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Malaysian Economic Development: Looking Backwards and Forward

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Abstract: This paper provides an analytical and forward-looking overview of Malaysian economic development. Looking back over its 53 years of Independence, we identify the key stylized facts to include the country's generally rapid economic growth and structural change; its consistent openness, especially for merchandize trade and foreign direct investment; its creditable record of macroeconomic management; its consistently high inequality, in spite of the developing world's most consistently implemented affirmative action program; and its mixed record with regard to institutional development. Looking forward, the government has identified the country's key development challenge as graduating to developed country status from its current upper middle income developing country ranking. Can Malaysia make this transition? Growth rates and especially investment levels have fallen substantially since the Asian financial crisis. We identify three key, interrelated challenges, which will be key determinants of its upgrading efforts: fiscal policy reform; the development of institutions and incentives that underpin more rapid innovation and technological progress; and a complete overhaul of affirmative action programs so that they become well targeted social policy instruments.

Key words: Malaysia, ASEAN economies, upgrading, middle-income trap.

JEL codes: N15, O30, O53.

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(1) Introduction

With a population of just under 30 million people and an economy a little over 0.5% of global GDP (in PPP terms), Malaysia is a relatively small country. But it has a distinctive and largely successful development record, from which many poorer countries can profitably learn. This chapter presents an analytical overview of Malaysian economic development and the challenges the country faces as it attempts to 'graduate' from middle to high-income status. Drawing on the chapters that follow, section 2 reviews the past development record, while section 3 identifies the key issues associated with the process of upgrading.

Two sub-themes inform the analysis. The first is that Malaysia is undeniably a development success story since Independence in 1957. Over this period, per capita incomes have risen more than eight-fold. Thus, going forward, there is much that does not require any fundamental change. The second is that there is a disjuncture in its growth trajectory before and after the Asian financial crisis. That is, growth and especially investment levels have slipped over the past decade. One of the major contributions of this volume is to add to an understanding of the factors explaining this phenomenon. Specifically, are the explanations external (such as negative exogenous shocks, increased international competition), are they related to the general challenges of upgrading from middle-income status, or do they derive from a particular set of domestic economic and political events? As will be evident from the conclusions to this volume, all three factors are present. The current slowdown in growth has triggered a lively debate at the highest levels inside government and in the broader community, as vigorous as any on development policy issues in Malaysia's independent history.

Official thinking is reflected in the words of Prime Minister Najib, who in October 2009 observed that:

> 'We are now at a critical juncture, either to remain trapped in a middle-income group or advance to a high-income economy. … We now have to shift to a new economic model based on innovation, creativity and high value added activities.'[1]

In a similar vein, Tan Sri Nor Mohamed Yakcop, Minister in the Prime Minister's Department, was reported in the Malaysian press as stating that the country needs to move its economy from a middle to a high-income model:

> 'We are trapped in a middle income gap…. We need a model which is more relevant to current times. To move to a higher-income based economy, we have to move towards a knowledge and innovation-based economy where skilled labour is needed …' (Bernama, May 7, 2009)

Academics have also engaged in the debate, in a forthright manner, and attributing at least some of the problems to the country's long-running affirmative action policies. Typical are the recent remarks of two of the country's most eminent economists, respectively Professors Mohamad Ariff in the Preface to this volume and Wing Thye Woo:

[1] As quoted in World Bank, 2009, p. 59.

> ‘Multiracial Malaysia’s major structural problems are largely attributed to the New Economic Policy (NEP). … The objectives of the NEP were laudable. … The NEP is an addiction for some, redundant for some others and unjust for the rest. [But] … the NEP, like the legendary Gordian knot, cannot be loosened, it has to be cut [while maintaining] a clear focus on the poor and the marginalized groups regardless of race, colour or religion.’
> ‘… by focusing too much on the redistribution of income and not enough on the generation of income, NEP rejects meritocracy and institutionalizes racism, thereby preventing full mobilization of human resources [and explaining why] very few Malaysian firms have moved from import-competing goods to become major exporters.’[2]

(2) The Record: Six Stylized Facts

Malaysia is unusual in comparative development perspective in at least three respects. First, it had favourable initial conditions: it had a relatively painless transition to independence, it inherited an adequately functioning system of public administration and jurisprudence, and it is well endowed with natural resources. Second, with the significant exception of the bloody communal conflict in May 1969, and to a lesser extent Indonesia’s konfrontasi of the mid 1960s, Malaysia has not experienced domestic conflict or external threat on a major scale. Third, its economic policy settings have been remarkably stable and consistent. It is very difficult to identify any substantial changes in policy direction, much less the ‘U-turns’ observed for example in major Asian states such as China, Indonesia, and Vietnam.

In what follows, we identify a set of stylized facts that in our view characterizes Malaysian economic development. We also place that record in comparative perspective. The choice of comparators is somewhat arbitrary. The country has out-performed the two countries with which it was commonly compared in the early post-colonial period, namely Ghana and Sri Lanka, owing to similarities among the three in colonial experiences, ethnic diversity, and natural resource endowments. In the comparative tables and figures below, we have chosen four high-growth Asian economies, China, (South) Korea, Singapore and Thailand. Despite the obvious differences, Malaysia still shares much in common with Singapore. Korea has often been viewed by Malaysian governments as an aspirational model. Both these countries have successfully completed the transition to high-income status. China and Thailand are middle-income competitors. In its policy settings, Malaysia also has a good deal in common with Thailand.

Development economists have grappled with how best to characterize Malaysian development. E.K. Fisk (1982, p.2) regarded it as a country ‘fortunate in many ways’. The World Bank (1993) classified it as one of the high performing ‘miracle’ economies. Hla Myint’s (1972) classic included it as one of Southeast Asia’s ‘outward-oriented economies’. Kunio Yoshihara

[2] Based on a lecture delivered at the Institute of Southeast Asian Studies, Singapore, April 2009.

(1988) saw it (along with most of Southeast Asia) as ‘ersatz’, with the connotation of shallow, rent-seeking development, heavily reliant on natural resource exploitation and foreign capital. Mohamad Ariff (1991) emphasized openness and ‘Pacific connections’. Political scientists have also found it difficult to apply simple labels to the country. Jomo (1986) drew attention to the country’s historically deep ethnic and class divides. Harold Crouch (1996) regarded its political system as ‘responsive-repressive’, Peter Searle’s dissection of the business sector pointed to ‘the riddle of Malaysian capitalism’, while for Terence Gomez and Jomo (1999) ‘patronage’ is central to their political economy analysis.

Rapid Economic Growth

The first and most important stylized fact is that Malaysia has been a consistently high-growth economy for over five decades. By decade, the highest rate of growth in GDP per capita was in the 1970s, at 5.2% (Table 1). In subsequent decades, in spite of at least one negative shock in each period, growth has always averaged at least 3%. In the 1990s, growth was a good deal higher, at 4.5%, notwithstanding the Asian financial crisis. This record has been matched by few developing economies outside East Asia. By East Asian standards, Malaysia’s record is respectable but not stellar. Since 1980, its growth rate has been less than half that of China’s, and significantly slower than Korea’s, especially in the earlier decades. It lagged Singapore and Thailand over the period 1970-90, but since 1990 its average growth rate has been almost identical to these two neighbours. These comparisons are with respect to per capita GDP growth. Given that Malaysia has one of the highest rates of population growth in the hemisphere, its GDP growth lags less in the comparisons.

(Table 1 about here)

Malaysia’s growth has been the most volatile of the five countries, as measured by the coefficient of variation of these growth rates. Like Singapore and to a lesser extent Thailand, this volatility reflects the economy’s openness, and therefore its vulnerability to external shocks. Significant growth slowdowns have occurred about once every decade (Figure 1), and all have involved a mix of external and domestic factors. In the mid 1970s it was in the aftermath of the oil shock and global recession. In the mid 1980s commodity prices fell sharply, necessitating painful macroeconomic adjustment. In 1997-98 there was the Asian financial crisis, which saw the sharpest economic decline in the nation’s history. There were shocks at the beginning and end of the 2000’s, following the electronics downturn and the global financial crisis respectively. An important feature of the record is that there has been no great difference in growth rates across the four administrations (that is, excluding the nation’s first and most recent prime ministers) covered in Figure 1, suggesting that changes in political leadership within the ruling UMNO do not appear to be of great significance for economic outcomes.[3]

[3] Three of the slowdowns occurred during the tenure of Dr Mahathir. But he of course has had by far the longest prime ministership, and there were external

(Figures 1 & 2 about here)

Although policy consistency has been a dominant theme in Malaysian economic development, there have been more or less distinct and identifiable. episodes of growth and variations in policy emphasis. In the immediate post-Independence period, the priorities were dominated by the continuation of the colonial era policy settings of an open economy and stable macroeconomic management, combined with increased attention to rural Malay welfare. Political stability was also a high priority, in the wake of the 1950s communist insurgency, the incorporation of the two East Malaysian states in 1963, Indonesia’s campaign of konfrontasi, and the short-lived union with Singapore, 1963-65. The events of May 1969 marked a turning point in Malaysian economic and political life, and we concentrate here on the period since 1970, which coincides also with the availability of nation-wide economic and social statistics. At the risk of over-simplification, there appear to be at least five fairly distinct episodes over the past four decades:

The 1970s: This was a period of high growth, fuelled by strong commodity prices, together with a concerted push for affirmative action, with the introduction of the New Economic Policy (NEP). The historically prudent macroeconomic policies began to give way to more adventurous fiscal policies, both in response to the buoyant terms of trade and to pursue NEP objectives. Late in the decade and into the 1980s, there were also the beginnings of the controversial ‘Look East’ and heavy industry policies.

1980-85: Falling commodity prices necessitated a major macroeconomic adjustment, especially to bring the very large fiscal deficits under control. Slower growth also reduced the scope for NEP-style redistribution programs.

