0.06)	116 (0.06)
Myanmar	458 (1.51)	495 (1.56)	566 (1.40)	503 (1.13)	500 (1.04)	2,522 (1.29)
Philippines	130 (0.43)	126 (0.40)	199 (0.49)	300 (0.68)	289 (0.60)	1,044 (0.54)
Singapore	462 (1.52)	537 (1.70)	550 (1.36)	618 (1.39)	725 (1.51)	2,892 (1.48)
Thailand	881 (2.90)	835 (2.64)	994 (2.45)	944 (2.13)	1,148 (2.40)	4,802 (1.98)
Vietnam	420 (1.38)	466 (1.47)	608 (1.50)	712 (1.60)	631 (1.32)	2,837 (1.46)

Source: Data from the Ministry of Higher Education.

overseas students. China, an emerging player in 2007, has joined the league of the "middle powers" in this market, although its market share remains at 7 percent. In contrast, France and Germany (the other two players in this group) experienced a drop in their shares from 10 percent each to 9 percent each. The evolving destinations (Canada, Japan, and New Zealand) have also experienced a drop in their respective market shares from 5 percent, 5 percent, and 3 percent to 4 percent, 4 percent, and 2 percent during the same period. Malaysia and Singapore, classified as emerging contenders, maintained their respective market shares at 2 percent each. The Republic of Korea joined the group of emerging contenders in 2009, with a market share of 1.5 percent.

Most medical services from Malaysia are exported within the ASEAN region (80 percent in 2007), although Malaysia also attracts European and Japanese patients (table 5.6). Policy measures have not identified specific niches for medical treatment in the country; however, the procedures in demand by medical tourists are procedures for coronary heart disease, plastic surgery, hip and knee implants, dental implants, and high-end diagnostic services (Chee 2007). The share of patients visiting Malaysia for treatment who are from ASEAN countries increased from 75 percent in 2003 to 80 percent in 2007. Within the ASEAN region, Indonesia accounts for more than 95 percent of patients visiting Malaysia for treatment. Most of the increase in patients coming from ASEAN countries was due to an increase in patients from Indonesia.

In the case of medical tourism, Malaysia's share in the global market is less than that of Thailand, Singapore, and the Philippines. Malaysia's share in the global medical tourism market, estimated at US$20 billion in 2006, is currently 0.27 percent (US$54 million). Thailand comes in at 3.75 percent (US$750 million), followed by Singapore at 2.13 percent (US$425 million) and the Philippines at 0.63 percent (US$125 million) (Choy 2010).

In the case of general tourism, the top source country is Singapore, followed by Thailand, Indonesia, China, Brunei Darussalam, Japan, and Australia (table 5.7).

Table 5.6. Top Destination Countries for Medical Tourism Exports, 2003–07

	2003	2005	2005	2006	2007	2003–07
Total	102,883	174,189	232,161	296,687	341,288	1,147,208
China	1,829 (1.77)	1,974 (1.13)	2,664 (1.15)	3,765 (1.27)	5,099 (1.49)	15,331 (1.34)
Japan	7,213 (7.01)	7,166 (4.11)	9,006 (3.88)	11,382 (3.84)	11,210 (3.28)	45,977 (3.13)
European countries	3,270 (3.18)	3,776 (2.17)	5,563 (2.40)	7,383 (2.49)	9,219 (2.70)	29,211 (2.55)
ASEAN[a]	77,406 (75.24)	142,587 (81.86)	189,247 (81.52)	235,692 (79.44)	274,998 (80.58)	919,930 (80.19)
Brunei Darussalam	209 (0.20)	449 (0.26)	788 (0.34)	711 (0.24)	1,028 (0.30)	3,185 (0.28)
Indonesia	74,579 (72.49)	138,387 (79.45)	183,503 (79.04)	228,486 (77.01)	266,227 (78.01)	891,182 (77.68)
Philippines	579 (0.56)	631 (0.36)	1,090 (0.47)	1,878 (0.63)	1,902 (0.56)	6,080 (0.53)
Singapore	1,248 (1.21)	2,184 (1.25)	2,656 (1.14)	3,141 (1.06)	3,812 (1.12)	13,041 (1.14)
Thailand	791 (0.77)	936 (0.54)	1,210 (0.52)	1,476 (0.50)	2,029 (0.59)	6,442 (0.56)

Source: Data from the Ministry of Health.

a. Figures for ASEAN countries include only the countries shown.

