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THE ECONOMY OF MALAYSIA
Present, Problems, Prospects

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Introduction

The economic development of Malaysia since 1957, by all accounts, has been a spectacular trajectory of restructuring and of rapid economic growth, punctuated only by the Asian Financial Crisis in 1997, and by the economic crisis in 2008. Malaysia has also been able to graduate from a predominantly agricultural base to that of a manufacturing and services base through prudent economic management, balancing economic efficiency considerations with that of the redistribution of the economic pie. In recent years, however, the government has come to realize that the traditional approach of restructuring and diversifying the economy may not be sufficient to propel Malaysia to the level of other high-income nations. Furthermore, the historical engines of agriculture and manufecturing that have been driving Malaysia's economic growth has been losing its momentum over the past decade. Part of the slowing momentum is largely due to the fall in private investments: from 25 per cent of GDP throughout the 1990s to about 10 per cent in the past decade.

The Tenth Malaysian Plan (2011–15) succinctly outlines what needs to be undertaken for Malaysia:

> [the] challenge is to move from an economy that competes on cost and natural resources, to an economy that is driven by productivity, innovation and that is able to nurture, attract and retain talent, companies and capital. In order to move into the league of high income economies, Malaysia will also need to move from a strategy of diversification of the economic base, which successfully elevated the nation to a middle-income economy, to a strategy which focuses on specialisation in a few selected economic sectors and geographies where Malaysia has a relative competitive advantage.[1]

Can Malaysia transform its economy up to the level of other high income countries? How has Malaysia landed in its present dilemma of the middle income trap? What are some of the challenges that need to be overcome that will move the country to join the ranks of a high-income and developed country? What are some of the suggested policies that can bring Malaysia to the next stage of development?

A number of recent works have been undertaken on the Malaysian economy. Notably, three recent publications, dealing with a mix of issues confronting Malaysia's economic development all have one aim: to examine the economic challenges facing the country in order to reach the status of a high-income country, and to escape from the current trap of being a middle-income economy.

The publication edited by Hal Hill, Tham Siew Yean and Ragayah Haji Mat Zin (2012) examines the various economic, political and developmental challenges facing Malaysia in its aim to graduate from a middle-income to high-income economy.[2] In this volume, microeconomic, macroeconomic and distributional factors have been analysed to be crucial to Malaysia's transformation to become a developed nation.

Another publication edited by Rajah Rasiah (2011) on the *Malaysian Economy: Unfolding Growth and Social Change* systematically and collectively examines development from a sectoral perspective, filling the gaps in macroeconomic and microeconomic developments with a historical anchor. Notably, the publication by the Institute of Strategic and International Studies (ISIS) Malaysia (2011), on *Malaysia:*

Policies and Issues in Economic Development involves a thematic approach which includes economic analysis balanced with historical, socio-economic and institutional approaches in looking at Malaysia's economic development process.[3]

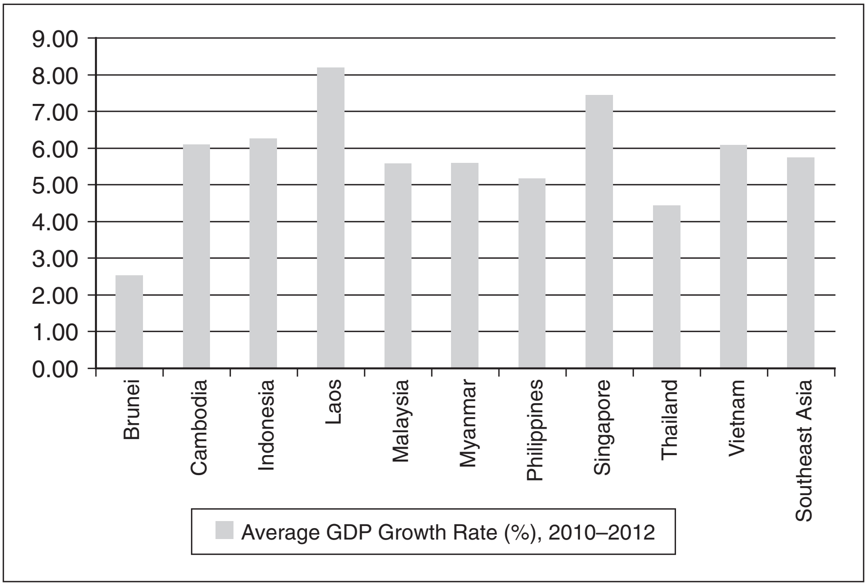
The present volume builds on the works published in these publications but it adopts a different approach in that it is a stocktake by individuals from the academia, international organizations, and the private sector to understand the past; to discuss and analyse the reasons behind Malaysia's successes in graduating from a low-income to middle-income economy; and to critically analyse the challenges and obstacles that Malaysia needs to overcome in order to become a developed country by 2020.

The various chapters are broken down into thematic approaches which focus on economic issues; political, decentralization, and environmental issues; and social issues confronting Malaysia's development. In doing so, this book hopes to provide a multi-disciplinary approach to understand and analyse Malaysia's economic development and the challenges confronting the country. Short commentaries are also interspersed between some of the chapters. These provide a quick and sharp analyses of certain issues that are also pertinent to Malaysia's transformation process.