1986-96: Economic growth resumed quickly, and with it a renewed emphasis on the 1970s priorities, albeit with greater private sector involvement, much of it politically connected through selective privatizations. This growth led to the end of the ‘labour surplus’ period of economic development. Malaysia became a labour-scarce economy, unemployment fell sharply, and migrant labour inflows began to rise rapidly.

1997-99: Malaysia was one of the four East Asian economies to experience a major economic crisis. The peak to trough deceleration in growth rates was very large, about 15 percentage points. But the crisis was short-lived and nearly V-shaped. The government emerged from this episode with enhanced credentials for macroeconomic management. It was the only crisis-affected economy not to enter an IMF package, and its unconventional (at the time) approach to the crisis was largely successful.

The 2000s: This decade saw the resumption of moderately strong growth, with two external shocks at the beginning and end of the decade, in the

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factors at work in all three events, as indicated also by the slower growth in Singapore and Thailand (see Figure 2).

context of major policy concern about upgrading, much lower investment rates and a somewhat unsettled political environment.

There is some debate about productivity trends. Labour productivity across the three main sectors has grown quite strongly in most decades, with industry (broadly defined) generally recording the fastest growth (Table 2). But estimates of total factor productivity (TFP) growth vary, depending as usual on methodologies and what remains as unquantifiable in the 'residual'. In the original Krugman-inspired debate about 'perspiration versus inspiration' in East Asia, Malaysia appeared to be Singapore-like, with low TFP growth. These results appeared intuitively plausible in view of the very high rates of investment and labour force growth. More detailed country work has sometimes supported this conclusion. For example, through to the early 2000s, Mahadevan (2007, p. 39) concluded that 'the Malaysian economy is very much input-driven and capital input in particular is the driving force of output growth.'[4]

(Table 2 about here)

Rapid Structural Change

Second, rapid economic growth has led to and under-pinned far-reaching structural change in the economy. The major transformation has been the shift from a resource-based economy, in which rubber and tin were the dominant, export-oriented sectors, to large-scale manufacturing. Compared to 1970, agriculture is now one-third of its former share, while industry (broadly defined) has almost doubled (Table 3). The share of manufacturing has risen even faster than that of industry as a whole. Perhaps surprisingly, the service sector share is little changed.[5] Malaysia's richer natural resource endowments result in a larger share of commodity-based sectors than is observed in its resource-poor comparators. At the aggregate three-sector level, the country's structural transformation over the period 1970-2007 is almost the same as that of Thailand, again illustrating the similarity between the two economies.

(Table 3 about here)

The transformation in the composition of merchandise exports has been faster still, with manufactures rising from 6.6% to 61.2% of the total (Table 4). This comparison partly reflects the statistical artifact of comparing value added from the national accounts with gross value of output in the trade statistics, with many of the manufactured exports having thin domestic value

[4] More detailed sectoral work, such as that by Kim and Shafi'i (2009), shows considerable inter-industry variations in TFP growth. However, the short time period of most of these studies cautions against drawing strong conclusions.

[5] Note that these sector shares differ from those reported in Malaysian statistics. The latter classify construction and utilities as 'services' whereas they are generally regarded as 'industry' in international classifications. Hence the service sector share is higher in Malaysian statistics.

added. However, the share of manufactures in Malaysian exports is lower than our four comparators, owing to the continuing importance of commodities, principally now oil and gas.

(Table 4 about here)

A disaggregation of major exports underlines this changing composition (Table 5). In 1970, Malaysia's top three exports at the 3-digit ISIC level accounted for almost two-thirds of total exports, and they were all commodities. By 2008, the share of the top three had halved, and electronics and related products dominated. A similar transformation is evident in the other countries. If electronics were aggregated into one trade group, it could be argued that Malaysia's export concentration has not changed significantly, in the sense that the switch has been from rubber and tin to electronics. But this overlooks the highly diverse nature of the global electronics industry, and the many product and process niches within it.

(Table 5 about here)

Comparative analyses of export structure and performance draw attention to Malaysia's prominence in the vertically integrated global production of electronics products, referred to as 'fragmentation trade'.[6] Among 'developing economies' (that is including the four Asian NIEs), Malaysia has steadily progressed up the ranks of significant manufacturing exporters: from 15th ranked and 1.2% of the total in 1969-70 to 8th ranked and 3.8% in 1989-90, and 5th ranked and 5.2% in 2006-07. In the latter year, for example, with the exception of China, it was well ahead of all the so-called 'BRIC' economies, not to mention aspirants to this club such as Indonesia, South Africa and Thailand. Malaysia is ranked more highly still in global trade in parts and components. Here it has benefited from its traditional openness, its aggressive early-mover advantage in the early 1970s, and the proximity to Singapore, both as a model to emulate and as a destination for lower end activities as Singapore graduated into higher value added activities in the 1980s.[7] In 2006-07, for example, Malaysia's global share of parts and

[6] See in particular the work of Prema-Chandra Athukorala, for example Athukorala (ed, 2010). See also Yusuf and Nabeshima (2009) for a detailed Malaysian study, with regional comparisons. The figures in this paragraph are from Athukorala and Hill (2010).

[7] In passing, the reference to Singapore draws attention to the highly complex relationship between these countries that were briefly one. Although the political relationship has been occasionally fractious, the economic benefits for Malaysia have been unambiguously positive, principally in the two dimensions referred to in the text. That is, the numerous demonstration effects that result from clever policy (for example, in world-class infrastructure, R&D programs, managing the MNE presence), and the spillover effects from Singapore's dynamism and upgrading. It is true that there has been a continuous brain drain to and through the island state, but much of these flows stay within the region, and some return to Malaysia with augmented skills.

components exports was 3.8%, higher than any other ‘developing economy except for China (10.9%) and Korea (4.9%).

Stepping back from the statistics, this structural change has been driven primarily by rapid economic growth and changing comparative advantage, in the context of global changes in production and distribution systems. In addition, three sets of domestic policies have shaped the transformation. First, trade policy has protected some heavy industry sectors (principally steel and autos) and food crops (mainly rice), resulting in slightly larger sectors than would otherwise be the case. Perhaps the same could also be said for services, since the government has been slower to liberalize this sector, although this may also have retarded the internationalization (and hence growth) of certain service sector activities (see Tham and Loke, chapter 8). Second, and related, industry-specific policies have played a minor part in the process of structural change. Successive Malaysian governments have adopted a largely passive approach to industry policy, with the conspicuous exception of the costly failures in autos and heavy industry.[8] In the most successful export-oriented industry, electronics, the government has facilitated the supply of the key ingredients of good infrastructure, a flexible labour market, a stable regulatory environment, and openness to trade and investment. But as Rasiah (chapter 9) shows, most of the innovation in the industry comes from foreign firms, with few cases of successful domestic innovation. A third policy factor is the very open labour market, particularly from the late 1980s. This has prolonged Malaysia’s specialization in labour-intensive activities beyond what would have otherwise been the case, and hence delayed the process of industrial upgrading (see Jones, chapter 12).

Consistent Openness

The third stylized fact is that Malaysia has always been one of the most open economies in the developing world. Few developing economies can match this record, as the comparative ‘always open’ indicators developed by Sachs-Warner illustrate (see also Menon, 2000). This openness applies especially to merchandise trade, labour and FDI, and to a lesser extent services trade. Table 6 provides four widely used indicators of openness that measure the country’s strong international orientation. It is more open than China, Korea and (marginally) Thailand on trade policy (both ‘revealed’ and actual) and FDI. According to a widely used ranking of economic freedom, Malaysia is comfortably in the top half, but lower than in other comparisons, presumably because of the NEP restrictions on business.

(Table 6 about here)

Malaysia’s trade regime has always featured low average tariffs, fairly low dispersion of tariffs, and limited resort to NTB’s (Ariff, 1991; Ramasamy and

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[8] In passing, the disappointing outcomes from the 1980s industry policies contrast notably with the earlier, highly effective agricultural innovation initiatives where Malaysia led the developing world as an efficient tropical cash crops producer, especially in rubber and palm oil (see Barlow, 1997).

Yeung, 2007). The principal exceptions, heavy industry, automobiles and some food crops, have all been highly visible, and the former two contentious. The export sector has been largely insulated from these distortions owing to the effective operation of export zones and other arrangements. (Nevertheless, it has resulted in some measure of industrial dualism among firms inside and out of these zones.) Some of the heavy industry has been state-owned, which explains both the durability of the protection and the fact that some of it has taken the form of direct subsidies rather than simply import barriers.

Malaysia has also been very open to foreign investment (FDI), especially for export-oriented manufactures, with relatively few restrictions and easy repatriation of profits. Although not in Singapore's league, it has the highest stock of FDI to GDP among the other three comparators (Table 6). Moreover, the imposition of controls over the short-term capital movements in 1998 did not interfere with this openness to FDI. Thus it has enjoyed a significant early mover advantage, following Singapore in the early 1970s into MNE-dominated electronics for export. In this respect, also, the policy regime has hardly wavered. The FDI regime has not been as open for import-substituting manufactures, and for services, especially in the latter case where GLCs (government-linked corporations) are involved, or vested interests have impeded liberalization (see Tham and Loke, chapter 8).[9] In some respects, one might even argue that the FDI regime has been 'too open', in the sense that the regulatory agency, MIDA, the Malaysian Industrial Development Authority, has consistently provided very generous fiscal incentives, in part presumably to compensate for the absence of policy reform in the heavily protected sectors. Malaysia has also become a significant outward foreign investor, second only to Singapore in Southeast Asia.