Table 5.7. Top Source Countries for Tourists, 1999–2009

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2009
Total	7,931,149	10,221,582	12,775,073	13,292,010	10,576,915	15,703,406	16,431,055	17,546,863	20,972,822	22,052,488	23,646,191	171,149,554
China	257,832	501,590	597,857	674,056	422,624	632,807	432,570	532,914	789,783	949,864	1,019,756	6,811,653
Share (%)	3.25	4.91	4.68	5.07	4.00	4.03	2.63	3.04	3.77	4.31	4.31	3.98
Japan	286,940	455,981	397,639	354,563	213,527	301,429	340,027	354,213	367,567	433,462	395,746	3,901,094
Share (%)	3.62	4.46	3.11	2.67	2.02	1.92	2.07	2.02	1.75	1.97	1.67	2.28
Australia	134,311	236,775	222,340	193,794	144,507	204,053	265,346	277,125	320,363	427,076	533,382	2,959,072
Share (%)	1.69	2.32	1.74	1.46	1.37	1.30	1.61	1.58	1.53	1.94	2.26	1.73
ASEAN	5,944,804	7,190,421	12,868,029	9,877,168	8,032,705	12,479,185	13,226,107	13,839,325	15,565,385	16,567,282	18,289,362	133,879,773
Share (%)	74.96	70.35	100.73	74.31	75.95	79.47	80.49	78.87	74.22	75.13	77.35	78.22
Singapore	4,900,084	5,420,200	6,951,594	7,547,761	5,922,306	9,520,306	9,634,506	9,656,251	10,492,692	11,003,492	12,733,082	93,782,274
Share (%)	61.78	53.03	54.42	56.78	55.99	60.63	58.64	55.03	50.03	49.90	53.85	54.80
Thailand	498,578	940,215	1,018,797	1,166,937	1,152,296	1,518,452	1,900,839	1,891,921	1,625,698	1,493,789	1,449,262	14,656,784
Share (%)	6.29	9.20	7.97	8.78	10.89	9.67	11.57	10.78	7.75	6.77	6.13	8.56
Indonesia	307,373	545,051	777,449	769,128	621,651	789,925	962,957	1,217,024	1,804,535	2,428,605	2,405,360	12,629,058
Share (%)	3.88	5.33	6.09	5.79	5.88	5.03	5.86	6.94	8.60	11.01	10.17	7.38
Brunei Darussalam	187,704	195,059	309,529	256,952	215,634	453,664	486,344	784,446	1,172,154	1,085,115	1,061,357	6,207,958
Share (%)	2.37	1.91	2.42	1.93	2.04	2.89	2.96	4.47	5.59	4.92	4.49	3.63
Philippines	47,238	81,927	122,428	107,527	90,430	143,799	178,961	211,123	327,140	397,884	447,470	2,155,927
Share (%)	0.60	0.80	0.96	0.81	0.85	0.92	1.09	1.20	1.56	1.80	1.89	1.26
Vietnam	3,827	7,969	18,729	21,158	21,663	42,088	52,543	63,866	119,973	122,933	149,685	624,434
Share (%)	0.05	0.08	0.15	0.16	0.20	0.27	0.32	0.36	0.57	0.56	0.63	0.36
Cambodia	—	—	—	7,705	8,725	10,951	9,957	14,694	23,193	35,464	43,146	153,835
Share (%)	—	—	—	0.06	0.08	0.07	0.06	0.08	0.11	0.16	0.18	0.09

Source: Tourism Malaysia website, http://www.tourism.gov.my.
Note: — = not available.
a. Figures for ASEAN countries include only the countries shown.

Singapore's share declined in the past decade, from 62 percent in 1999 to 54 percent, whereas Indonesians' interest in visiting Malaysia increased, rising from 4 percent to 10 percent. Thailand's share increased to 12 percent in 2005 but in 2009 declined to its 1999 level of 6 percent.

On the basis of available data, the World Economic Forum travel and tourism competitiveness index ranked Malaysia ahead of Thailand, Indonesia, and the Philippines but behind Singapore in terms of competitiveness in travel and tourism (table 5.8). Malaysia was ranked higher than Singapore for subindexes on human, cultural, and natural resources, probably because of the lack of resource availability in Singapore.

The emergence and subsequent expansion of Malaysia's first low-cost carrier, AirAsia, has facilitated regional travel for inflows and outflows of tourists by making regional travel much more affordable than before. The emergence of low-cost carriers in other countries in Southeast Asia has also enhanced tourist flows in the region. The rise of the middle class in the countries in the region is another factor contributing to increased regional travel. Hence, intraindustry trade is expected to be higher in this subsector than in other subsectors. Because Malaysia and the Gulf Cooperation Council are the two main centers in the application of Islamic finance contracts to financial products and cover a major portion of the total market of global Islamic finance, intraindustry trade is expected to prevail in the Islamic financial sector. Despite differences in *Shariah* opinions between the two Islamic financial centers, some contracts are universally accepted—namely, the *mudaraba* contract for project financing and deposits (Gintzburger 2010). Hence, it is expected that for universally accepted contracts there will be cross-border flows between the two centers.

Factors behind the Success of Service Exports

Several factors explain the success behind Malaysia's service exports. The fundamentals are covered here.

Table 5.8. Travel and Tourism Competitiveness Index, 2009

Country	Regional index	Overall index	Regulatory framework	Business environment and infrastructure	Human, cultural, and natural resources
Singapore	2	10	6	5	23
Malaysia	7	32	42	38	14
Thailand	8	39	70	40	19
Indonesia	15	81	113	79	40
Philippines	16	86	85	89	70

Source: Blanke and Chiesa 2009.

Economic performance

Political and economic stability are important for attracting providers and consumers of services. Malaysia's overall economic performance has been very satisfactory over the 14 years from 1995 to 2008. Annual GDP has risen, with growth rates of well over 5 percent in most years during that period, with one exception during the Asian financial crisis in 1998, when negative growth was recorded. As a result of the continued positive economic growth, Malaysia's GDP per capita almost doubled, from US$4,479 in 1995 to US$8,197 in 2008.

Although the economy grew at high rates, inflation was relatively well managed, with rates below 3.6 percent in most years. The exceptions were in 1998 and 2008, when inflation rates exceeded 5 percent. One main factor for the higher inflation rates was the world price of oil, particularly in 2008.