The Present Malaysian Economy

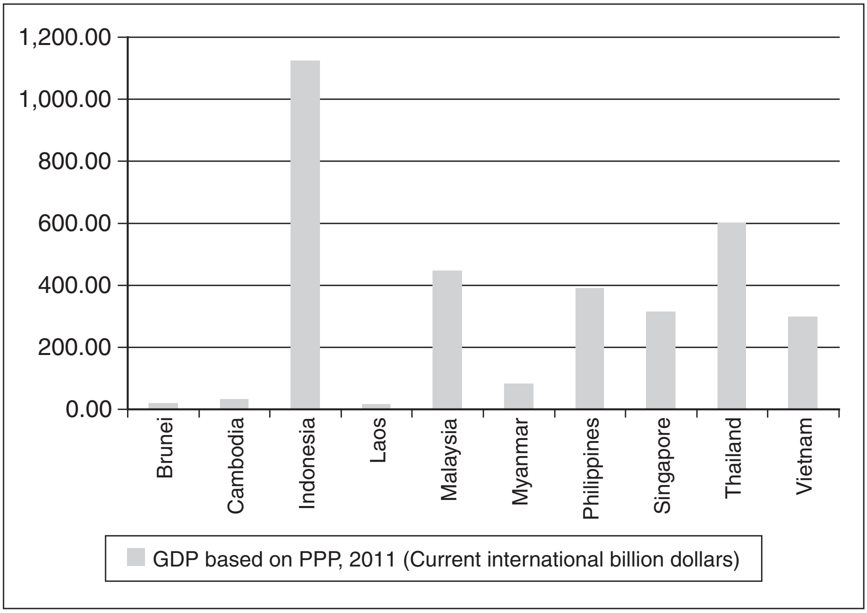
After a feeble growth rate of 1.6 per cent during 2008–09, the US$306 billion Malaysian economy bounced back and showed many signs of improvement. In real terms, the economy grew at a rate of 5.6 per cent during 2010–12, at par with an average growth rate of 5.7 per cent for its neighbours[4] in Southeast Asia (see Figure 1.1). It was the third largest economy in the region by purchasing power parity (PPP), and its per capita at US$15,568 (in terms of PPP) put it in the middle income bracket among the world economies (see Figures 1.2*a* and 1.2*b*). The economy also exhibited a modest inflation rate of 2.5 per cent during the period, with low interest rates at 3.0 per cent by end of 2011. Externally, the country's exports were growing by 20 per cent in U.S. dollar terms (see Figure 1.3) during 2010–11, despite uncertainty in the U.S. and the EU economies. These feel good factors have also been reflected in the stock market as

FIGURE 1.1
Average GDP Growth Rate in Southeast Asia, 2010–12



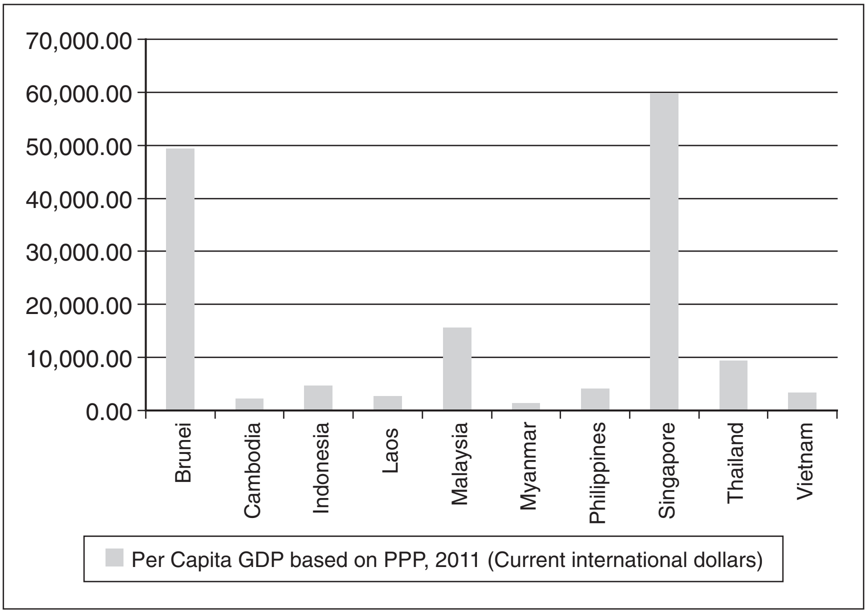
Source: World Economic Outlook Database, IMF, April 2012.

FIGURE 1.2*a*
GDP (based on PPP) of Southeast Asian Nations, 2011



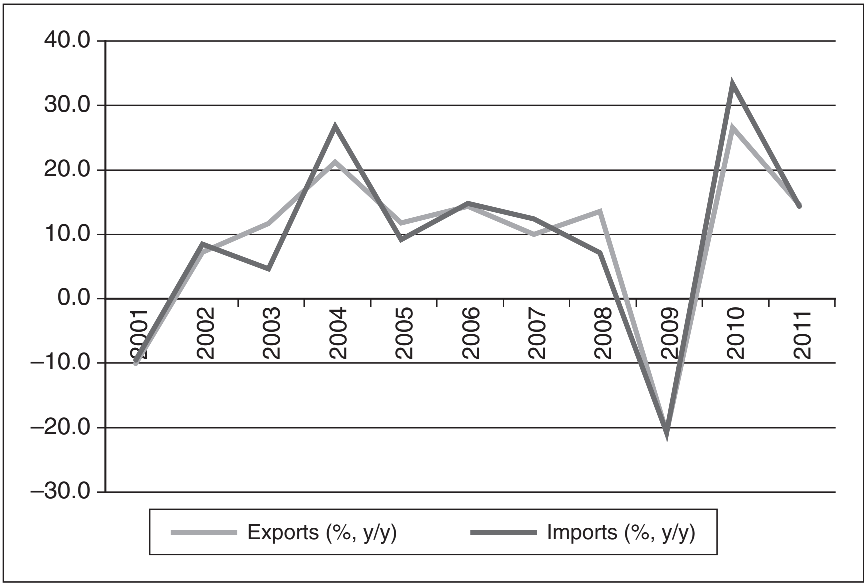
Source: World Economic Outlook Database, IMF, April 2012.