Malaysia's labour market is one of the most open in the developing world. In 2009, there were officially estimated to be about 1.9 million foreign workers, and an additional 0.6 million illegal migrants. This represents almost 25% of the workforce. Its two lower-income neighbours, Indonesia and the Philippines, supply about two-thirds of the foreign workers, most of who are unskilled or semi-skilled. There continues to be a debate about the merits of this policy (Jones, chapter 12). On the one hand, it could be interpreted as an indicator of development success, that so many workers flock to the country. It adds flexibility to factor markets, and it augments the workforce without the corresponding requirements for social expenditure. It also contributes to labour welfare in lower income ASEAN neighbours. Moreover, as Singapore has shown, upgrading can occur in the context of a very open labour market. In a segmented labour market, low-skilled migrant workers can augment the workforce participation of skilled workers by lowering the costs of services, for example such as the increased availability of domestic workers releasing well-educated parents into the workforce. But there need to be incentives for firms to undertake the upgrading, and these have been largely absent in Malaysia until recently.

[9] Although dated, Salazar's (2007) comparative study of the political economy of telecommunications reform in Malaysia and the Philippines remains instructive, on why and how Malaysia was slower to liberalize.

Malaysia's openness is central to an understanding of the political economy of the country's broader economic development path, in at least three respects. First, the continuing openness in part reflects the country's good macroeconomic management. That is, Malaysia has mostly avoided balance of payments crises, that elsewhere have led to 'temporary' protection that in turn was quickly embraced by powerful vested interest groups and therefore became permanent. Second, this openness has always placed a discipline on political excess and policy error. The presence of a large export sector with a fundamental imperative of international competitiveness, for example, exposes the protected sectors, and it requires at least reasonably efficient government operations, infrastructure and financial services. A third illustration is the connection between trade policy and NEP objectives. That is, since much of the domestic economy continues to be dominated by non-Bumiputera interests, the political pressure for protection from within the dominant UMNO party has always been minimal (Lee, 1986), with the result that most of the redistributionist business measures have been confined to non-tradables, in addition to the share allocations and employment quotas.

Competent Macroeconomic Management

Fourth, Malaysia has rarely encountered serious macroeconomic problems. Inflation has almost always been low, typically less than 5%, apart from a brief spike during the early 1970s oil crisis. The country has had few major fiscal crises, and the cases of very large fiscal deficits, such as the early 1980s, have been brought under control. Apart from the special, and short-lived, case of 1997-98, Malaysia has never had a balance of payments crisis. Consistently high savings rates have to some extent 'insulated' the economy from potential debt problems, both external and public. The key economic policy institutions, particularly the central bank, Bank Negara Malaysia (BNM), have a well-deserved reputation for policy credibility (Kwek and Yap, chapter 5), and the country has generally been able to borrow internationally without difficulty. It is also one of the few developing economies never to have to go cap in hand to the Bretton Woods institutions, including conspicuously in 1997-98. We now briefly examine these features of macroeconomic management.

First, inflation has always been low, except briefly during the 1970s commodity price booms, when monetary policy instruments were not developed to handle these shocks (Figure 3). This record is 'Singapore like', and along with openness it is one of the principal common elements that unite these economies, reflecting their shared monetary policy history. Second, as a result of these macroeconomic outcomes, the exchange rate has been remarkably stable (Figure 4). The Ringgit has been closely aligned to the US dollar, as a de facto nominal anchor, apart from the special case of the 1997-98 crisis, which effectively resulted in a one-off devaluation of over 50% against the dollar.

(Figures 3 and 4 about here)

Malaysian debt levels have always been manageable and generally comfortable. There have been two instances when external debt rose sharply, but both were handled effectively. In both cases, the external debt ratio was approximately halved within about five years of the peak (Figure 5). In the first case, the Malaysia government entered the 1970s virtually debt free, but debt began to build up rapidly, from 10% in 1970 to 100% in the mid 1980s (Figure 6). This was initially the era of very high commodity prices, and the subsequent need to recycle the petro dollars. Malaysia was an attractive borrower, and with the adoption of the NEP objectives the government had an ambitious development agenda (Athukorala, chapter 4). Malaysia ran sizeable current account surpluses in the late 1970s, but these quickly turned to deficits in the early 1980s, as commodity prices began to fade and then fall sharply. There were also, suddenly, very large fiscal deficits from the late 1970s (Figure 7). Both external and public indebtedness more than doubled in the first half of the 1980s, and could well have triggered a serious debt crisis, of the type that occurred in many other natural resource exporters at this time.

(Figures 5-7 about here)

Five factors explain why Malaysia did not experience such a crisis in the 1980s, either externally or with respect to public debt. First, the government very quickly reined in its alarmingly large fiscal deficits (Figure 7). Second, the high level of international trade in the economy meant that its debt service ratios remained quite low. There was therefore never a serious debt-service problem. Third, the government's general macroeconomic policy credibility enabled it to continue to borrow abroad. Fourth, the government was able to reduce public debt in the late 1980s quite quickly through an extensive program of privatization, even though some of these transactions merely converted federal government debt into broader public sector debt, and the enterprises were generally sold on preferential terms to the politically well connected, to shore up its support within elite Bumiputera circles (see Gomez and Jomo, 1999; Tan, 2007). Fifth, for reasons to be discussed shortly, savings rates have been consistently high (Figure 8), enabling the government to draw on this quasi-captive source of funds.

(Figure 8 about here)

The second case of external debt problems was in 1997-98. The immediate trigger was the collapse of the Thai baht in July 1997, that in turn caused a run on other regional currencies. This resulted in a sharp depreciation of the Ringgit, and exposed the currency mismatch of the country's external borrowings. Over the preceding decade, fiscal policy had become progressively more prudent which, combined with the restoration of growth, resulted in surpluses by the early 1990s. The current account had swung into surplus briefly during the mid 1980s slowdown, but then returned to large deficits from the late 1980s, as a result of strong economic growth and large capital inflows, especially in the wake of the Plaza Accord currency realignments. The result was that, in the period leading up to the AFC, public debt to GDP fell sharply, to less than half the mid 1980s levels, while external debt to GDP stabilized at about 40%, with the trend current account deficit broadly similar to GDP growth.

The 1997-98 crisis resulted in another sharp turnaround in the balance of payments, as in the other crisis-affected countries, and for similar reasons: imports contracted, export growth accelerated in response to the exchange rate depreciation, and capital flows contracted. The crisis also pushed the budget back into deficit, owing to sharp economic decline, corporate bailouts and social support measures. The curious feature about Malaysia – and also Singapore and Thailand to some extent – is that the resumption of growth from 1999 was not accompanied by a decline in the current account surplus. Figure 8 provides a proximate explanation: investment has remained sluggish for the past decade, at about 20% of GDP, about the same level as in the mid 1980s recession, while savings have remained buoyant. The consequence was the extremely large surpluses, of 10-15% of GDP.

The result has of course been a rapid increase in foreign exchange reserves. These peaked at $126 billion in mid 2008, before running down during the global financial crisis (partly as the authorities sought to defend the currency), then stabilizing at around $100 billion in late 2010. Like neighbouring countries, the Malaysian government has not been unhappy with this rapid increase in these assets, presumably for self-insurance reasons in the event of another crisis, even though the reserves earn very low rates of return. That is, like its neighbours, the government does not have high levels of trust in the international monetary and financial architecture, particularly the role of the IMF. The concern that any crisis management plan would entail major changes in its affirmative action program has also been a major consideration. Relative to the size of the economy, Malaysia's surpluses are in fact larger than those of China, Japan and other economies that are the subject of US accusations of 'currency manipulation'. However, its smaller size means that it will probably be able to continue to fly beneath the radar screen on this issue.[10]

Returning to the savings-investment imbalances, the puzzle then is why investment has remained subdued, a point to which we return in the next section. Lest it be thought of as a Malaysia-specific problem, somewhat similar trends have occurred elsewhere in East Asia. However, Malaysia's fiscal deficits have remained at 3-5% of GDP throughout the past decade, larger than the other crisis-affected economies in the comparison. The country now seems to have the problem of structural fiscal deficits, riddled with poorly targeted subsidies, patronage networks underpinning the public works contracting system, and an unhealthy dependence on oil revenues (Narayanan, chapter 6). We return to these issues in the following section.

[10] There was a clear disagreement between the authorities and the IMF in the latter's most recent report on the Malaysian economy (IMF, 2010), with the IMF arguing that the country's real effective exchange rate is undervalued. It seems unlikely, however, that this disagreement will develop into a more substantial problem of international commercial diplomacy involving the US administration.

The factors behind the three crisis events – the mid 1980s, 1997-98 and 2008-09 – and the government's response to them provide an opportunity for a deeper analysis of the quality of macroeconomic management (Athukorala, chapter 4). The most serious economic contraction, during the AFC, has been the subject of two comprehensive and largely complementary studies, by an 'insider' (Mahani, 2002) and an 'outsider' (Athukorala, 2001). Both studies draw attention to the favourable general policy backdrop, but in addition examine the particular strategies developed in mid 1998, and implemented from September of that year. The authors point out that the initial Malaysian response to the crisis was 'IMF like', even though the country eschewed an IMF package, the only one of the four crisis-affected economies to do so, and itself an indication of the country's macroeconomic strengths. They then demonstrate that the package of short-term capital controls and peg to the US dollar was effectively implemented, enabling the government to run looser fiscal and monetary policy than would otherwise have been the case, even though by September 1998 much of the capital flight had already occurred. As a result, Malaysian appeared to recover more quickly from the crisis, aided significantly by the fact that the reflation program appeared to have been undertaken in a reasonably non-political manner. It is impossible to test the counter-factual, that the alternative more conventional policy approach, could have led to similar outcomes. Per capita growth in Malaysia 2000-2008 was slightly lower than that of Korea and Thailand, but that is hardly evidence. Undeniably, the Malaysian government garnered considerable international policy credibility as a result of this policy episode and, as Athukorala (chapter 4) notes, the IMF subsequently recognized its policy achievements.