Unemployment rates in the period from 1998 to 2008 also were relatively low, at about 3 percent every year. The country's domestic supply of labor has not been able to meet market demand. Labor shortage is particularly acute for low-skilled jobs such as plant assemblers and shop floor workers. Malaysia relies on foreign labor, mainly from neighboring countries such as Cambodia, Indonesia, Myanmar, Nepal, and Vietnam.

Business climate

In general, Malaysia's business climate is relatively conducive to both domestic and multinational corporations. It is still relatively easy to start a business in Malaysia, as compared to other countries in the region and throughout the world (table 5.9). However, increasing competition from other countries and the emergence of new markets in the world in recent years, coupled with some other domestic factors such as the perception of increasing corruption and deteriorating safety in the country, have caused Malaysia's ranking to deteriorate (table 5.10). According to the World Bank's *Doing Business* indicators for 2006,

Table 5.9. Ease of Starting a Business: Malaysia and Regional and Global Averages, 2010

Indicator	Malaysia	East Asian and Pacific average	Global average
Procedures (number)	9	8	8
Time (days)	30	41	36
Cost (% of income per capita)	25	26	41
Paid-in minimum capital (% of income per capita)	0	21	60

Source: World Bank 2009.

Table 5.10. Ease of Doing Business: Ranking of Malaysia and Selected Economies, 2006–10

Economy	2006	2009	2010
Singapore	2	1	1
Thailand	20	12	12
Korea, Rep.	27	23	19
Malaysia	21	21	23
China	91	86	89
Vietnam	99	91	93
Indonesia	115	129	122

Source: World Bank 2005, 2009.

Malaysia was preferred to countries such as Korea and almost equal to Thailand for locating a business. However, in 2010, Korea improved in its ranking, whereas Malaysia dropped in its ranking.

Nevertheless, basic political and macroeconomic stability as well as ease of doing business in Malaysia are only three prerequisites for attracting consumers and providers of services to Malaysia. Other factors need to be in place, as explained in the following sections.

Natural endowment and cultural factors

Malaysia has abundant natural resources to support tourism, especially ecotourism in East Malaysia (Sabah and Sarawak). East Malaysia has extensive forest and tree cover that supports its megabiologically diverse endowments, including exotic flora and fauna as well as different species of mammals, invertebrates, fish, and birds. A number of national and state parks have caves, including some of the largest and longest in the world. The country also hosts a large variety of bird species as well as migratory birds, because it is located on the Australasian cross-migratory bird paths.

A number of tourism destinations have been established as gazetted terrestrial or marine protected areas. Daud (2002, 129) reports that 5 percent of the terrestrial area, covering 1,464,973 hectares, is protected. This protected area includes 1 national park, 18 state parks, 18 wildlife reserves, 3 wildlife sanctuaries, 3 bird reserves, and 2 protected landscapes. Marine protected areas include more than 40 islands. The protected areas are managed by the Department of Wildlife and National Parks, the Forestry Department, the Fisheries Department, and various state park authorities.

Malaysia is well known as a multiethnic society. Its population of 28 million in 2009 comprises Malays (53 percent), indigenous or other *Bumiputera* groups

(12 percent of the population), Chinese (26 percent), Indians (8 percent), and other unlisted ethnic groups (1 percent). This multiethnic composition inevitably implies a multicultural society. In addition, Malaysia's long-standing openness to international trade and FDI in the manufacturing sector has also led to a significant population of expatriates working in the country, thereby further enhancing the diversity of cultures. The increasing presence of foreign workers since the early 1990s, estimated at 1.9 million in 2009, has further added to the country's diversity. This diversity is a source of advantage for Malaysia because Malaysian workers are comfortable working with other ethnic groups and foreigners find it relatively easy to adapt to working with Malaysians. The Chinese and Indian diasporas in Malaysia may be able to use kinship ties to penetrate the markets in China and India.

Special factors

A number of special factors have also encouraged the development of service exports.

Government support of service exports

The Multimedia Super Corridor was established in 1996 to build a competitive cluster of local ICT companies and a sustainable ICT industry. Malaysia developed the MSC by providing financial and nonfinancial incentives such as 100 percent foreign equity ownership and no restrictions on the employment of foreign knowledge workers. By 2005, a total of 1,421 companies had been established in the MSC and were given MSC status. Of these, 349 companies were foreign owned and 39 were 50-50 joint ventures. By 2009, the number of firms in the MSC had grown to 2,520, of which 25 percent were foreign, including joint ventures. Cumulative FDI in 2009 amounted to RM 5.8 billion (US$1.65 billion).

For travel service exports, the government approved the establishment of the first low-cost carrier in 2001. Although AirAsia is not the first low-cost carrier in Southeast Asia, it is certainly the most successful—partly because it did not intend to remain a domestic carrier even though it was established as one. By 2007, AirAsia had captured 48.6 percent of the domestic air traffic volume, leaving 51.4 percent of the domestic market to the national carrier, Malaysian Airlines (WTO 2009, 65).

In line with its regional ambitions, AirAsia quickly formed joint ventures in Indonesia and Thailand to capture those markets as well as to position itself for the ASEAN open-skies policy (Tham 2008, 24). It is the biggest low-cost carrier in Southeast Asia, measured by fleet size, and has since ventured into long-haul travel by establishing AirAsia X. After AirAsia's entry into the domestic market, the government deregulated the underserved, lucrative Malaysia-Singapore monopoly in 2008. This route previously had been served by the national carriers of the two countries.