FIGURE 1.2*b*
Per Capita GDP (based on PPP) of Southeast Asian Nations, 2011



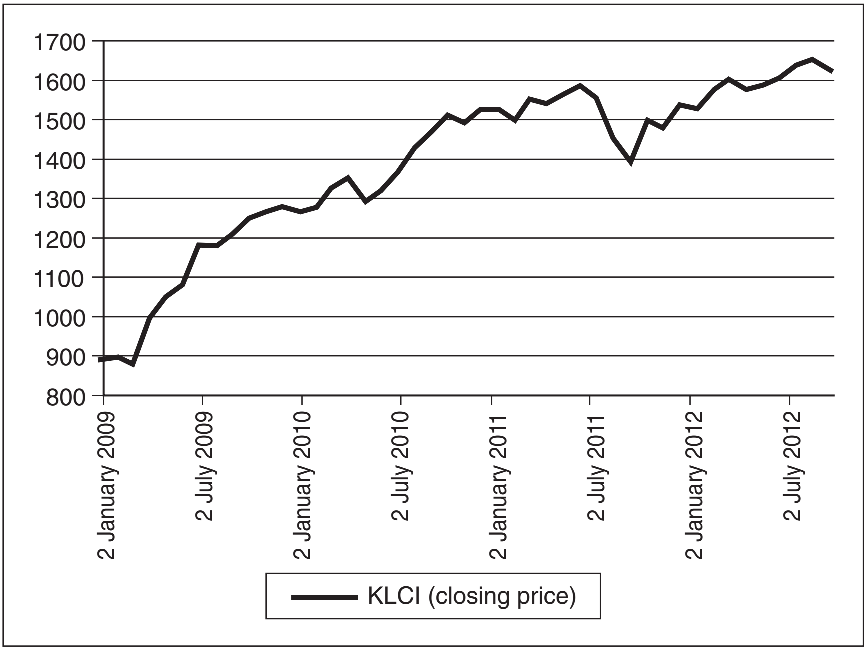
Source: World Economic Outlook Database, IMF, April 2012.

FIGURE 1.3
Trend in Malaysia's Merchandise Trade, 2001–11



Source: WTO Trade Database, authors' calculation.

FIGURE 1.4
Monthly Kuala Lumpur Composite Index (KLCI), 2009–12



Source: Yahoo Finance.

the Kuala Lumpur Composite Index (KLCI) has jumped 83 per cent (in absolute terms) since early 2009 (see Figure 1.4). The Malaysian economy was also ranked tenth in the World Competitiveness Scoreboard in 2010. This was a significant improvement from a ranking of 18th in 2009.

Despite these positives, the Malaysian economy is said to be a classic case of the "middle-income trap". After rising rapidly at 7.0 per cent from 1991–2000, the economy grew by only 4.6 per cent from 2001–10, far short of the 6.7 per cent average growth rate targeted for the decade (8MP target: 7.5 per cent and 9MP target: 6.0 per cent). Investment rate went down by 10–15 per cent compared to the same period in the 1990s. The 1997–98 Asian Financial Crisis caused a dent in Malaysia's growth story. The economy suffered from a lack of creativity and innovation needed for technological transformation and economic development as concluded in the New Economic Model (NEM) report.[5]

In general, the middle income trap represents a stage where a country is stuck at a relatively comfortable level of per-capita income (World Bank: US$1,006–US$12,275) but cannot seem to take the next big step to become a developed nation. It is relatively simple to get into the middle income level. With low levels of income in the country, it can make the transition by taking advantage of the cheap labour available and make the economy competitive in labour-intensive manufacturing. The real challenge comes when a country has to leap into the ranks of advanced economies. This is because, as income increases, so does cost, which means that a country like Malaysia has to move up the value chain of production and export more technologically advanced products. In addition, the country needs to innovate and use capital and labour more productively. This calls for a highly educated workforce and more investment in research and development (R&D). Hence, the middle-income trap is a development problem for Malaysia.

Things have become further complicated with the presence of big Asian neighbours, China and India, who can squeeze labour costs both in low and high value-added jobs. Moreover, Malaysia's policy of lifting the poor ethnic Malays (Bumiputera) to a higher level of income by introducing quotas and preferential treatment in education, jobs, housing etc. since the 1970s has become a barrier in itself.[6]

Aiming to be a developed nation within thirty years from 1990, the then Malaysian Prime Minister Mahathir bin Mohamad announced Vision 2020 or *Wawasan 2020*. The vision called for a self-sufficient, democratic, economically just, mature, liberal and tolerant society, and a united Malaysian nation which would achieve US$6,000 per capita income in 1980 prices by 2020. Vision 2020 became a part of the Sixth Malaysian Plan in 1991 and remained an important vision for the subsequent five-year development plans. As Malaysia continued to struggle with its vision for a developed economy, Prime Minister Najib Razak in 2010 felt it necessary to undertake bold economic reforms.

The Government Transformation Programme (GTP) was introduced in 2010 to address seven key areas concerning the people of the country. These are — reducing crime, fighting corruption, improving student outcomes, raising living standards of low income households, improving rural basic infrastructure, improving urban public transport and addressing the issue of cost of living. The programme was planned to be implemented until 2012 as a foundation for the transformation of Malaysia. The objective was to improve the lives of all Malaysians regardless of race, religion and social status.

In the same year, Malaysia unveiled the New Economic Model (NEM), which was expected to improve competition, double per capita income in 2020 and start abolishing ethnic preferential treatment for Malays (e.g., in education, public sector jobs and housing). The overall objectives, policy framework, and specific strategies of the NEM were integrated into the Tenth Malaysian Plan (10MP) and the Economic Transformation Programme (ETP). In the Tenth Malaysian Plan (10MP) 2011–15, the focus was on higher education, recruitment and large brain drain from Malaysia. The main macroeconomic objectives were to sustain 6.0 per cent average annual GDP growth rate during the 10MP. This was on the back of stronger domestic demand, increased private investment, and improved productivity. Gross national income (GNI) per capita was targeted to increase to around US$17,700 by 2020.

The Economic Transformation Programme (ETP) was launched in September 2010. It focused on the key growth areas known as twelve National Key Economic Areas (NKEAs) — oil, gas and energy; palm oil; financial services; tourism; business services; electronic and electrical; wholesale and retail; education; healthcare; communications content and infrastructure; agriculture and greater Kuala Lumpur/Klang Valley. ETP suggests ways for Malaysia to come out of the trap between middle and high-income economy and tend to help Malaysia to achieve the targets set under Vision 2020. All these show the sense of urgency to shift Malaysia to a high income gear.

Given this background, the chapter is organized as follows. The next section briefly discusses Malaysia's economic journey since 1970. Despite being one of the Newly Industrialized Economies (NIE) in the 1990s, Malaysia was hit hard by the 1997–98 Asian Financial Crisis and since then it is struggling to come out of its lackluster performance. Section 3 throws light on some of the important issues that have become a drag for the Malaysian economy. The last section argues that given its current state, it is difficult for Malaysia to achieve a developed country status by 2020. The chapter concludes by giving some policy recommendations.