The government's response to the global financial crisis of 2008-09 was prompt and effective (Athukorala, chapter 4). Unlike the AFC, this was of course a crisis entirely external in its origins, and the transmission mechanism was primarily through the real sector, in the form of reduced external demand. As a very open economy, Malaysian was highly exposed to the sharp decline in international trade in late 2008 and early 2009. The government's response took the form of both aggressive fiscal and monetary policy. A fiscal stimulus equivalent to about 3.2% of GDP was implemented, one of the largest in the Asia-Pacific region. Between November 2008 and March 2009, the key policy rate, overnight interest rates, was dropped from 3.5% to 2%. Statutory reserve requirements were reduced by three percentage points. There were no serious financial sector problems, a testimony to effective financial supervision, which had been greatly strengthened after the AFC. Government deposit guarantees supported this outcome.

Although the economy has recovered quickly from these episodes (Figure 1), at least certainly the first two at the time of writing, macroeconomic management has tended to be reactive rather than pro-active. As Athukorala (chapter 4) observes, the government was hardly the innocent bystander that then Prime Minister Mahathir portrayed the country to be, as he lashed out at assorted evils, including even an international Jewish conspiracy (Wain, 2009). Particular vulnerabilities in 1997/98 included the very rapid growth of outstanding credit, which had risen from 85% of GDP in 1985-89 to 160% in mid 1997, combined with lax corporate governance. This credit expansion had inflated asset prices, as revealed in the fact that the Kuala Lumpur Stock

Exchange then had the world's highest ratio of stock market capitalization to GDP, of around 300%. This resulted from the government's ambitious development program, including some projects of doubtful viability. An additional vulnerability was the rapid build in short-term debt and other forms of 'mobile capital', relative to the size of the reserves. The sudden exodus of this capital in the second half of 1997 exposed this vulnerability. Similarly, there were significant domestic policy factors behind the mid 1980s crisis. In particular, the government had made very little effort to prudently manage the large but temporary windfall revenue gains from the 1970s commodity boom. Indeed, driven by the imperative of the NEP, fiscal policy was decidedly pro-cyclical, with large and rising fiscal deficits being piled on top of the historically high terms of trade.

Returning to the broader narrative, it can also be observed that this broadly competent macroeconomic management, combined with large supply-side investments in infrastructure and education and flexible factor markets, explain why Malaysia has largely avoided the well-known 'natural resource curse' developed by Sachs and Warner (2001) and others. This is the thesis that natural resource abundance frequently results in inferior economic performance: price volatility complicates macroeconomic management, fiscal effort may be weakened, there is a tendency to under-invest in education, and the political economy may come to be dominated by disputes over rent appropriation rather than productivity-enhancing economic reform. From a micro viewpoint, however, Malaysia's environmental management scorecard is a mixed one, according to Hezri and Dovers (chapter 13). Environmental amenities have been under-priced and resources mismanaged, especially in the frontier states of East Malaysia.

One final point to observe on the macroeconomic record is that, as noted above, the consistently high savings have provided a policy buffer, enabling the government to run sizeable fiscal deficits and limiting the dependence on external borrowings. As in neighbouring economies, these high savings rates are explained by a combination of factors (Ang, 2009). These include the virtuous circle of high growth and high savings, clearly defined property rights, a youthful population, occasional fiscal prudence, a trusted financial sector, and an element of compulsion through the Employees Provident Fund.[11] The latter has been mobilized by the government for its own development objectives, arguably resulting in a lower rate of return than would otherwise have been the case. But as we shall argue in the next section, this fortuitous combination of factors is unlikely to be present to the same extent in the coming years.

Social Progress

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[11] The EPF is a mandatory defined contribution scheme for all non-government employees and the self-employed in the formal sector. It currently has about 6 million members, equivalent to approximately half the workforce.

A fifth stylized fact is that social indicators have also improved significantly, but not quite at a pace commensurate with the country's fast economic growth, while inequality remains a major challenge. Independent Malaysia inherited deeply ingrained patterns of inequality, across ethnic groups and regions, reflecting the nature of development enclaves centred on extractive industries and plantations. Its experience bears testimony to the difficulty of overcoming high levels of inequality even when, as in Malaysia, the least privileged ethnic group of society has been in continuous power for over half a century, and made concerted efforts to address the problem. The country's social policies are of great international interest, precisely because it has the developing world's longest running affirmative action program, from which there are clear lessons after 40 years of practice.

The comparative data on human capital and social progress indicate that Malaysia's ranking is about what would be expected on the basis of its per capita income (Table 6). Its human development index (HDI) ranking is almost the same as that for per capita GDP, unlike Korea which significantly 'over achieves' with respect to its HDI, and in contrast to both Singapore and Thailand notably 'under achieving'. Similarly, Malaysia's top-to-bottom quintile income shares are fairly high by international standards, but actually lower than all in the comparison except Korea. However direct comparisons are of limited value given inter-country differences in measurement concepts.[12] With regards to years of schooling in the adult population, it is marginally ahead of China and Thailand, and just below Singapore. The 'quality' indicators look less impressive, being well below Korea and Singapore, and only just ahead of Thailand. However, Korea and Singapore typically rank among the very highest in these test scores.

Ragayah (chapter 11) provides a detailed analysis of poverty and inequality. She rates the reduction in poverty 'an outstanding success', driven by rapid, labour-intensive economic growth. Although pockets of poverty remain, destitution has been all but eliminated at least among its citizens and registered foreign workers. The record on inequality is more mixed. Here, three main conclusions stand out. First, after falling in the early years of the NEP, there has been no major trend in inequality over the past three decades, with small upward or downward movements in inequality more or less balancing each other out. These fluctuations have been determined at least as much, if not more, by external circumstances (eg, rising terms of trade, global economic slowdowns) as by deliberate government policies. Second, there can be no doubting the substantial decline in inter-ethnic inequality, particularly the crucial Chinese/Bumiputera differential. This has fallen sharply, from 2.3 in 1970 to 1.4 in 2009. Thirdly, while there is no clear overall trend in intra-group inequality, that for the Bumiputeras appears to have risen somewhat, consistent with the fact that some of the NEP programs, particularly the share allocations and government contracts, have been awarded to the Bumiputera commercial/political elite (see also Gomez, chapter 3 on this point).

[12] For further analysis of this point, see the discussion in Ragayah, chapter 11, particularly Table 8 and related text.

Can one conclude that the government's affirmative action programs have failed or succeeded? Either case could be plausibly advanced. The former view would point to the absence of any clear trend in inequality, in spite of the overwhelming priority accorded to the NEP and its successor programs, in addition to the rising intra-Bumiputera inequality, and the patronage and corruption associated with it. Proponents for the latter view would point to the absence of serious racial discord since May 1969, and the fact that in most neighbouring countries inequality has risen, whereas it has at least been stable in Malaysia. Moreover, if the primary objective was to narrow the Chinese/Bumiputera income differential, then clearly the policy has succeeded. Clearly the labour-intensive growth path was a key early factor contributing to the moderation in inequality through to the 1980s (Athukorala and Menon, 1999).

One surprising feature of the Malaysian inequality debate is how little the impact of the huge foreign worker presence is analytically dissected. If fully enumerated, which they do not appear to be, an increase in inequality among all residents of the country would be expected, since most of the foreign workers are unskilled or semi-skilled, and take on work shunned by Malaysian citizens. Even if these workers are not enumerated, one might expect some increase in inequality, to the extent that they depress the earnings of unskilled Malaysians. Nevertheless, in a segmented labour market model these effects may be muted by the complementarities foreign workers introduce, in addition to the fact that this in-migration is in the context of a dynamic economy characterized by chronic labour scarcity.

On the education record, Shyamala and Lee (chapter 10) advance three major generalizations. First, education has always been a key priority of Malaysian governments, as revealed in high levels of expenditure and generous scholarship programs. Education was rightly a major plank in the NEP, and there have been impressive improvements in virtually all quantitative indicators. Second, the record on educational quality, the equality of educational outcomes across various socio-economic and racil strata, and by implication the effectiveness with which subsidies have been targeted, are less impressive. There are quite high dropout rates for low socio-economic classes – not all of who are Bumiputera – while pedagogic techniques need to be upgraded consistent with the needs of modern educational practices. Third, and related, there has generally been an over-investment in tertiary education, and a corresponding under-investment in primary education, whereas for both equity and efficiency reasons the reverse priority should be adopted.

With universal primary education achieved, and the country well on the way to high secondary enrolment ratios, attention has turned to the tertiary sector. There has been extremely rapid expansion in public university sector enrolments which, combined with racial quotas and the switch away from English-language instruction, has lowered quality, relatively in comparative East Asian standards, if not absolutely. Perhaps the past emphasis on quantitative expansion was understandable, and there is now scope for more attention to quality. Meanwhile, the deregulation of the tertiary education sector, while inevitably posing challenges in terms of accreditation and quality, has opened the market to major international education suppliers. Several major foreign campuses have been established, the largest by Monash and Nottingham Universities, alongside a rapidly increasing number of domestic suppliers of variable quality. As a result, Malaysia appears to be well positioned to become the Southeast Asian hub for private international tertiary education.

Institutional Quality, Political Economy and Ownership Structures

Sixth, reflecting the country's unique political economy, institutional quality is variable and ownership patterns are unusual. We draw on Nelson (chapter 2), Gomez (chapter 3), together with a range of comparative indicators to draw the following conclusions.