The establishment of the Low-Cost Carrier Terminal in 2006 boosted travelers' use of AirAsia. The rapid expansion of AirAsia has led to the expansion of the current facilities as well as to plans to build a similar terminal in the near future.

The enactment of the Islamic Banking Act in 1983 introduced Islamic banking into the country. Islamic banks offer the entire range of Islamic products. Although conventional banks offer conventional products, they are also allowed to offer Islamic products. A national Shariah Advisory Council was established by the Securities Commission in 1996 to facilitate the development of the Islamic capital market in the country (Securities Commission 2009). Members of the council are highly qualified Malaysians with wide international exposure and international scholars in the region. The council serves as the sole authority for the issuance of rulings and guidelines on the Islamic capital market. The provision of specialized institutions gave Malaysia a first-mover advantage in setting standards for Shariah-compliant equities for the stock market in Malaysia. Subsequently, other stock markets around the world followed suit, thereby increasing competition in the Islamic capital market.

Strategic positioning of Malaysia

Malaysia has leveraged its relative strengths to focus on selected service subsectors. First, Malaysia has strategically positioned itself to benefit from its geographic proximity to Singapore and its historical links to Singapore. Key factors are Malaysia's lower costs of services, Malaysians' proficiency in the English language, and the central role of Islam in the country. Malaysians' English-language skills have also helped Malaysia to position itself against large countries in ASEAN such as Indonesia and Thailand, where English proficiency is lower. The University of Nottingham has acknowledged that Malaysians' proficiency in English was one of the main factors that led to it to choose Malaysia over Thailand for its branch campus in the region.

The relatively lower cost of living in the country has distinguished Malaysia from Singapore. Although Singapore has numerous strengths relative to Malaysia, it is considerably more expensive to live there. Private hospitals that are based in Singapore have invested in Malaysian hospitals in order to tap the lower cost of facilities in the country. Patients who have found Singapore hospitals to be too expensive are diverted to the Malaysian counterparts, which can perform the same procedures at lower cost. Similarly, branch campuses in Malaysia are less expensive than branch campuses in Singapore.

Consequently, complementary services have developed between the two countries in three areas of service exports: higher education, medical services, and tourism. Malaysia provides services in the lower-priced market according to its lower-cost advantage, while Singapore provides the same services for the higher end of the market. This complementarity has also attracted Singaporean investment in Malaysian services in the case of medical tourism. U.S.-owned Singapore hospitals (such as Parkway Holdings) have invested in Malaysian hospitals to tap the synergies of complementary services. In that way, foreign patients can be directed to either Malaysian or Singaporean hospitals according to their budget constraints. The launch of the Iskandar Development Region in 2006 was expected to capture more of the potential synergies between Singapore and the southern part of Malaysia for the development of complementary services.

Finally, the Muslim population in Malaysia has led to the creation of an alternative banking system that can serve the needs of Muslims and to the subsequent vision of making Malaysia a hub for Islamic finance. By positioning itself as a modern Islamic country, Malaysia has been able to draw tourists, students, and patients to the country.

Unilateral liberalization and fostering of domestic competition

The provision of certain public goods such as higher education and health by the Malaysian government has been limited by financial constraints. Consequently, the government has permitted private operators to provide for such services in the country. The number of private providers grew rapidly in response to the excess demand in the country, leading to a substantial presence of private providers in both the higher education and the health sectors. In 2009, there were 454 private higher education institutions and 222 private hospitals, including private maternity and nursing homes. Although local providers predominate in those two sectors, foreign providers also exist. For example, in the case of higher education, five branch campuses are operating in the country.

The large pool of domestic health and higher education providers has created a competitive domestic environment. It has also created increasing pressures to extend the services of these providers to international students and patients, which in turn has led to increasing exports of these services, primarily in the form of mode 2. Moreover, as discussed earlier, domestic providers are also venturing overseas.

Progressive liberalization at the national, regional, bilateral, and multilateral levels

Malaysia is progressively liberalizing the service sector at the national, regional, bilateral, and multilateral levels. In particular, the lack of progress at the multilateral level has accelerated the liberalization process at the regional and bilateral levels. Under the ASEAN Framework Agreement on Services (AFAS), seven packages of liberalization have been undertaken thus far. Malaysia is also party to additional ASEAN agreements that cover services, such as the ASEAN-China, ASEAN-Japan, and ASEAN-Korea agreements. At the bilateral level, Malaysia has signed agreements with Japan, New Zealand, and Pakistan.

Although no study has been conducted to assess the extent to which the recent commitments have pushed domestic liberalization, the number of sectors that have been committed has progressively increased over time. For example, in the case of AFAS, Tham (2009) has shown that the number of sectors committed at the three-, four-, and five-digit level increased substantially from AFAS 2 to AFAS 7. There are also three sectors with 100 percent coverage: construction, education, and tourism and travel-related services. At the bilateral level, Malaysia increased the extent of foreign equity permitted in the higher education sector from less than 50 percent to 70 percent in the Malaysia–New Zealand agreement because this sector is important to New Zealand.

Domestically, Malaysia has undertaken unilateral liberalization, but only after local providers secured a competitive capacity for providing the selected services. Some examples are higher education, medical, telecommunication, and airline services, all of which were originally provided by the public sector. When the public sector could not provide sufficient services to meet the growing demand, the government introduced the first stage of liberalization by allowing the private sector to offer similar services. For example, because public universities are unable to offer enough places of study, the government allowed the private sector to fill this shortfall. This change then became a catalyst for the development of private higher education. A similar process took place in the case of medical, telecommunication, and airline services. Subsequently these service sectors were liberalized, which led to foreign service providers participating in the local market and domestic providers exporting their services and investing abroad with their enhanced capacity.