The Economy of Malaysia

1970–2000

The economy of Malaysia has always been hailed as a model of export-led growth. Foreign Direct Investment (FDI) has played an important part in its transformation from a largely agrarian economy to a manufacturing-based one. In 1970, the primary sector was dominated by plantation agriculture and tin mining. But soon the government realized the need for diversification and in its New Economic Policy (NEP)[7] of 1971, the stance moved to stimulate manufacturing growth by attracting FDI.

The NEP was launched through the Second Malaysia Plan in 1971 with the two objectives of alleviating poverty and restructuring the economy. At the same time, the Malaysian government implemented policies to favour bumiputera (including affirmative action in public education) to create opportunities, and to defuse inter-ethnic tensions following the extended violence against Chinese Malaysians in 1969. The policy also aimed to increase capital ownership among the Malays ethnic groups comparable to other races, especially Chinese.

This was followed by the New Development Policy[8] (NDP) in 1990, which avoided a blanket measure to redistribute wealth and employment and emphasized assistance only to "Bumiputera with potential, commitment and good track records" (Malaysian Government 1991).[9] The NDP was part of a larger plan, known as Vision 2020, aimed to turn Malaysia into a fully industrialized country and to quadruple its per capita income by the year 2020. This required the country to rise up the technological "ladder" from low- to high-tech types of industrial production, with a corresponding increase in the intensity of capital investment.

With all these measures in place, the Malaysian economy grew at an unprecedented rate of 8.0 per cent during 1971–80, 6.1 per cent during 1981–90 and 9.3 per cent during 1991–97. The per capita income, at current prices, grew from US$1,812 in 1980 to

TABLE 1.1
Structural Change in GDP
(% share)

Year	Agriculture	Industry	Services
1970	29	27	43
1980	23	41	36
1990	15	42	43
2000	9	48	43
2010	11	44	45

Source: The World Bank, World Development Indicators Online, October 2012, available at <http://data.worldbank.org/country/Malaysia> (accessed 17 October 2012).

US$4,029 in 2000. The country invested heavily in infrastructure and the volume of manufactured exports, notably electronic goods and electronic components increased rapidly. The economy also underwent a complete transformation with significant changes in GDP composition (see Table 1.1). In the 1970s, the agricultural sector contributed 29 per cent to GDP, while manufacturing contributed 27 per cent, and services 43 per cent in the same year. By 1980, manufacturing had increased from a 27 per cent to 41 per cent share of GDP. In tandem, the incidence of poverty fell from 52.4 per cent in 1970 to 16.5 per cent in 1990 and further reduced to 5.7 per cent in 2005. In line with policy objectives, the proportion of Bumiputeras in the administrative and managerial job category increased from 22.4 per cent in 1970 to 36.6 per cent in 2000.

In between, in 1997–98, Malaysia became a major victim of the Asian Financial Crisis (AFC). With heavy outflow of foreign capital, the Malaysian ringgit against one U.S. dollar fell from RM2.42 to RM4.88 by January 1998. To counter the crisis the International Monetary Fund (IMF) recommended austerity changes to fiscal and monetary policies. While some countries (Thailand, South Korea, and Indonesia) reluctantly adopted these, the Malaysian government made the ringgit non-convertible externally and pegged the ringgit at RM3.80 to the U.S. dollar. Despite international criticism, these actions stabilized the domestic situation, restoring net growth at 8.9 per cent in 2000.

2001–10

In 2001, the National Vision Policy (NVP) was launched, which incorporated the critical thrust of the previous development policies. Thus, poverty eradication, restructuring of society and balanced development remained as key strategies until the year 2010. In addition, focus was given to developing local skills and raising productivity in order to increase national competitiveness.

During 2001–10, although GDP went up by 5.0 per cent, private investment remained relatively small compared to public investment (see Table 1.2). This reflected the fact that Malaysia's economic growth was led by the public sector, despite its strategy to increase the role of private sector in the economy.

Through all these years, manufacturing sector remained the main sector for the economy and it dominated the share of overall gross exports. Malaysia continued to work as an open economy with trade to GDP ratio at 152 per cent in 2010 and its external sector enjoyed a surplus balance after the 1997–98 crisis (see Figure 1.5).

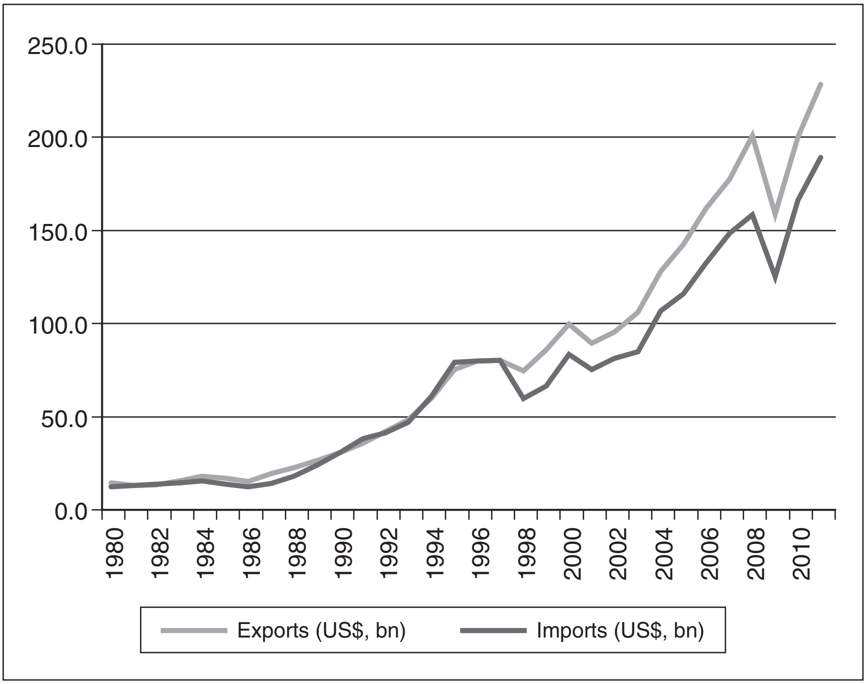
In 2010, Malaysia unveiled the New Economic Model (NEM), which intended to more than double the per capita income in Malaysia by 2020. The programme aimed to shift affirmative action from being ethnically-based to being need-based and hence becoming more competitive as well as market and investor friendly. This was again reflected in the Tenth Malaysia Plan (10MP: 2011–15), where the private sector was expected to take the lead.