Malaysia's dominant political party, UMNO, is the longest-serving party currently in government anywhere in the world among what may be termed quasi democracies. That is, it has been in continuous power as the major force in the ruling Barisan Nasional (BN, National Front) since Independence. The period could be longer still if one also includes the years immediately prior to 1957, when it effectively governed the country under transitional arrangements. Applying Crouch's (1996) 'responsive-repressive' dichotomy, UMNO can clearly point to the country's creditable long-term economic performance. Regular elections are held, at both the national and state jurisdictions. These are genuine political contests, where the opposition is able to consistently win a minority of seats and (in most years) state governments. The contests within UMNO are reportedly more democratic still. And, as the only federal state in developing East Asia, the states have considerably autonomy,[13] especially the two in East Malaysia, which joined the federation more recently, in 1963, and have constitutionally guaranteed powers of enhanced autonomy.

This continuous political control points both to a mostly weak and divided opposition, and a ruling party that has maintained a ruthless grip on power. Evidence of the latter can be found in the heavily gerrymandered electoral districts, tight restrictions on freedom of expression in university campuses, the government monopoly over the print and communications media,[14] and in extreme circumstances a willingness to employ the oppressive Internal Security Act provisions to silence critics. The country's intermediate ranking on voice and accountability indicators in Table 6, similar to that of Singapore and Thailand, therefore seems appropriate. The characterization of a generation ago, that Malaysia was considered to have one of the more open political systems in developing East Asia, clearly no longer applies, as Korea, the Philippines and Taiwan made the transition from authoritarian to democratic rule in the 1980s, while Indonesia followed in the late 1990s.

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[13] On which see Setapa and Lin (2009) for a recent case study.
[14] Though not, more recently, the internet, including lively sites such as www.malaysiakini.com.

An earlier Malaysian literature posed the question as to whether the country could be regarded as a ‘developmental state’, along the lines of the earlier literature on the four Asian NIEs that highlighted their governments’ single-minded commitment to economic growth, and a propensity to push aside parochial vested interests that stood in the way. The conclusion from that literature (see for example Embong, 2008) was that, while Malaysia shared some features with these states, including export orientation and good macroeconomic management, it also differed in a number of respects. In particular, its governments have been more beholden to vested interests, corruption levels are higher, and public administration capabilities are weaker. Malaysia’s mixed record on industry policy has already been referred to. Its ranking on various subjective exercises referred to in Table 6 is generally similar to that of its per capita income, that is, ahead of China and Thailand, but below Korea and Singapore, in the latter comparison markedly so. There is a widespread perception that institutional quality deteriorated during the Mahathir era, particularly with the politicization of senior levels of the civil service, the judiciary and the universities. Where Malaysian governance quality consistently scores more highly is in areas that are central to running an efficient export-oriented economy. As shown in Table 6, the country’s infrastructure and financial development compares favourably with many OECD economies.

There are few countries in the world where race matters more than in Malaysia. Malaysians take great pride in the fact that, in spite of the very pronounced and continuing differences, there has only once been a serious eruption of race-based violence. The prominence of race is reflected in the fact that all political parties are essentially race-based, and that all key government policies have a racial consideration, many directly in the form of employment quotas, share allocations and university entrance. The civil service has been a vehicle for the objective of ethnic redistribution, with its rapid growth drawn almost entirely from the Malay community. Education has been central to NEP programs. As Shyamala and Lee (chapter 10) observe, ‘the structure of the education system has institutionalized ethnic stratification in education so deeply that ethnicity has become an important and accepted determinant of educational outcomes.’

The interplay of politics, history and race is also reflected in the nature of modern Malaysia’s business sector. As Gomez (chapter 3) shows, three key features stand out. First, there has been a significant redistribution of ownership along ethnic lines. The original NEP document targeted the Bumiputera share to rise from 2% to 30% of the modern commercial sector. The share has risen somewhat less, peaking at about 20% in the early 1990s, and the composition of this calculation is contested, as much depends on how the large Bumiputera trust funds, nominee companies and GLC’s are classified. But a significant increase in Bumiputera commercial participation is undeniable, and a welcome trend. Although frequently overlooked, it also needs to be noted that Chinese commercial participation has risen since 1970, notwithstanding this community’s declining share of the population. This has occurred because the very high foreign ownership share in the early post-Independence period has fallen over the past four decades, enabling the shares of all domestic groups to rise.

A second feature of these ownership structures is their dualism, which result from the country's inherited uneven development patterns and greatly reinforced subsequently by policy interventions. For example, Malaysian business comprises firms in both efficient, export-oriented sectors, such as electronics, cash crops, tourism and (emerging) higher education, alongside those in a range of protected – some would say cosseted – sectors. The latter are typically found in non-tradables activities, such as construction, utilities, domestic trade and protected manufactures. This dualism also has its counterpart in ownership patterns, with foreign and Chinese businesses dominating in the former, and Bumiputera firms (sometimes in the guise of 'Ali-Baba' operations) and GLC's in the latter. This divide also explains the powerful political economy imperative that dictates a continuing large public sector, and the resistance to microeconomic reform. A predominantly Bumiputera civil service regulating a predominantly Chinese or foreign business sector further reinforces this dualism.

Ownership patterns have also been central to the debate about business dynamics in Malaysia, in particular whether its business sector can be characterized as primarily rent seeking or entrepreneurial. As in all countries, the detailed research on the subject (eg, Gomez, chapter 3; see also Searle, 1999) concludes that both characteristics are evident. There has been the spectacular enrichment of government-connected business players, especially during the Mahathir era, where a particular breed of 'can do' businessmen, most but not all Malay, suddenly rose to prominence (Wain, 2009). In addition, and like their counterparts in Singapore, the operations of the large GLC sector are non-transparent in to their funding, subsidies and staffing (Narayanan, chapter 6). Several are large on an international scale, notably the state-oil company Petronas. But overall, in which direction is business traveling along the rent-seeking/entrepreneurial spectrum? Here the evidence is less clear. It may take more than a generation to discern whether the recipients of government largesse in the Bumiputera community will morph into a genuine entrepreneurial class that outgrows its heavy reliance on patronage.

Digging beneath the aggregate indicators of governance quality, including those presented in Table 6, there appears to be a pronounced divide between the macro and micro realms. As Lee (chapter 7) points out, there has yet to be a thorough-going process of microeconomic reform, presumably owing to the political economy constraints that have built up around continuous UMNO government, particularly in its affirmative action measures. Thus, for example, privatizations have generally not been undertaken with a national interest objective being paramount, since firms have not been sold off to the highest bidders. The government has frequently maintained a majority interest, or at least a 'golden share' provision, and the measures thus conflict with the objective of achieving increased efficiency through private sector control. The 'privatized' entities have often retained their privileged market power provisions, further undermining the potential reform dividend. This has been the case particularly in services (Tham and Loke, chapter 8). The government has also been slow to establish agencies that act as an independent arbiter of consumer interests, for example in the fields of competition policy, financial supervision, and cost-benefit analysis of major government projects and policies. The public sector contracting system is notorious for its deeply entrenched patronage.

Several more general lessons flow from this analysis of institutions and ownership. First, as with all governments, successive Malaysian administrations have had to balance the sometimes conflicting objectives of rapid growth and political patronage. Since 1970, for example, the pendulum has swung back and forth between these objectives depending on external circumstances and the political authority of the leadership. Favourable external circumstances, as in the 1970s, led to more vigorous implementation of the NEP goals, while a softer approach was evident during more difficult periods such as the mid 1980s, late 1990s, and currently. A similar calculus has applied in the case of the political authority variable. The implementation of the most recent policy manifesto, the 'New Economic Model' (NEM), introduced in April 2010, will be shaped by these contending influences.

Second, as noted, the fact that Malaysian administrations have never deviated fundamentally from open economic policies is central to understanding a range of policy settings and outcomes. The maintenance of a successful export orientation strategy has in turn required a credible central bank, an efficient financial sector, and good infrastructure, even if patronage politics has intruded extensively into the allocation of infrastructure projects. It has also provided a check on UMNO political excesses, most particularly the various NEP-type programs.

Thirdly, the Malaysian experience has broader implications for the debate about institutions and openness as drivers of economic growth. The notions that 'institutions rule', and openness is a much less important factor, associated with one of the most influential thinkers in the field, Dani Rodrik (eg, Rodrik, ed, 2003), receives at best mixed support. If anything, the Malaysian evidence tends to point in the opposite direction, namely that it is openness that has maintained bureaucratic quality which, in a less open economy could well have undermined by long-term one-party rule and vigorous implementation of affirmative action policies.

Fourth, it might even be argued that it is actually the rarity of major economic or political crises, combined with favourable initial conditions, that explains the absence of major reforms in Malaysia over the past three to four decades. Crises as catalysts for change is one of the conjectures in the comparative political economy literature (see for example Lal and Myint, 1996). The intuition is straightforward – that crises embolden governments and enable them to overcome the build up of vested interests otherwise resistant to reform. Variants of this thesis include, for example, major external threats (relevant for all four Asian NIEs in different guises), political upheaval and the collapse of an old order (Indonesia in the mid 1960s), a looming economic crisis (India in 1991), a recognition that the status quo is unable to deliver on a leadership's development objectives (China in 1978), and the prospect of the cessation of support of a major benefactor (Vietnam in the mid 1980s). As noted, Malaysian history fits none of these typologies, while its two major shocks – the May 1969 ethnic clashes and the 1997-98 financial crisis – were both comparatively short-lived.

(3) Challenges for the Future

The General Context

Explaining the past is much easier than predicting the future. Looking forward, the starting point is that, if history is any guide, Malaysia is likely to continue to be a high-growth economy. A linear extrapolation suggests that it would graduate to the high-income club perhaps up to a decade after the NEM's 2020 target. That is, Malaysia has averaged 3.5% annual growth in GDP per capita since 1980, implying a doubling of real per capita income about every 21 years. Definitions of 'graduation' are arbitrary, but for illustrative purposes the World Bank classifies upper middle-income developing economies as those with a per capita Gross National Income (GNI) in the range $4,000-12,000. Malaysia's GNI in 2009 was about $7,000.