Encouragement of inward FDI in Islamic finance and higher education

In Malaysia, there are significantly more local establishments in most services than foreign establishments, partly because of foreign equity restrictions in the service sector. The New Economic Policy allocated equity ownership in Malaysia to 30 percent for Bumiputera, 40 percent for non-Bumiputera, and 30 percent for foreigners. The Foreign Investment Committee (FIC) was set up in 1974 for the approval of nonmanufacturing activities that are not under the jurisdiction of any ministry as well as for the acquisition of corporate ownership (under the Guidelines for the Acquisition of Assets, Mergers, and Takeovers) and property ownership (under the Guidelines for the Acquisition of Property by Local and Foreign Interests). After the Asian financial crisis in 1999, this restriction on foreign equity ownership was removed for the manufacturing sector. It was also relaxed for selected service subsectors such as telecommunications and ports. But the banking and insurance sector is an exception to the pattern. Unlike other sectors, 100 percent foreign equity ownership is permitted for locally incorporated foreign banks, foreign Islamic banks, international Islamic banks, international *takaful* operators, and Islamic reinsurers.

The restrictions on equity ownership have limited FDI inflow, which consequently might have retarded the growth of the service sector, except in the case of Islamic finance where there is large participation by multinational firms: 61 percent of commercial banks and 34 percent of Islamic finance banks are foreign owned. In addition, there are 4 international Islamic banks and 11 foreign-owned Islamic banks.

Similarly, the higher education subsector was liberalized unilaterally in 1995, when foreign higher education providers were given licenses to operate. Five foreign universities have since established their branch campuses in Malaysia.

Because of increasing concern over the inflows of FDI, the Department of Statistics has published—for the first time—data on inflows by sectors and countries of origin. Data from the Quarterly Survey of International Investment and Services indicates that the stock of FDI[3] in the country grew from RM 129.1 billion (US$33.97 billion) in 2001 to RM 253.8 billion (US$73.83 billion) in 2007. Equity capital is the largest component in the stock of FDI, followed by reinvested earnings; other capital is the smallest component. Although data on the first two components revealed an upward trend, data on other capital showed a converse downward trend.

It is worth noting that the service sector had the largest increase in its share, from 1 percent in 2003 to 9 percent in 2007.[4] However, manufacturing remained the largest recipient of FDI for the period, even though its share in total FDI declined from 58 percent in 2003 to 53 percent in 2007. The share of financial intermediation, including insurance (the second-largest recipient in 2003), also fell—from 29 percent to 16 percent. In contrast, the share of mining (the third-largest recipient in 2003) increased, from 5 percent to 8 percent. Investment in upstream activity constituted an important component in this sector, as Petroliam Nasional Berhad (PETRONAS) and its foreign partners continue their exploration, production, and development of the oil and gas resources in the country. The share of trade and commerce (the fourth-largest recipient in 2003) also increased, from 5 percent to 8 percent.

According to Bank Negara Malaysia, net inflows fell from RM 29.1 billion in 2005 to RM 26.7 billion in 2008, partly because FDI was rechanneled to the service sector, where the scale of investment is smaller because it is less capital intensive (Bank Negara Malaysia 2010, 36; WTO 2009, 11). Competition for FDI from China, India, and Vietnam (as well as from Hong Kong SAR, China, and from Singapore) is also cited as a reason for moderation in net inflows into Malaysia. Bank Negara Malaysia's 2009 annual report estimated that net inflow into the financial sector, including Islamic finance, amounted to RM 41.6 billion (US$11.8 billion) from 1999 to 2009, after the liberalization of that sector (Bank Negara Malaysia 2010). This figure is in line with the government's plan to build Malaysia as a hub for Islamic finance.

The relaxation of foreign equity restrictions in financial services has been mapped out in the Financial Services Master Plan of 2001. For example, foreign equity limits for investment banks, insurance companies, and Islamic insurers were raised from 30 percent to 49 percent in 2005 and then to 70 percent in 2009 (WTO 2009, 60). An increasing number of banking licenses with 100 percent foreign equity have been given for Islamic banks over time. Hence, there was net inflow in the financial sector for the period 1999–2009. On April 22, 2009, foreign equity restrictions on 27 service subsectors were removed. This move was followed a week later by the relaxation of foreign equity ownership in financial services. In June 2009, the government announced that the FIC guidelines would be deregulated and that limitations on foreign equity would be decided by the regulator of the industry. These changes in equity restrictions indicate that the government has been progressively opening up the service sector to foreign investment.

Quality assurance

In higher education, quality assurance is provided by the Malaysian Qualifications Framework for higher education in the country. The framework is a description of the national education system, including all qualifications and learning achievements in higher education. It is governed by the Malaysian Qualifications Agency (MQA). In 2009, 7,074 programs were offered in the country, of which 2,298 had achieved minimum standards while 2,167 (or 35 percent of the total number of programs) had received full accreditation. Quality assurance is provided for international students, because only accredited programs are allowed to recruit international students. The MQA's accreditation does not imply recognition.