TABLE 1.2
Resource Balance 2000–10
(% of GDP)

Sector	2000	2005	2010
Public Saving	17.6	16.5	13.9
Public Investment	13.9	11.7	10.5
Private Saving	22.5	20.6	21.2
Private Investment	15.9	9.0	11.2
Total Saving	40.1	37.1	35.1
Total Investment	29.8	20.7	21.7
Balance in Total	10.3	16.4	13.4

Source: Malaysia, 2006, 9MP and 2011, 10MP.

FIGURE 1.5
Malaysia's Merchandise Trade, 1980–2010



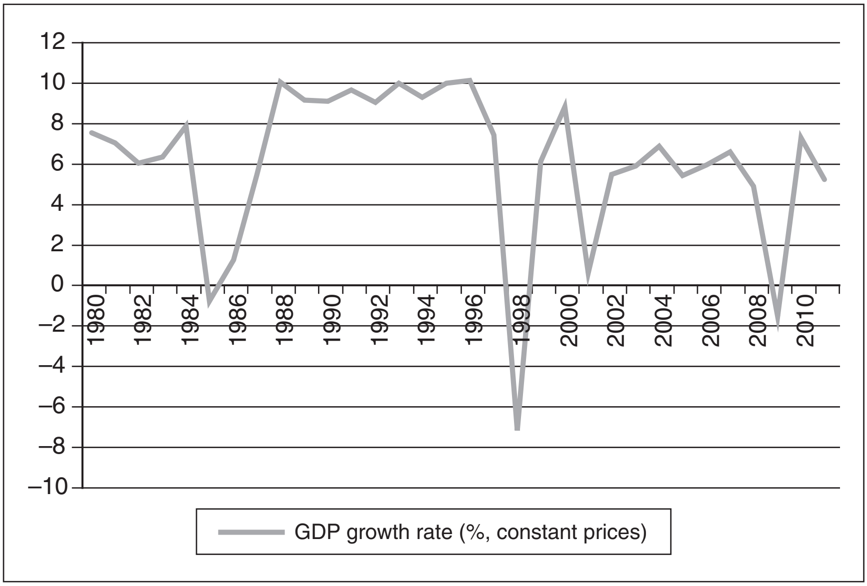
Source: WTO Trade Database.

Malaysia's Key Ailments

Despite Malaysia's achievements in terms of economic growth, per capita income and poverty eradication, the country has been unable to come out of its lackluster performance post the 1997–98 crisis and move to a "higher-income" bracket (see Figure 1.6). Why has it been so difficult?

Pre-mature De-industrialization: Malaysia has undergone considerable structural change since 1970s. From being predominantly mining and agriculture-based economy in the 1970s and 1980s, it moved to become a manufacturing driven economy by late 1980s and foreign capital was injected to promote export manufacturing. Manufacturing expanded strongly until 2000, when it began to cool off due to a lack of human capital and policy support to stimulate firms' participation

FIGURE 1.6
Malaysia's GDP Growth Rate, 1980–2010



Source: World Economic Outlook Database, IMF, April 2012.

in higher value added activities. Since then, services have become the most important sector, which in the 1990s mainly focused on infrastructure development. The government concentrated on expanding the knowledge infrastructure and gave attention especially to finance, insurance, real estate, business services, trade, accommodation, and restaurants. But the country was not yet ready for a service-based economy as it was challenged by lack of education and cheap and unskilled labour.

The government has recognized that the lack of human capital and innovative capacity have restricted the country's progress. Keeping this in mind, ETP has been introduced as a new initiative in 2010, but this has no linkages to the actual structure of the national economy. Rajah Rasiah in Chapter 3 states that the disconnect between policy-making and the national economic reality is mainly due to over reliance on outside experts to suggest policies, whose understanding of the ground realities of the national economy remain shallow.

Services Sector: While Malaysia's services sector has grown to be the largest in terms of its contribution to GDP and employment, its labour productivity and share in total exports are lower than that of the manufacturing sector. Thus, although the government has targeted the services sector as a new engine of growth, it continues to behave like a supporting sector for manufacturing and domestic consumers. Things got more complicated with the changing nature of the services sector — the consumers and producers are no longer required to be in the same geographical location. Moreover, Malaysia's services sector is confronted with increased competition. This is due to the country's foreign policy to pursue bilateral and regional trade agreements in order to improve market access.

One should note that the services sector is labour intensive and when it is coupled with unskilled labour, productivity suffers. Thus, according to Tham Siew Yen and Loke Wai Heng in Chapter 4, the challenge lies in the rise in efficiency and productivity of the sector, which is again linked to Malaysia's shortage of skilled workers. Despite the country's early effort to promote the sector (the Multimedia Super Corridor was established in 1996), the shortage of skills have restrained the export of information and technology services.

Migrant workers have also made a significant contribution to the Malaysian economy, and have been critical to Malaysia's economic growth in the last two decades. Theresa Devasahayam in Chapter 17 highlights that migrant workers make up around 16 per cent of Malaysia's total labour force. However the employment of migrant labour has led to a complexity of issues. While the Malaysian government has acknowledged that migrant labour is important for the economy, it has also had to carefully and strategically regulate the import of labour, and stem its over reliance on this source of labour. Migrant workers have also at times been blamed for worsening security in the country.

Productivity: In recent years, Malaysia has slipped in meeting its growth targets (see Table 1.5). The gap between the growth accounting targets and actual performance for both the 8MP and 9MP suggests that of the three sources of growth, the targets for Total Factor Productivity (TFP) have been the most difficult to achieve. Malaysia's labour productivity growth has lagged behind several other Asian countries, and its annual average change post-1997 has been lower in the period 1998–2007 (see Tables 1.3 and 1.4).

TABLE 1.3
Malaysia's Productivity Growth Compared to Selected Asian Countries

	Pre-Crisis: 1987–97	Post-Crisis: 1998–2007
China	4.5	9.2
India	3.5	4.4
Asian NIEs	4.8	3.4
Malaysia	5.5	2.9
Thailand	5.2	3.1
Indonesia	3.1	3.0
Singapore	4.5	2.4
Philippines	–0.7	2.3

Source: Tenth Malaysia Plan.