There are at least two broad sets of reasons why this target might not be achieved. First, domestic and international circumstances may change for all manner of reasons. The domestic policy settings may become less development-oriented, there could be some major, destabilizing political events, or – importantly for such an open economy – the international environment could become less favourable. Second, as countries grow, policy settings have to adjust to new development challenges. That is, the formula for development success is a constantly moving target, and policy makers need to have both the will and the capacity to reform and innovate. Since the first factor is more in the realm of crystal ball gazing, we focus here on the second of these considerations.

The international literature on graduation from middle to high-income status is ambivalent, in part because it has been achieved by few countries outside East Asia. In the words of the World Bank (2007, p.1):

> 'History shows that while many countries have been able to make it from low income to middle income, relatively few have carried on to high income. … A lot of complex challenges have to be met, from raising the skills and innovativeness of the labor force to creating sophisticated financial systems, to maintaining social cohesion, to greatly reducing corruption. Without these sorts of tough policy and institutional changes, countries stay where they are, unable to bust out of middle income.'

In thinking about this issue, a number of general considerations are relevant. First, the literature on economic growth, built on the assumption of 'convergence', does not shed much light on an understanding of these issues. Empirically, the gap between high and low income countries over the past two centuries has widened rather than narrowed (Maddison, 2006). In principle, the notion of conditional convergence is of greater relevance, but there is hardly a consensus in the economics profession as to what constitutes these conditioning factors. Arguably the major contribution of this literature is the proposition that the potential upper bound of economic growth is likely to slow as countries approach the frontier of global per capita income. This consideration is obviously not relevant to Malaysia currently.

Second, the international literature on growth dynamics and changing economic fortunes is also of limited relevance. One strand has examined the experience of countries experiencing long-term stagnation, or at least slipping significantly in economic rankings. Examples include Argentina's decline from global pre-eminence back to middle-income status during the 20th century, New Zealand's slip from the top to near the bottom of OECD rankings since the 1950s, and Japan's sudden transition from hyper-growth to two decades of stagnation. An alternative strand of literature has looked at turning points in economic development, where countries' economic growth rates have been elevated durably and significantly. The major Asian examples have been Korea and Taiwan in the early 1960s, China in 1978, Indonesia in 1966, Vietnam (and the smaller Mekong economies) in the mid 1980s, and India in 1991. While these experiences are profoundly relevant in understanding economic development dynamics, they shed only limited light on the question of graduation. These major turning points were generally associated with major liberalizations of the kind that Malaysia has never had to undertake.

Third, as a 'follower' country, Malaysia has much to learn from the development success stories, especially recent cases of spectacular growth in the neighbourhood. Nelson's comparative analysis (chapter 2) of the political economy dimensions in Korea and Taiwan is instructive in this respect, particularly that economic and political liberalization went hand in hand. The obvious caveat in these international comparisons is that each country's development trajectory is to some extent sui generis. For example, the five original Asian success stories were all resource poor economies. They forged their export-oriented strategies during a period when there was much less export competition, notably from China. (Although conversely the global market for manufactures was then much smaller.) And none had to contend with the delicate ethnic considerations that so dominate Malaysian development priorities. More generally, as Harberger (1984, p. 427) has reminded us, '... there is no magic formula [for economic growth] – no combination of one or two or even ten or twelve policy buttons that, once pushed in the right order, will guarantee economic growth.'

One strand of literature that is relevant to the challenge of Malaysian upgrading comes from what is generally referred to as evolutionary economics, developed for example by Richard Nelson and others (see for example Nelson (2008), the source of the quotes below).[15] The key to catch-up is innovation, 'learning to do effectively what countries at the frontier have been doing, often for some time.' (p.16) Compared to the earlier success stories of Korea and Taiwan, the challenge is both easier and harder, Nelson argues. It is easier in the sense that the body of codified knowledge underlying most technologies has become much stronger than was the case

[15] An approach to this issue that focuses primarily on political economy considerations but is nevertheless complementary to that of evolutionary economics is provided by Doner (2009), who examines why Thailand is similarly struggling to upgrade its industrial structure.

30 years ago, and it can also be accessed through training in advanced sciences at leading universities through the world. But in some ways it is also harder. There is arguably a greater need to build up indigenous skills and capacity in engineering and science. Two of Nelson's observations are particularly relevant to Malaysia. First, 'catch up will be impossible unless a country builds up its education system from bottom to top.' (p. 16). Second, the process of catch up entails rapid structural change, including sometimes a painful process of creative destruction as older firms and technologies are swept away. This may be difficult in view of the 'political power of old firms. … For comfortable, politically well-connected old firms, creative destruction is not a welcome thing.' (p. 17)

The Malaysian Context

In addition, several specific comments on the Malaysian context are relevant. First, in any discussion about 'new economic models', Malaysia has some obvious strengths that do not require any fundamental modification. These were alluded to in the previous section: the largely open economy, the effective monetary policy, the good infrastructure, the commitment to universal education (though with caveats below), the attention to large inter-ethnic income gaps, and the pragmatic response to economic crises.

Second, the international economic environment is likely to continue to be largely benign for Malaysia, as arguably it always has been. In particular, Malaysia does not face any serious external constraints on its 'policy space', in the sense that, within the obvious dictates of international competitive pressures, its government is relatively free to adopt its preferred policies. For example, as noted above, the government has never had to seek support from the IMF, and hence be subject to its dictate, even during the 1997-98 crisis. It has also been largely unconstrained by the World Trade Organisation, with its actual tariff rates being well below its bound rates. Perhaps the only trade policy constraint has come through AFTA, and even there in the relatively minor (and arguably beneficial) case of competition from the Thai auto industry. Some of the bilateral trade and economic partnership agreements currently under negotiation may also have more demanding requirements. Nelson (2008) puts it aptly: while globalization has affected many aspects of Malaysian society and policy, the country's '… economic policy space has been surprisingly unconstrained by globalization pressures.' The fact that the country has been able to maintain its 'policy autonomy' reflects of course the past policy successes, particularly its open economy settings and effective supply-side investments.

Of course, global competition is likely to intensify, particularly from efficient lower wage economies such as China, India and Vietnam. But this competition is a useful discipline in prodding the government to accelerate reform. Moreover, the rise of China is not a zero sum game proposition, with as many commercial opportunities as challenges. Malaysia faces increased competition in third country markets, but there is also a China locomotive effective, providing cheaper manufactured products, and increasing the demand for both Malaysian natural resource exports, and its export-oriented manufactures within increasingly China-centred global production networks.[16]

Third, while structural change and sector shares are of no great normative significance, Malaysia is likely to become an increasingly service-driven economy. Its manufacturing share in GDP is already high by international standards, and the rising service sector share is consistent with increasing per capita income. A declining manufacturing share is no cause for concern, except insofar as it might be indicative of a 'competitiveness' problem, as in the case of Malaysia's automotive and heavy industries. The trend towards a services-based economy will however put pressure on some service industries, as the government has been slower to open up these industries, and the NEP contract system plays a larger role in services than other sectors.

Fourth, although it is an overstatement to assert that Malaysia's growth rate has dropped below historical standards – per capita growth in the 2000's and 1980s is very similar – as noted above (Figure 8) investment levels have declined significantly since the Asian Financial Crisis. Although a similar trend is observable elsewhere in the region, Malaysia appears to have experienced the sharpest decline in East Asia.[17] Given the continuing high savings rate, the series of exceptionally large current account surpluses transformed the country's net external position rapidly: relative to GDP, in 2002 there were net external liabilities of 35%, while in 2008 there were net external assets of 20% (World Bank, 2009).

Why has investment declined significantly, and is it of concern? There are a number of possible explanations. First, the decline could have reflected a return to more 'normal' investment levels, as economic growth also slowed. This is partly the case, as Malaysia (like Thailand) was arguably over-investing in the mid 1990s boom. It had one of the highest investment rates in developing East Asia in 1995, including no doubt some mega projects of doubtful economic viability. Moreover, there has been something of a reverse accelerator effect, as slower growth called forth less investment, and firms ran down inventories. Nevertheless, on some plausible assumptions about capital-output ratios, Malaysia's investment rate is now 'too low' to support the government's ambitious growth targets. Moreover, the effects of the growth slowdown on inventory accumulation should have worked their way through within a few years after the AFC.

Second, it might be argued that 2008 and 2009 were aberrant years, owing to the global financial crisis, or that the current lower rate reflects Malaysia's economic maturity in the transition to high-income status. Neither of these statements is correct: the rate has been low throughout the past decade, and Malaysian per capita income is still well below OECD levels.

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[16] See Ianchovichina et al (forthcoming) for estimates of some likely orders of magnitudes.
[17] The Economist, January 23, 2010 also drew attention to this issue.

Third, were the recent years atypical in other respects? It is difficult to think of any major negative external factors operating, at least prior to the global financial crisis. For most of the 2000's, the external environment was favourable, with a buoyant international economy, rapid growth in the electronics-based global production networks, and high commodity prices.

Fourth, the investment slow down might be attributed to a fiscally more constrained government, which in the early 1990s had embarked on major investment projects, such as the construction of the Petronas twin towers, the new capital Putra Jaya, and other major infrastructure developments. Hence this engine of growth is now much diminished. However, this does not appear to be a major factor, as the ratio of public investment to GDP has remained fairly stable throughout the period. Growth is slower, but the fiscal surpluses of the 1990s have given way to continuous and sizeable deficits.

Fifth, almost the entire decline in the investment/GDP ratio has in fact occurred in the private sector. As the World Bank (2009, p. 53) observes: 'Malaysia's large private surplus on the current account suggests that investors find it more attractive to invest overseas than domestically.' If the latter explanation is correct, then the solution is to address those aspects of the domestic investment environment where Malaysia is slipping behind competitors. The remainder of this chapter therefore focuses on these challenges.