There are ongoing efforts to increase recognition through the MQA's collaborative links with several international networks in quality assurance, such as the International Network for Quality Assurance Agencies in Higher Education. At the ASEAN level, mutual recognition agreements have been signed for seven areas: engineering services, nursing services, architectural services, survey qualifications, medical practitioner services, dental practitioner services, and accounting services. Malaysia is also a member of the Washington Accord, which provides recognition for engineering degrees for its member countries.

In the health sector, the Malaysian Society for Quality in Health (MSQH) is the only body that is recognized to carry out accreditation. The MSQH emphasizes patient safety and medical audits. It was formed through the initiative of the Ministry of Health, the Association of Private Hospitals of Malaysia, and the Malaysian Medical Association. It is based on international standards with local modifications, and it is affiliated with international health care accreditation bodies such as the International Society for Quality in Health (ISQua) and the Joint Commission International (JCI). Both the MSQH and the JCI are recognized members of the International Accreditation Federation Council. MSQH is also in the process of forming ASQua, or the Asian equivalent of ISQua. As of 2009, 79 hospitals were accredited by MSQH, of which 24 were private (Tham 2009). Only accredited hospitals are allowed to take in international patients. JCI standards are internationally accepted, so JCI accreditation has implications for the insurance coverage of the patient. Malaysia has six JCI-accredited hospitals and health-related establishments (Choy 2010).

These quality assurance efforts are more effective for mode 2 rather than mode 4 exports. International students and patients are drawn to Malaysia because these quality assurance factors work in conjunction with other factors, such as costs, marketing, and the recruitment initiatives of the providers and the government. Malaysian domestic regulations do not hinder the movement of these students and patients.

In contrast, domestic providers seeking to export their services through mode 4 may face other problems, because quality assurance and recognition are not the only factors that determine the mobility of Malaysian providers to other countries. For example, Malaysian architects who seek to export their services abroad must satisfy regulations in the country to which they plan to export, which will include factors besides recognition. They must have the necessary network to find a local partner for an overseas project if domestic regulations so require.[5]

Regulatory framework

The service sector is regulated by various government ministries, departments, and agencies. Table 5.11 summarizes the relevant regulators and regulations for selected services: Islamic banking and finance services, private health care services, private tertiary education services, and tourism and travel-related services.

As shown in table 5.11, the regulatory framework for these services is relatively well laid out in the domestic legislation. Each of the acts listed spells out the procedures for obtaining a license to operate and the guidelines for conduct for establishments covered by the act. The licensing system ensures that operators conform to minimum standards before they are given the license to operate. The governance of the system is made readily available to the public through the

Table 5.11. Regulators and Regulations for Selected Services

Services	Regulators and promoters	Regulations
Islamic banking and finance	Bank Negara Malaysia Securities Commission Islamic Financial Services Board (International)	Exchange Control Act 1953 Islamic Banking Act 1983 Securities Industry Act 1983 Takaful Act 1984 Banking and Financial Institutions Act 1989 Securities Industry (Central Depositories) Act 1991 Securities Commission Act 1993 Islamic Financial Services Board Act 2002 Capital Markets and Services Act 2007
Private health care services	Malaysian Health Travel Council Association of Private Hospitals Malaysia Various professional organizations	Fees Act 1951 (amended in 2003) Medical Act 1971 Dental Act 1971 Standards of Malaysia Act 1996 Malaysian Health Promotion Board Act 2006
Private tertiary education services	Malaysia Qualification Agency Higher Education Department, Ministry of Higher Education	Immigration Act 1959 and 1963 Employment (Restriction) Act 1968 (revised in 1988) Universities and University Colleges Act 1971 National Accreditation Act 1996 National Council on Higher Education Act 1996 Private Higher Educational Institutions Act 1996
Tourism and travel-related services	Tourism Malaysia Bahagian Perkhidmatan Perlancongan, Ministry of Tourism	Innkeepers Act 1952 National Parks Act 1980 Malaysia Tourism Promotion Board Act 1992 Tourism Industry Act 1992 Tourism Vehicles Licensing Act 1999

Source: Authors' compilation based on data from the website of the Attorney General's Chambers of Malaysia (http://www.agc.gov.my) and information provided by the respective ministries.

act, and it is transparent to the providers. For example, in the case of Islamic finance, domestic regulations as specified in the legislation reflect the distinct features of Islamic finance and aim to instill financial stability, market discipline, and public confidence (bin Ibrahim 2007). There are, therefore, guidelines on corporate governance, a framework for the rate of return, guidelines on financial disclosure and Shariah governance, and Islamic money market and capital adequacy standards. A dedicated high court adjudicates cases that are related to Islamic finance.

The respective regulators also ensure that the standards required are adhered to. For example, the Ministry of Higher Education works with the MQA on issues related to course accreditation. The ministry also reviews the licenses that have been awarded. There is also benchmarking to international best practices to ensure that the standards conform to best practices. Dialogues between the regulators and the providers (which are represented by their respective associations) are held at regular intervals. These dialogues serve as important lines of communication between the providers and regulators, so that problems that emerge in the respective sectors are resolved. Malaysia, therefore, has a well-developed system in place to govern the sectors listed in table 5.11.

Factors Constraining Service Exports

A number of factors constrain service factors, as described in this section.

Trade restrictions by other countries

The service sector is highly regulated in most countries. Even though there are ongoing liberalization efforts at both the regional and the bilateral levels, the outcomes of these negotiations do not necessarily enable Malaysian exporters to penetrate and capture the markets of partner countries in these agreements because there are domestic regulations to contend with. Understanding the domestic regulations of the targeted export country is essential if Malaysian exporters are to penetrate the markets of partner countries to these agreements. For example, a moratorium on the establishment of new institutions of higher learning in a country will render the country's offer of no limitations in mode 3 meaningless.