TABLE 1.4
Sources of Growth for Malaysia's Labour Productivity, Annual Average Change

	1987–97	1998–2007
Labour Productivity	5.5	2.9
Contribution of:		
Capital	3.4	1.0
Education	0.3	0.3
Land	0.0	–0.1
Total Factor Productivity	1.7	1.6

Source: Tenth Malaysia Plan.

TABLE 1.5
Growth Targets and Actual Performance

	8MP (2001–05)		9MP (2006–10)		10MP (2011–15)
	Target	Achieved	Target	Achieved	Target
GDP Growth (%)	7.5	4.7	6.0	4.2	6.0
Contribution of Capital	N.A.	1.8	2.0	1.4	2.3
Contribution of Labour	N.A.	1.5	1.8	1.3	1.4
Contribution of TFP	N.A.	1.4	2.2	1.5	2.3

Sources: Eighth, Ninth and Tenth Malaysia Plans.

According to Cassey Lee in Chapter 5, TFP's contribution to growth after increasing from 1.1 per cent (1996–2000) to 1.4 per cent (2001–05), stagnated at 1.5 per cent in the five years to 2010.

For the 10MP, the growth strategy is targeted at the private sector (microeconomic reforms to enhance the dynamism of the private sector, promotion of innovation, rationalization of government activities and SME development), and the private sector investment is expected to go up by 12.8 per cent during 2011–15. This is a significant challenge given that private investment only grew at a rate of 2 per cent in the 2006–10 period. Moreover, with the global economic slowdown and the sovereign debt crisis in Europe, it would be more difficult to raise the private investment, especially the FDI.

Private Investment: FDI played a critical role in this transformation, and domestic investment was also robust at around 40 per cent of GDP, up until the Asian Financial Crisis (AFC). Since then, both the domestic and foreign private investment in Malaysia remained weak, with Malaysia finally turning a net exporter of capital since 2005. Jayant Menon argues that (Chapter 6) Malaysia's investment malaise can be attributed to two inter-related factors: (a) distortions introduced by the New Economic Policy (NEP) and its reincarnates, and (b) the widespread presence and overbearing influence of government-linked corporations (GLCs) that deter new investment. While the impact of both factors may have been masked before the AFC, it is no longer the case in the current competitive environment.

Fixing the problem requires addressing the distortions of the NEP and curtailing the influence of the GLCs. Although there have been a few recent moves to dilute the NEP, some of these measures have already been reversed. Similarly, while there has been an active programme of divestment from GLCs, there have also been GLC acquisitions in new sectors, making it more of a diversification than a divestment programme.

Infrastructure: The development of infrastructure is crucial to a country's economic development. G. Naidu in Chapter 7 provides a detailed discussion of investment and infrastructural modernization in Malaysia by categorizing development into the pre-privatization phase from 1966 to 1990 and the private-participation phase from 1991 onwards.

Starting from the Sixth Malaysia Plan (1991–2000), the private sector started to participate in infrastructure development but public sector spending did not decrease as a result of the private sector. Public sector investment between 1991 and 2010 was RM166.5 billion compared to RM60 billion during the 1966–90 period. Nevertheless private sector investment supplemented public sector investment, boosting total investment in infrastructure.

The road network in Malaysia increased eightfold between 1965 to 2010, from 15,000 km to 135,000 km. There has also been the development of the urban railway sector in the 1990s in Kuala Lumpur. Likewise, the development of port facilities, telecommunications, and electricity infrastructure has risen manifold and generally kept pace with economic growth.

Nevertheless, challenges still remain, the government has to address the growing needs of the external sector as Malaysia continues to become increasingly globalized. There is also a need for the state to ensure that the provision of infrastructure continues for the poorer and less developed parts of Malaysia, and that these less developed regions are not inadvertently overlooked. Another important aspect would be the need to promote efficiency and to continue to remove regulatory oversight.

Malaysian Politics: As Ooi Kee Beng in Chapter 11 points out, major ills became evident with the success of the opposition parties in the general elections of 2008. Power had become centralized in the hands of UMNO. This was apparent in the steady abolition of local elections, which became complete in 1976 when the Local Government Act was passed in 1976. While the NEP sought to push Malays into the fields where they were under-represented, no outflow of Malays from areas where they were over-represented took place. Where the civil service in general was concerned, as was the case with the military, the paramilitary, the police and even the judiciary, the NEP ambition "to reduce and eventually eliminate the identification of race with economic function" was ignored.

To be sure, many Malay leaders did not see the NEP as a temporary affirmative action programme aimed at dissipating socio-economically defined racial divisions, but as the concrete formulation of the indeterminate "special privileges" expressed in Article 153 of the Constitution. UMNO's wish for permanent power could therefore ride steadily on the back of the wish for permanent special rights for the Malays.

Federal System: Francis E. Hutchinson in Chapter 12 states that the Malaysian state is one of the world's most centralized federations. The centre receives almost 90 per cent of all government revenue and performs duties beyond fiscal, monetary, and trade policy measures. The federal government is also responsible for most types of infrastructure, science and technology policy, and all levels of education. However, this overlooks the fact that Malaysia has thirteen state governments that are responsible for particular jurisdictions. They are important providers of goods and services, and can play a role in creating an enabling environment for business.

The chapter further stipulates that an excessive concentration of responsibilities may not always be an optimal condition. Public finance literature holds that an appropriate attribution of responsibilities and revenue sources between levels of government can enhance welfare. For example, while some services benefit from economies of scale and are best provided nationally, others require detailed knowledge of local conditions and should be supplied locally. Despite this, Malaysia has continued to centralize responsibilities at the national level. Its policy frameworks such as the 10MP, NEM, and ETP have the potential to further undercut the effective functioning of state governments. If this continues, it will stifle the vital role that state governments can play in creating an enabling environment for business and leveraging local-level knowledge to foster economic growth.

Environment: As Wee Chong Hui argues in Chapter 13, Malaysia struggles with conflicting demands on the finite environment. Urgent attention is required on the conservation of forest resources and gene pools, sufficient supplies of energy and clean water, and the prevention of water and air pollution. As Malaysia continues to grow, transport and communication infrastructure, industries, township and residential projects will compete for its forested land, which will adversely affect water catchment for human and industrial needs. The increasing commercial and household demands for energy are a strain on resources, and, together with growing industries and human settlements, degrade water and air resources for a long-term liveable quality of life.

