

# Introduction

## The Malaysian Economy Towards 2020 and Beyond

**Cassey Lee and Francis E. Hutchinson**

In 1991, Malaysia's then Prime Minister, Mahathir Mohamed, declared that the country should aim to be "fully-developed" and "industrialized" by 2020. To attain this goal, Malaysia would have to grow at an annual average of 7 per cent (in real terms) for thirty years. Prosperity and economic inclusiveness were overarching objectives, and education levels as well as scientific and technological progress were means to these ends.

Twenty-six years on — and a mere three years away from the target date — Malaysia's economy has undergone profound transformation, incomes have risen, and extreme poverty has been virtually eliminated. However, the prospect of high-income status is — for now — just beyond reach. The country's economy has grown at a slower pace in recent years, averaging 4.5 to 5.0 per cent annually. While this is respectably above the global average of 2.5 per cent, it is about half the level achieved by the country before the Asian Financial Crisis. This is also below the target rate needed for sustained progress towards higher income status. Furthermore, in an era of metrics and rankings, the ringgit's sharp devaluation in 2015 saw Malaysia's per capita income in U.S. dollar terms actually decrease — a first since 1997.

Apart from a temporary growth slowdown, Malaysia's economy has also undergone an unusual structural change. The share of manufacturing sector in the country's gross domestic product (GDP) has declined from 30.9 per cent in 1999 to 20.1 per cent in 2016. While it is common to observe deindustrialization among high-income economies, Malaysia is experiencing it at a lower income level than most economies.

In addition, high-income countries attained this status by exporting an increasingly diverse and sophisticated "basket" of goods and services based on more efficient methods of production. However, in Malaysia's case, much of its manufacturing sector is dependent on imports for assembly, as well as labour-intensive processes. Multinational corporations are at the heart of production, with limited linkages to local firms that, in turn, have little technological depth.

This raises the question of Malaysia's economy being stuck in a middle-income trap. Has the country sustainably made the transition from labour- and capital-intensive growth to productivity- and technology-driven growth? Beyond specific income thresholds, the discussion around the trap is — at a deeper level — about

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the type of economy that can sustainably generate high levels of income from goods and services produced by its citizens.

While macroeconomic stability, good physical infrastructure, and openness to trade and investment are vital (and are areas where the country performs very well), Malaysia needs to make sustained progress on a number of inter-related fronts. Key among these are: the quality of its labour force; the innovative potential of its firms; and the strength of its institutions.

Following the tradition established during the pre-independence period, Malaysia has produced high-level planning documents every five years. The eponymous Malaysia Plans provide detailed data on the country's progress along a number of fronts, as well as a narrative of the challenges the country sees for itself.

The most recent of these, the Eleventh Malaysia Plan, 11MP (2016–2020) was launched in May 2015. Like previous Plans, the quest for faster growth rates and high-income status remains at the centre of 11MP. With this document as one axis, and the looming date of 2020 as another, the Regional Economic Studies Programme of the ISEAS – Yusof Ishak Institute organized two events — a workshop in October 2015, and a conference in March 2016 — to examine some of the key long-term development issues and policy challenges confronting the Malaysian economy.

Six of the papers from these events are included in this volume. Collectively, they cover a number of dimensions that are key to understanding the long-term changes in — and challenges to — the Malaysian economy as it seeks to attain high-income status.

In the first article, Cassey Lee and Lee Chew-Ging trace the evolution of the Malaysian economic planning process. Through a close reading of Malaysia Plans, analysing the impact of internal and external events, and tracking key organizational developments, the authors scrutinize the crucial existential issues that have preoccupied the country's planners over the past decades. In doing so, Lee and Lee evaluate the independence, quality, and transparency of Malaysia's planning process.

In the subsequent article, Francis E. Hutchinson probes how Malaysia's policymakers have grappled with a perennial development issue — how to deal with income disparities between different parts of the country. While Malaysia has made enviable progress in increasing income levels and reducing poverty, internal disparities have been stubbornly persistent. Over the years, policymakers have tried a variety of approaches in line with the country's rising income, changing economy, and evolving understandings of how equitable regional development can best be promoted. Some aspects of this evolution mirror those observed in other countries, but others do not. This may, indeed, raise new challenges.

In the third article, Kai Ostwald examines how Malaysia's government structure has evolved over time, looking at how form and function flow (or do not) between the central, state, and local governments. In a context where many countries are seeking to devolve, decentralize, and delegate revenue sources and service delivery to sub-national governments, Malaysia, curiously, has gone the other way. Finance and a range of public services have gravitated to the centre, negating the efficiency-enhancing and service delivery-improving potentials offered by decentralization. Recent initiatives to establish growth corridors and create "smart" cities recognize the potential of proximity and local initiative to catalyse growth, but may be thwarted if underlying governance issues are not resolved.

Jayant Menon and Thiam Hee Ng, in the subsequent article, look at the prime political economy question facing Malaysia — is the role of the government in the economy too extensive? East Asian countries have developed different institutional arrangements from the West and have ownership models characterized by a far higher degree of state ownership. However, in Malaysia's case, it is worth asking if this has now reached excessive levels. Through systematic evaluation of the relationship between the extent of state ownership and private investment across a range of sectors, the authors raise questions about the sustainability of Malaysia's model of corporate ownership.

In the fifth article, V.G.R. Chandran and Evelyn S. Devadason look at one of the erstwhile motors of the country's economy — the manufacturing sector — by scrutinizing its progress, capabilities, and innovative potential, as well as recent policy initiatives to address key challenges. Consequently, the article focuses on aspects such as the country's innovative potential, learning capacities of firms, effect of the country's wider institutional framework, as well as the ability of the government to successfully identify and address market failures, and work with firms to increase their capabilities. Their findings highlight the importance of institutional quality, state capacity, and constant communication between the state and private sector to identify and successfully address market failures and other bottlenecks.

Lee Hwok-Aun, in the sixth article, looks at Malaysia's labour markets and the institutional context within which they operate to determine their effect on standards, productivity levels, and regulatory efficiency. Comparing Malaysia with high-income countries, Lee evaluates the country's progress in terms of increasing productivity, wage levels, incorporating greater numbers of women and younger workers, and managing foreign

labour. With this as a backdrop, recent policy frameworks are scrutinized for their potential to address these key challenges. The article suggests that while a subset of these issues are addressed, policy frameworks need to go beyond a focus on increasing productivity, towards improving the overall quality of labour markets and their supporting institutions.

Collectively, a key message coming from the articles is that Malaysia's quest of becoming a developed and high-income nation is a challenging one. For a country with a GNI per capita of US\$9,850 in 2016, this goes beyond merely achieving the minimum GNI per capita level of US\$12,736 that, according to the World Bank, is associated with being a high-income economy. The ongoing structural changes occurring at the global level driven by disruptive technological changes necessitate policy responses that not only enhance growth, but also promote inclusive outcomes. Moreover, as signalled by the various contributors to this Special Issue, Malaysia continues to face a number of policy dilemmas. It is hoped that the articles contained herein provide insight into some of the deep structural and institutional reforms that are likely to be required in the coming years.