As identified by Mattoo (2003), the main barriers to trade in services in mode 4 are immigration issues, especially visa-related barriers, discriminatory treatment of foreign service providers, and inadequate recognition of qualifications. Structural barriers, such as limited opportunities for gaining local experience, also exist. Communication skills, lack of a professional network, and limited knowledge of the local job market are other barriers.

Shortage of skills in Malaysia

The recently released NEM notes that, in 2007, only 25 percent of Malaysia's labor force was in the highly skilled category. This percentage is alarmingly low compared with neighboring countries such as Korea (35 percent); Singapore

(49 percent); and Taiwan, China (33 percent). The share of highly skilled labor also declined across various industries in the country between 2002 and 2007. The electrical and electronic sector, for example, experienced a notable decline in the share of highly skilled labor usage, from 54 percent in 2002 to 46 percent in 2007 (NEAC 2010, 50, figure 10).

The lack of highly skilled workers in the labor force is due to at least two factors: (a) the weaknesses of the country's education system and (b) a constant outflow of talented workforce. The percentage of adults with tertiary education in the country is relatively low compared with countries such as Korea and Singapore (table 5.12). The *Human Development Report 2009* (UNDP 2009) noted that only 8.0 percent of Malaysian adults had tertiary education. This percentage is far lower than in Hong Kong SAR, China (15.2 percent); Korea (23.4 percent); and Singapore (19.6 percent). Even the Philippines has a slightly higher percentage (8.4 percent).

The recent *Global Competitiveness Report 2009–2010* (Schwab 2009) confirms the relatively low level of skills in the labor force (table 5.13). Although Malaysia performs much better than other ASEAN economies such as Thailand in terms of labor force skills, the skills level is still low for most of the indicators when compared with Singapore and Taiwan, China. In the case of India and Korea, the relative performance is mixed, with some indicators in Malaysia scoring higher (such as quality of education system, local availability of research and training services, and extent of staff training) and other indicators scoring lower.

In addition to the low percentage of highly skilled workers in the country, feedback from many industry players indicates that Malaysian graduates lack the skills needed in the market. As a result, in 2008, about 25 percent of local graduates from public universities remained unemployed six months after graduation (NEAC 2010). The 2007 Trends in International Mathematics and Science Study (TIMSS and PIRLS International Study Center 2007) shows that Malaysia's scores in both mathematics and science were below the international average scores,

Table 5.12. Percentage of Adults with Tertiary Education

Economy	Share (%)
Malaysia	8.0
Philippines	8.4
Hong Kong SAR, China	15.2
Singapore	19.6
Korea, Rep.	23.4

Source: UNDP 2009.
Note: Percentage of the population age 25 years and older who have attained tertiary education.

Table 5.13. The Global Competitiveness Index, Selected Indicators for Skills, 2009–10

Indicator	India	Korea, Rep.	Malaysia	Singapore	Taiwan, China	Thailand
Quality of education system	37	47	23	1	17	67
Quality of math and science education	22	18	34	1	6	62
Quality of management schools	15	44	34	5	31	59
Local availability of research and training services	32	35	26	14	22	61
Extent of staff training	34	29	16	2	19	62
Availability of scientists and engineers	4	25	33	14	7	54

Source: Schwab 2009.
Note: Rankings are out of 133 economies.

thereby implying that Malaysia is not producing good-quality students. Thus, there is a shortage of skilled human capital in the country, and improving the situation is critical if Malaysia is to enhance its export of knowledge-based services. To a great extent, this constraint has affected Malaysia's ability to export ICT services, despite the early advantages offered by the MSC, because Malaysia's size and the availability of the labor force—as well as the country's financial incentives for business process outsourcing services—are less attractive than those of India and the Philippines (A.T. Kearney 2009).

The large inflow of low-skilled migrant workers into the country since 1990 has contributed to the reluctance of industries to move to high-value-added activities using more skilled workers. The availability of low-skilled labor has encouraged industries in the agriculture, manufacturing, and service sectors to continue their activities and maintain the same level of profitability. As a result, industries are unwilling to train and upgrade the skills of local workers.

Increasing competition from other countries

The initial advantages of Malaysia in the case of low-cost carriers and Islamic finance are being challenged by the rapid emergence of competitors, especially from countries within the region. Low-cost carriers have been established in other countries, such as One-Two-Go and Nok Air, which were established in Thailand in 2003 and 2004, respectively (Zhang and others 2009). Singapore established Tiger Airways in 2004. The Australian carrier Qantas established Jetstar in 2004 also. Similarly, Singapore has established terminals for low-cost carriers.

In the case of Islamic finance, the general increase in interest in Islamic instruments in the world has led Singapore to also focus on Islamic finance to strengthen its position as a financial center. Korea is also venturing into Islamic finance.

Similarly, economies such as Bahrain; China; Hong Kong SAR, China; India; Qatar; Singapore; Thailand; and the United Arab Emirates are also aiming to be hubs for higher education as well as for medical tourism. Increasing competition will require Malaysia to innovate constantly in terms of products and costs to provide a competitive edge for the country.