Education System: Hwok-Aun Lee writes that in the past (Chapter 14), partly due to government's higher budgetary allocation to education,[10] there were considerable quantitative gains in primary and secondary levels of education. More recently, the nation witnessed rapid expansion in tertiary education. Despite this, Malaysia has witnessed a decay in the quality of education. This has been demonstrated by a lack of basic skills, critical thinking, English proficiency and racial integration among students and graduates.

It was also observed that the quality of institutions has fallen short or even regressed and most of the time the fundamental problem lay in a systemic decline in the calibre of educators and a demoralization of the teaching profession. While national examination results continued to be decked with stellar performances, other trends, such as a strong preference for vernacular schools over national ones, suggest loss of confidence in the national schooling system.

The new administration has, once again, made education a priority, but the proposed policies refrain from systemic reforms and only rely on marginal measures and small-scale programmes. They do not look to promote excellence or to prevent the "brain drain" of highly qualified citizens to other countries for work.

In terms of the provision of higher education, financing higher education has also become an important issue. In Lee Hock Guan's Chapter 15, he discusses the funding of higher education in Malaysia in some detail and points to the importance placed by the Malaysian government in prioritizing higher education as a proportion of the total education expenditure. Increasing privatization has helped to ease government higher education spending, such that increasingly, students and parents are responsible for the costs.

The growth and pattern of financing higher education has been shaped by Malaysian politics and the political system prevailing in the country, where the government has intervened in the equity and access aspects of higher education to ensure that enrolment would reflect the country's racial breakdown. These mandated racial quota policies has affected the equity and access to and thus the financing of higher education. In addition, shifting the responsibility to financing education to students and parents would make it increasingly difficult for lower-income students to attend higher education. This is an important consideration which the state has to take into account if inequity is to be reduced in the years ahead.

Income Inequality: In Chapter 16, Ragayah Haji Mat Zin observed that inequality, as measured by the Gini ratio was rising prior to 1976. But it was reduced by about 16.6 per cent by the end of the

NEP 1971–90. Income inequality has fluctuated in the last twenty years and currently remains at the same level as in 1990. Income disparities between urban and rural areas remain high. Explanations for the persistent high inequality include trade and globalization, labour market policies, constraints on the process of internal migration, formation of clusters and agglomeration effects, and state-government-party collusion. The high inequality in Malaysia can hinder the process of absolute poverty eradication and jeopardize economic growth.

Again, the strategies for accomplishing a 6 per cent growth under the 10MP tend to be inequality widening (driving growth by urban agglomerations, cluster- and corridor-based economic activities, and focusing on the National Key Economic Areas (NKEAs)). While the plan provides for various programmes to assist the bottom 40 per cent of households, the strategies are not that much different from what have been recommended in the earlier plans. Hence, the outcomes are not expected to be really transformational. Further, liberalization of selected sectors in the economy and low economic growth outlook in global economy would also tend to enhance inequality.

Growth and Liveability: The structural change in Malaysia from being agriculture dependent to industry driven has led to rapid industrialization and to the concentration of economic activities in a few urban areas. This led to the services sector development in the existing urban areas, compounding the concentration of population further. From 1980 to 2010, the urbanization rate increased from 34.2 per cent to 71 per cent (Department of Statistics 2010). The problems associated with rapid urbanization include transportation and traffic woes, lack of housing resources among the low income group, and social crime. In Tan Teck Hong's and Phang Siew Nooi's chapter (18), it is estimated that over 75 per cent of the nation's population will be urban by 2020, up from 71 per cent in 2010. This will be the fundamental obstacle in securing a better quality of life in the long term.

In order to cope with the problem, the Malaysian government has implemented various measures in relation to issues of environment, politics, governance, and the ethnic composition of the population. The chapter notes that the urban management will increasingly take on an integrated approach, and will be much aligned to the Government Transformation Programme (GTP) of 2010. Moreover, as cities are the powerhouses of economic growth, their sustainability lies within the ways to address the challenges in the urban areas. The government and economic transformation programmes exemplify this concept. Some of the outstanding issues of the transformation programme that are relevant to deal with greater urbanization are reducing crime, improving urban transport, and improving housing affordability. Another significant area is good governance (accountability, transparency, equity, etc.).

Malaysia by 2020

Looking at the above, one can conclude that although Malaysia has successfully achieved its upper middle income country status, its path to graduating to a high income country remains highly uncertain. Moreover, the on-going global economic problems and slowdown in key export markets, makes the annual growth target of 6 per cent, under the 10MP, unlikely to be achieved. Achieving the targeted growth rate during 2011–15 also requires the private investment to grow by more than 12 per cent annually. This is very ambitious, after a 2 per cent annual growth rate achieved during the Ninth Malaysia Plan (Menon, Chapter 6).

Policy Recommendations[11]

- To promote the manufacturing sector, Malaysia must invest in technology. Despite policy efforts, the lack of human capital and poorly led R&D organizations have denied the country the knowledge synergies essential to stimulate firms' upgrading to high value-added activities. Similarly, for the services sector, efforts are needed to improve the human capital resources so as to increase labour productivity and enhance its linkages with the manufacturing sector. In the longer term, enhancing export competitiveness in both manufacturing and services sector will require increasing domestic competition, reducing regulatory burden, understanding the free trade agreements as well as knowing the regulatory requirements of the targeted country of export.
- The Malaysian government needs to undertake significant fiscal reforms. This includes broadening the tax revenue base via Goods and Services Tax (GST) and reducing the size of public sector.

The government should not attempt to compensate any decline in private investments by undertaking public investments either directly or indirectly (via GLCs). These reforms should be accompanied by actions to improve economic and regulatory governance aimed at reducing arbitrary decisions in development spending and regulatory matters. They should also aim at bringing about more transparent and non-discriminatory procurement and regulatory systems. These are essential to deal with problems such as lack of FDI, inefficient infrastructure services, lack of human capital and brain drain.