<u>Key Challenges</u>

In light of this discussion, we conclude with an analysis of the three interrelated factors, microeconomic, macroeconomic, and distributional, that are central to the Malaysian graduation challenge. All are obviously deeply embedded in the country's political economy structures.

<u>Upgrading and innovation</u>: First, and linking the prognosis back to the framework developed by Richard Nelson, innovation and the capacity to tolerate and manage 'creative destruction' are key determinants of the speed with which Malaysia can upgrade. This is a public policy domain where Malaysian governments have found it difficult to reform decisively. Domestic firms have generally been slow to innovate and extract benefits from the large MNE presence, while the country does not score highly on various innovation indices, such as that developed by the World Bank (see Yusuf and Nabeshima, 2009). Consistent with the eclectic view of technological change, a wide range of factors is relevant in thinking about the obstacles to intensified innovation activities.

The first is the government's commitment to formal R&D programs. The public R&D effort is a modest one in comparative perspective, well below that of China and the NIEs (Table 6). Yet, from a low base it has been rising quite quickly, and is approaching 1% of GDP (Rasiah, chapter 9). The effectiveness of this expenditure is unclear, but a strong basic research culture in the public sector has not yet been established. On industry policy more generally, as noted Malaysian also has a mixed record, with successes in agriculture but disappointing results in industry. For example, in the 1970s

Malaysia might have been expected to become Southeast Asia's leading automotive producer. However, in spite of its initially weaker industrial base, Thailand has assumed that role, owing to Malaysia's (and Indonesia's) ill-fated, inward-looking national car projects and protectionism.

Second, the quality of the university system is central to the process of industrial upgrading. Here also the outcomes are mixed, as noted in the previous section (Shyamala and Lee, chapter 10). Malaysia was once arguably the leader in Southeast Asia. Its public universities are relatively well resourced, and the government has been generous in the provision of scholarships for Malaysian students abroad. The country is now positioned to be the Southeast Asian leader in the rapidly growing international education industry. Nevertheless, Malaysian universities do not rank highly in East Asian or international comparisons. Until recently, the incentives for excellence in research and teaching have been weak. Universities appear to have become somewhat politicized in their management and promotion procedures. The vice chancellors of all the public universities are from the Malay community. Their management is heavily influenced by a public service culture. There is a mismatch in the output of graduates, with large numbers of humanities graduates, many of who eventually become civil servants, alongside serious skill shortages in the private sector. There do not seem to be many innovation synergies and clusters with the private sector. The language policy has cut the universities adrift from the international intellectual mainstream.

Third, it is frequently argued that the heavy dependence on foreign labour has discouraged innovation and upgrading, since employers have little incentive to invest in skills. Nevertheless, the government has been increasing the levy on foreign workers and, as argued above, in some circumstances they could be complements to upgrading. Moreover, Singapore has managed upgrading successfully while maintaining a very large foreign worker presence, many of which are unskilled (Jones, chapter 12).

Fourth, Malaysia has an unusually large GLC sector. Have these firms acted as 'technological innovators'? Given their broader social missions and longer time horizons, this might have been expected, especially among the larger ones, such as Petronas, that is reportedly a well-managed, professional organization. Some of them have been generous in their provision of scholarships for Malaysian university students. But it is also well documented that the GLC's have been instruments of political patronage (Gomez and Jomo, 1999). Their operations are generally opaque, and we lack detailed case study evidence on whether they have fulfilled any broader technological missions. The GLC's domination of many service industries, and the government's consequent reluctance to liberalize (see Lee, chapter 7), has resulted in Malaysia missing out on many commercial opportunities in the fast-growing international services trade (Tham and Loke, chapter 8).

Fifth, it is not clear how, if at all, the pursuit of NEP-style policies has affected firms' technological behaviour. According to one influential school of thought, the Industrial Coordination Act has inhibited firm dynamics. This is because the many Chinese-owned SMEs and family enterprises prefer to remain unincorporated and below the size threshold above which the ICA employment quota provisions apply. Thus innovation and spillovers from the MNEs are less than what they might otherwise be, owing to this ceiling on their expansion. We are unaware of any detailed case study research on this topic, perhaps owing to its political sensitivity, so this remains a working hypothesis for future researchers.

More generally, one wonders whether the large-scale patronage associated with the affirmative action programs has fundamentally altered the commercial calculus of the Malaysian corporate sector, towards rent seeking and away from entrepreneurship. Many of the country's largest companies owe their existence to selective government support (Gomez, chapter 3). And yet it is important not to forget the country's commercial openness, and also the rapidly rising levels of investment abroad. Both these factors limit the general applicability of the patronage-driven model. Moreover, even in the protected non-tradables sectors, there have been some notable successes, such as Air Asia, Southeast Asia's leading budget airline.

Sixth, in spite of the large investments in education, Malaysia continues to lose talent. The loss of the highly educated from developing countries is of course a global phenomenon, as skilled labour markets become increasingly globalized, and OECD countries with ageing populations open up their labour markets. A key consideration is whether the out-migration is permanent or temporary. As the earlier experience of Korea and Taiwan illustrates, the educated may move abroad for extended periods, acquire education and skills, and then return home to a more comfortable environment in a now higher-income country that needs their skills. How much of Malaysia's out-migration is one-way movement by disaffected non-Bumiputeras, for the reasons articulated by Wing Woo above? There are no comprehensive data. But impressionist evidence suggests the outflows are substantial, and mostly one-way.

Seventh, a modern advanced economy requires high-quality, politically independent regulatory agencies and commercial/legal infrastructure, to guard against the abuse of monopoly power, to nurture the dynamic start-ups, to protect consumers, to advance the analytical case for national interest considerations, and to protect citizens from arbitrary government actions. How does Malaysia measure up, recognizing also that many rich countries do not perform well on this scorecard? The comparative indicators presented in Table 6 suggest that Malaysia performs quite well, at about the level expected for its per capita income. In the specific area of microeconomic reform, there has been some progress (Lee, chapter 7). Yet there is concern about the legacy of continuous one-party rule for over half a century, resulting in an Olsonian 'sclerotic' society, of powerful vested interests impeding reform.

Has Malaysia, from a position of strength, lagged in its institutional development since the 1970s? There is evidence to suggest that it has. There is the build up of powerful vested interests around the government contracts, the share ownership allocation system, and the extensive public subsidies. There is a widespread view that the independence and integrity of the judicial system has been weakened. Attempt to develop arms-length, independent regulatory institutions in the public sector, such as a competition commissions to check the exercise of monopoly powers, in addition to regulatory reform more generally, have progressed slowly. There has been limited reform of the large GLC sector, and there is little public information available on their performance against clear benchmarks. Also, how does the civil service perform against international yardsticks, and is it recruiting the 'best and brightest' regardless of background? Here too the evidence is mixed, given the pressure on the government to find employment for the large cohort of Bumiputera graduates who lack the skills needed by the private sector (Nelson, chapter 2).

Macroeconomic management: Malaysia's macroeconomic policy challenges are intensifying. Its acknowledged strengths of low inflation and a comfortable external payments position are not under threat. But there are major fiscal policy issues, and there is little evidence that the government is adopting a more pro-active approach to macroeconomic management, including preparedness for major financial and macroeconomic crises.

As noted above, Malaysia has a credible history of pulling back from threatening macroeconomic scenarios. Federal debt is about 55% of GDP, modest by OECD standards. In addition, a substantial proportion is domestically financed owing to the high savings rate, hence reducing the likelihood that any fiscal difficulties would develop into a balance of payments crisis. Nevertheless, there has been very little structural reform of government finances (Narayanan chapter 6; see also World Bank, 2009). First, fiscal policy has generally not been counter-cyclical, thus limiting its effectiveness as a tool for macroeconomic management. As noted, the government introduced effective fiscal stimulus measures in 2008, but it had been running deficits throughout the period since 1998, well after the recovery from the AFC. Second, subsidies are equivalent to about 20% of government revenue and are poorly targeted. An 'entitlement culture' has developed, particularly in the Bumiputera community, which renders reform of these subsidies difficult, particularly when, as currently, there is a fierce contest for this community's political support. Third, fiscal incentives and tax loopholes are provided liberally, without much conditionality. They have come to constitute a de facto industry policy, without the analytical apparatus to conduct such a policy. Fourth, the government has become heavily dependent on oil and gas, now about 40% of total revenue, but these flows will start to decline within a decade. Fifth, there are what Narayanan refers to as 'institutionalized leakages' in the budget. While the large public works projects have contributed to the country's competitive ranking on comparative infrastructure indicators, the decades-long cost-padding associated with them has also become deeply embedded in the UMNO patronage networks, and is thus essential for the party's survival. In this latter respect, UMNO shares much in common with Japan's Liberal Democratic Party. Sixth, the large GLC sector remains largely outside public scrutiny and accountability, and an annual integrated set of accounts for each entity is not presented. The system is almost certainly riddled with cross subsidies, with profitable GLCs such as Petronas financing the operations of the unprofitable corporations.

To address the large projected fiscal deficits under 'business as usual' scenarios, in 2010 the government brought forward its long-standing intention to introduce a value added tax. While reform of the indirect tax system is desirable, and the initiative received an in-principle endorsement from the IMF (2010), Narayanan persuasively argues that a fundamental reform of revenue and expenditure measures should have preceded the introduction of the tax.

In the coming years, therefore, the government will have to make some tough fiscal policy choices. Its fiscal room to move is becoming increasingly constrained, not just by these unsustainable expenditure commitments, but also by the slower rates of economic growth, the delayed effects of the fertility transition, and a still relatively young retirement age for public sector workers of 58. Malaysian will be one of the last developing Asian country to face the demands of an ageing population, but within about a decade it will begin to make the transition from ‘demographic dividend’ to ‘burden’ (Jones, chapter 12).