Broadband penetration, speed, and cost

In general, the pattern of service exports shows that Malaysia has been able to exploit its geographic and cultural proximity to other countries in the region. Most countries in this region are in the developing phase of their economy. Given the state of infrastructure in developing countries, Malaysian providers are limited by the infrastructure facilities available in the partner countries. Even though Malaysia has a high-quality telecommunication network, for instance, and an Internet penetration of 62 persons per 100 population, mode 1 service exports are inhibited by the quality of the telecommunication networks in destination developing countries. Moreover, although Malaysia has six higher education institutions that specialize in providing e-learning, these institutions have limited opportunities to expand their services to the less developed countries in the region (such as Cambodia, the Lao People's Democratic Republic, Myanmar, and Vietnam) because of those countries' limited infrastructure support for this type of learning. It would appear that mode 3 exports may be more useful than mode 1 exports to other developing countries until they have developed the infrastructure necessary to handle mode 1 exports from Malaysia.

Conclusion

Overall, exports of some selected services, such as higher education, medical tourism, and Islamic finance, are beginning to emerge as potential revenue earners for the country. These industries are expected to join tourism as major exporting sectors that can balance the present dependency on manufacturing exports. Malaysia is relatively more successful in exporting services under mode 2 (that is, bringing international consumers in the form of students, patients, or tourists into the country). The ability to bring investors into the country is improving over time with the increasing relaxation of the equity restrictions on foreign ownership. Limited data on mode 4 exports also suggest that the number of Malaysian professionals working in other countries has increased over time.

Several factors assist these emerging exports, including a stable political and macroeconomic regime and a relatively business-friendly environment. In particular, Malaysia's first-mover advantage in developing low-cost carriers, the MSC, and Islamic finance have provided an edge that has helped the country compete in the region. The fact that Malaysia ventured into certain service sectors has helped the country be a pioneer exporting these services. The success of these exports was facilitated by strong government support that recognized the potential of these service exports. Malaysia's natural endowment and a culturally diverse society enhanced its appeal not just in the tourist sector but also in higher education and medical tourism.

Another factor that explains Malaysia's success in exporting services is liberalization, especially in the higher education and Islamic finance sectors. For the higher education, medical, and airline services, Malaysia first liberalized domestically because the public sector could not provide sufficient services to meet the growing demand. Because public universities are unable to offer enough places of study, the government allowed the private sector to fill this shortfall. This move then became a catalyst for the development of private higher education. The medical and airline services underwent the same process, in which the private sector initially enhanced domestic capacity and later began to export. At the same time, at the bilateral and regional levels, Malaysia has progressively increased the number of committed sectors. For example, under the AFAS, Malaysia has made commitments in all the major service categories.

Finally, government policies have also significantly aided the provision of services in the international market. Policies that have worked for the country include quality assurance and a sound regulatory framework. In the case of higher education and medical tourism, the endowment was not natural but was built by developing domestic capacity and by setting international standards and a sound regulatory framework for domestic providers to adhere to. In the case of tourism, the government invested in global campaigns such as Malaysia Truly Asia, to promote the country as a major tourist destination in addition to providing the necessary infrastructure, such as airports, roads, and railways, to facilitate the movement of goods and people.

However, while the country has been relatively successful in bringing the world to Malaysia, it has been less successful in bringing Malaysia to the world. The main factors that are constraining Malaysia in penetrating the world service market in terms of mode 4 are trade barriers encountered in other countries. Because it is relatively easier to enter other developing countries, Malaysia is also constrained by the availability of suitable infrastructure in other developing countries for the provision of mode 1 supply. For example, Vietnam, Indonesia, and Pakistan have e-readiness scores of 64, 65, and 66, respectively, of 70 countries ranked (EIU 2009). At the same time, the country is challenged by increasing competition from other countries in all the main export subsectors. Finally, human capital constraints are increasing over time. In the short term, importing foreign skilled workers will help, because the development of human capital has a rather long gestation period. Attracting Malaysian expatriates back to the country is another intermediate solution. These improvements will also help restore the relative attractiveness of Malaysia as a host country for knowledge-based and technology services.

Notes

1. According to the linkage index, a backward linkage that is greater (less) than 1.00 implies that the sector or industry has an above (below) average dependency on a particular domestic industry for its input requirements. A forward linkage that is greater (less) than 1.00 implies that a particular domestic industry has an above (below) average dependency on the sector or industry in question for its input requirements.
2. Financial services covered in the balance of payments are defined as financial intermediary and auxiliary services, except insurance and pension fund services. They include deposit taking and lending, letters of credit, credit card services, commissions and charges related to financial leasing, factoring, underwriting, and clearing of payments. Also included are financial advisory services; custody of financial assets or bullion; financial asset management; monitoring services; liquidity provision services; risk assumption services other than insurance, merger, and acquisition services; credit-rating services; stock exchange services; and trust services (IMF 2009).
3. *FDI* is defined as equity capital, reinvested earnings, and other capital (defined as debt securities, trade credits, loans, deposits, and so forth).
4. The findings of the Quarterly Survey of International Investment and Services (QSIIS) are described by Masud and others (2008, 1). The QSIIS was first conducted in the first quarter of 1999, in conformity with the fifth edition of the *Balance of Payments Manual* (IMF 1993). The survey covered 2,500 companies with significant international transactions in financial assets, liabilities, or services that were incorporated or registered in Malaysia. Of these companies, 1,300 were classified as FDI companies.
5. See the website of the Malaysian Architects Exporters Club at http://www.pam.org.my/maec/benefits.htm.

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