- There is increasing recognition that the slump in Malaysia's private investment is rooted in the distortions resulting from the workings and implementation of the NEP and its reincarnates. It is believed that GLCs have crowded out private investment in a wide range of sectors. Hence, it is more important to address the GLC problem for the revival of investment, before turning into the NEP. However, it remains to be seen if the plans announced for government divestment in some of these GLCs will progress in a way that removes all barriers that have prevented or discouraged new firms from entering what have been traditional strongholds. Whether divestment proceeds will be channelled back into government involvement in different sectors, as has been happening lately, is another concern.
- Malaysia is on its way to be a part of an ASEAN Economic Community (AEC) by 2015. But implementing the AEC Blueprint at the national economic level is not easy. The country faces resistance from affected parties, monopolists and lobbyists apprehensive of increased competition and transparency in the economy (Rokiah Alavi, Chapter 10). Moreover, in Malaysia, there are some sectors and domestic regulations that are considered sensitive and strategic for national economic development. This is slowing down the progress of liberalization in Malaysia. Nevertheless, meeting the goals under AEC Blueprint is very crucial as this will not only be important for raising the country's competitiveness *vis-à-vis* other nations in the region but also to attain its own goals of Vision 2020. This will require strong motivation, political will and leadership.
- Malaysia needs to empower its state governments. The most effective means of revitalizing initiative at the state level is to

increase incentives for performance. At present, rankings of investor inflows to each state are published yearly, but current fiscal arrangements mean this has no impact on centre-state transfers. Thus, state governments have no direct incentive to engage in their investor liaison roles.

- The potential for innovation and policy transfer can be encouraged and systematized by more regular incorporation of state-level development plans into the federal government's Malaysia Plans. Many state-level plans have been financed exclusively by state governments, drawing on extensive local level knowledge and social capital. Yet, it is a frequent refrain from state government officials that their planning processes are by-passed by federal planning machinery. These plans, accompanied by transparent key performance indicators, would greatly enrich plans at both the state and national levels.
- In environmental conservation, Malaysia should intensify efforts for international cooperation on technology sharing, support in environmental management and collective responsibility. Carbon trading better captures environmental costs worldwide. Malaysia has one of the remaining tropical rainforests with a large gene pool and contribution as carbon sink. The burden of custody should not lie on Malaysia alone.
- Malaysia must work hard on reversing the decay in education, beginning with the public schools. This will entail difficult decisions to be made, in terms of the allocation of education funds, specifically to avail more for teacher's salaries and benefits. The relatively heavy spending in tertiary education, alongside persistent national under-achievement in secondary school enrolment and completion, warrant an examination of the distribution of spending between education levels. Another important area concerns the extent to which Malaysia's highly staffed public sector and administrative positions consume resources that could otherwise be directly committed to educational work.
- Raising the quality of teaching professionals is one element in a set of necessary changes. The increasing weight attached to performance auditing warrants reconsideration, taking cognizance of the need to balance policies that extract effort and meet targets

against those that give space for capable teachers, academicians, and students to thrive. Without political will and bold leadership, these necessary transformations will fail to materialize and academic mediocrity will persist.

- In order to reduce the income inequality, Malaysia must implement its plan of NEM efficiently. It has been more than a year since the NEM was introduced, but the ordinary public has yet to feel the changes. The government must have more political will to ensure that ordinary *rakyat* benefit from the programmes. Moreover, big cases of corruption still hog the limelight and these need to be tackled more seriously.
- Malaysia should look to increase labour mobility and raise labour market competition. Sharing information on job availabilities to reduce the costs of job search, as well as further easing of the regulations for setting up new businesses, would result in competitive labour markets that will make the firms more efficient and more conducive to better compensation practices. Regulations in hiring and firing workers should be reviewed. In addition, the government should intensify its efforts to encourage greater automation and mechanization of labour-intensive industries in order to reduce the dependence on foreign unskilled labour. Employers must provide continuous training for workers and the latter must be willing to be retrained and become multi-skilled in order to increase productivity.
- To raise its labour standards, Malaysia must set a minimum wage. Currently, workers are paid below their productivity. Workers would be motivated to be more productive with a higher incentive. The government has set up the National Wage Consultative Council to look into this matter. At the same time, employers must also provide workers with training and new skills while paying workers the appropriate incentives.
- The pressure of urbanization has made it necessary for urban planners to manage the cities efficiently. As mentioned in Chapter 18, a lot of politics in Malaysia is entrenched in the system, but urban planners have to enhance their abilities to cope with emerging issues of politics, finance, equity, corruption, and public awareness. Hence, capacity building is necessary for urban officials.

- Another critical factor for the success in urban management hinges upon the commitment of the public to sustain government strategies and initiatives. Every individual should be encouraged to take responsibility for their urban environment and governance of their city. This encompasses the NGO, the private sector, and some international agencies.

NOTES

1. Tenth Malaysia Plan, 2011–2015 (Malaysia: Economic Planning Unit, 2010).
2. Hall Hill, Tham Siew Yean, Ragayah Haji Mat Zin, eds., *Malaysia's Development Challenges: Graduating from the Middle* (London and New York: Routledge, 2012).
3. Institute of Strategic and International Studies (ISIS) Malaysia, *Malaysia: Policies and Issues in Economic Development* (Kuala Lumpur: Institute of Strategic and International Studies (ISIS) Malaysia, 2011).
4. Brunei, Cambodia, Indonesia, Laos, Myanmar, Philippines, Thailand, Singapore and Vietnam
5. Shankaran Nambiar, *East Asia Forum*, 27 December 2011.
6. The Bumiputera policy, enjoyed by an ethnic majority (Malays constitute around 50 per cent of the total population) and held up by the powerful Malay elite and the governing Malay majority party (UMNO), is difficult to reverse.
7. NEP was an ambitious socio-economic restructuring affirmative action programme launched by the Malaysian government in 1971 under the then Prime Minister Tun Abdul Razak. The NEP ended in 1990, and was succeeded by the National Development Policy in 1991.
8 The NDP replaced the NEP in 1990 but continued to pursue most of NEP policies.
9. Malaysian Government, *The Second Outline Perspective Plan, 1991–2000* (Kuala Lumpur: Government Printer, 1991).
10. Malaysia public expenditure of tertiary education is 92.7 per cent, the highest among Southeast Asian countries.
11. This section is derived from the subsequent chapters in the book.

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