By contrast, the monetary policy challenges are less serious, and more in the realm of fine-tuning a system that has served the country well since Independence. Kwek and Yap (chapter 5) lay out several interrelated elements of the reform agenda for BNM. The first is that its inflation indicator could be more transparently justified, and ideally calculated by an independent agency such as the Department of Statistics. Second, BNM has yet to publicly embrace inflation targetting as its primary objective, even though in practice it appears to adopt such an approach. Its inflation credentials are as noted impressive, but the ambiguity creates uncertainty in financial markets. Third, greater public accountability is seen as desirable, perhaps taking the form of common international practice such as a six-monthly report to parliament. Fourth, more generally, although BNM is regarded as a credible institution, steps should be taken to formally guarantee its independence from the executive, consistent with modern monetary policy practice.

<u>Social policy and affirmative action</u>: Thirdly, what is the future of the NEP and affirmative action policies? No other developing country can match Malaysia for its deliberate and consistent commitment to redistribution since 1970. And as Ragayah (chapter 11) clearly shows, the policy has been very successful in meeting the objective of narrowing the income gap between the Chinese and Malay communities. But this outcome has not been without significant costs, as the preceding analysis has argued. Meerman (2008) provides a balanced assessment of the NEP. Noting Malaysia’s ‘remarkable success’, he nevertheless worries about the strategy’s ‘high costs in financial losses’, and the ‘accelerated deterioration of institutions in public life and workplace behaviour’. More broadly, the ascendancy of ‘… patronage politics and the legitimacy of rent seeking rather than productive behaviour may be taking its toll in national unity, as well as slowing economic development …’

Ragayah (chapter 11) provides an authoritative analysis of the social policy reform agenda. She argues that the NEP approach needs to be redefined so that it focuses on deprivation and destitution regardless of race or religion. There are obvious gaps in the current race-based policies, most obviously among the poor rural Indian community, and also those in East Malaysia. The subsidies also need to be better targeted within the Bumiputera community, to explicitly address what appears to be widening intra-group inequality. Education and other public goods will be the most effective vehicle to achieve these goals. The creation of a 'rentier' class of Bumiputera business people may have been inevitable in the early years of the NEP, but a sunset clause is now long overdue.

The political economy of this reform agenda is deeply complex. How it is packaged and sold to the Bumiputera community will be crucial. Affirmative action is an article of faith among this community. The traumatic events of May 1969 are embedded in the nation's psyche. Attempts to formally dismantle the program will therefore be bitterly contested. Moreover, it needs to be remembered that the nation's demographics have changed dramatically since 1970, owing to pronounced ethnic differences in fertility and migration.[18] The precise numbers depend on definitions, but the general picture is that the Bumiputera share has risen from just over half of Malaysia's population to a likely three-quarters within a decade. Affirmative action targeted at the great majority of the population is an oxymoron. But given the sensitivities, reform will have to be about repackaging the measures as part of a 'pro-poor' strategy, not their abolition.

Moreover, political reform is about much more than just the ethnic dimension. Continuous one-party rule for over half a century has bred complacency and arrogance in government, and the disaffection is certainly not just confined to the Chinese and Indian communities. The past two decades have witnessed the emergence of a well-educated Bumiputera generation, many of whom have lived and studied abroad, are aware of the democratic transitions elsewhere in the region, and are not connected to the UMNO patronage networks. The presence of a genuine political contest has transformed the Malaysian political landscape. The March 2008 general elections saw the BN lose its crucial two-thirds majority in parliament, in addition to which five states (subsequently reduced to four) came under opposition rule. A unifying, charismatic if controversial opposition leader, Anwar Ibrahim, constitutes a genuine threat to the government, provided he can both maintain the unity of his unwieldy coalition and overcome a serious, bitterly divisive legal case. This political contest may proceed for years, with uncertain socio-economic consequences: will it lead to concerted economic reform to lift economic growth and living standards for the middle class, or will it lead to continuing policy uncertainty, declining investment and ever more pervasive patronage politics?

These challenges call for far-sighted, unifying national leadership, and reforms that go to the heart of national identity and social cohesion. There is increased urgency in the national discourse. The country's pre-eminent

[18] Detailed migration statistics by ethnicity are not publicly available, presumably owing to the sensitivity of the issue. But the flows in both directions would certainly increase the Bumiputera share of the population. That is, the Chinese and Indian communities are disproportionately represented in the outflows, while many of the immigrants eventually become citizens, and Indonesians are by far the most numerous in this group.

historian, Professor Wang Gungwu (2010, p. 40), recently referred to the widespread concern that '… communalism is getting worse and … there is a lack of communication between the communities. The lack of trust is growing. … People are moving away from that ideal.' Time will tell whether Malaysia's current leadership, particularly its Bumiputera leadership, is up to these daunting challenges. Malaysia is at the cross-roads, and the next few years will be crucially important in determining which way the country proceeds, towards institutional renewal, economic policy reform and higher living standards, or relatively comfortable middle-income stagnation. The past provides the basis for a measured optimism that it will more likely be the former.

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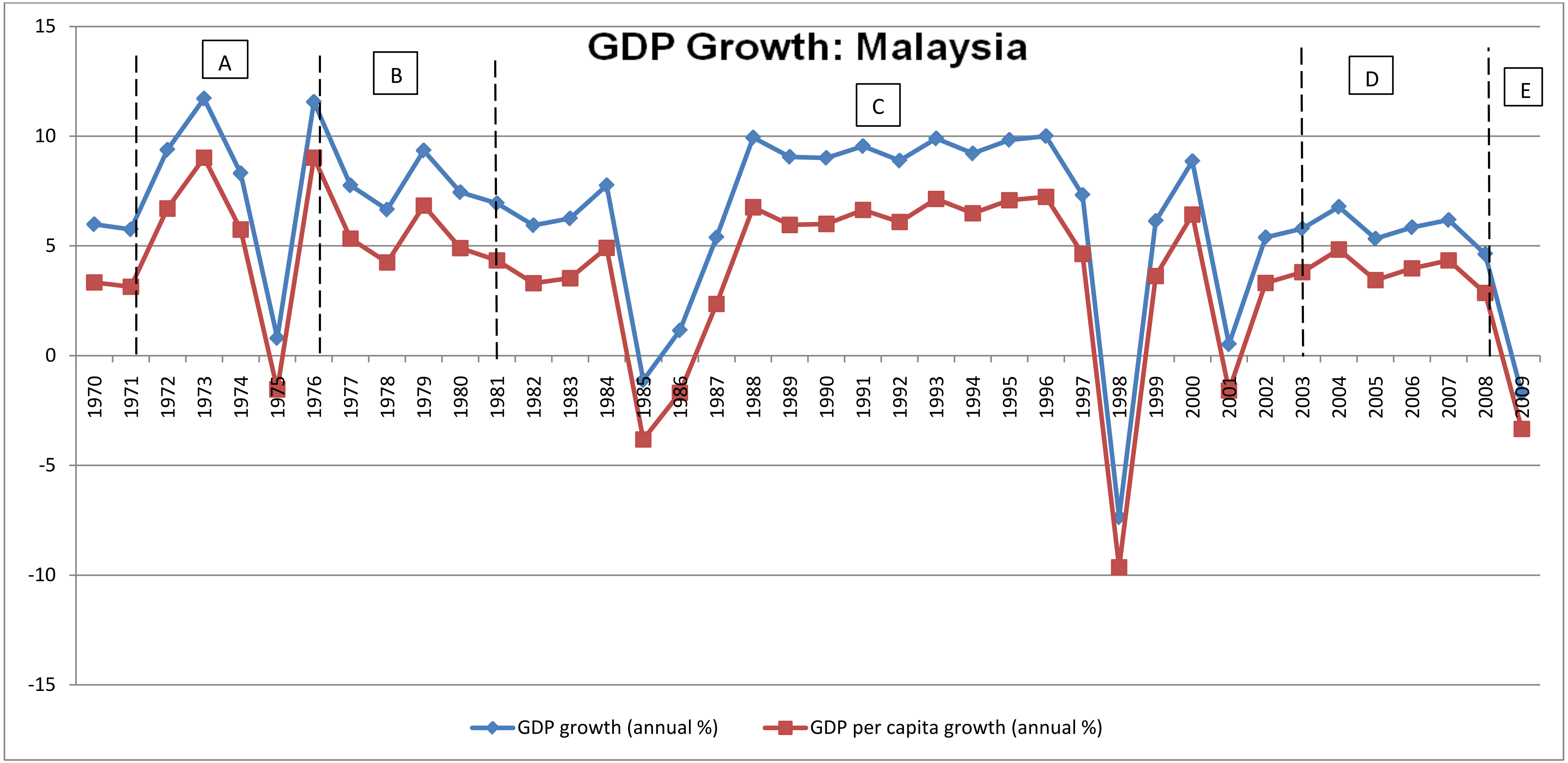
(251110, 15,270 words)

Table 1: GDP growth by decade, Malaysia and comparators, 1970-2009

(per capita, %)

year	Malaysia	Singapore	Thailand	Korea	China
1970-1979	5.2	7.6	5.0	6.3	5.3
1980-1989	3.1	5.3	5.6	6.4	8.2
1990-1999	4.5	4.4	4.1	5.2	8.7
2000-2009	2.8	3.2	3.1	3.9	9.6
Volatility SD/mean	0.96	0.83	0.91	0.64	0.49

Figure 1: Malaysian GDP growth, 1970-2009 (%)



A: TUN ABDUL RAZAK BIN HUSSEIN (1971-1976) B: TUN HUSSIEN B. ONN (1976-1981) C: TUN DR. MAHATHIR MOHAMAD (1981-2003)

D: DATO' SERI ABDULLAH AHMAD BADAWI (2003-2009) E: DATO' SERI NAJIB TUN RAZAK (2009 – present)

Figure 2: GDP growth, 1970-2009, Malaysia and comparators (%)

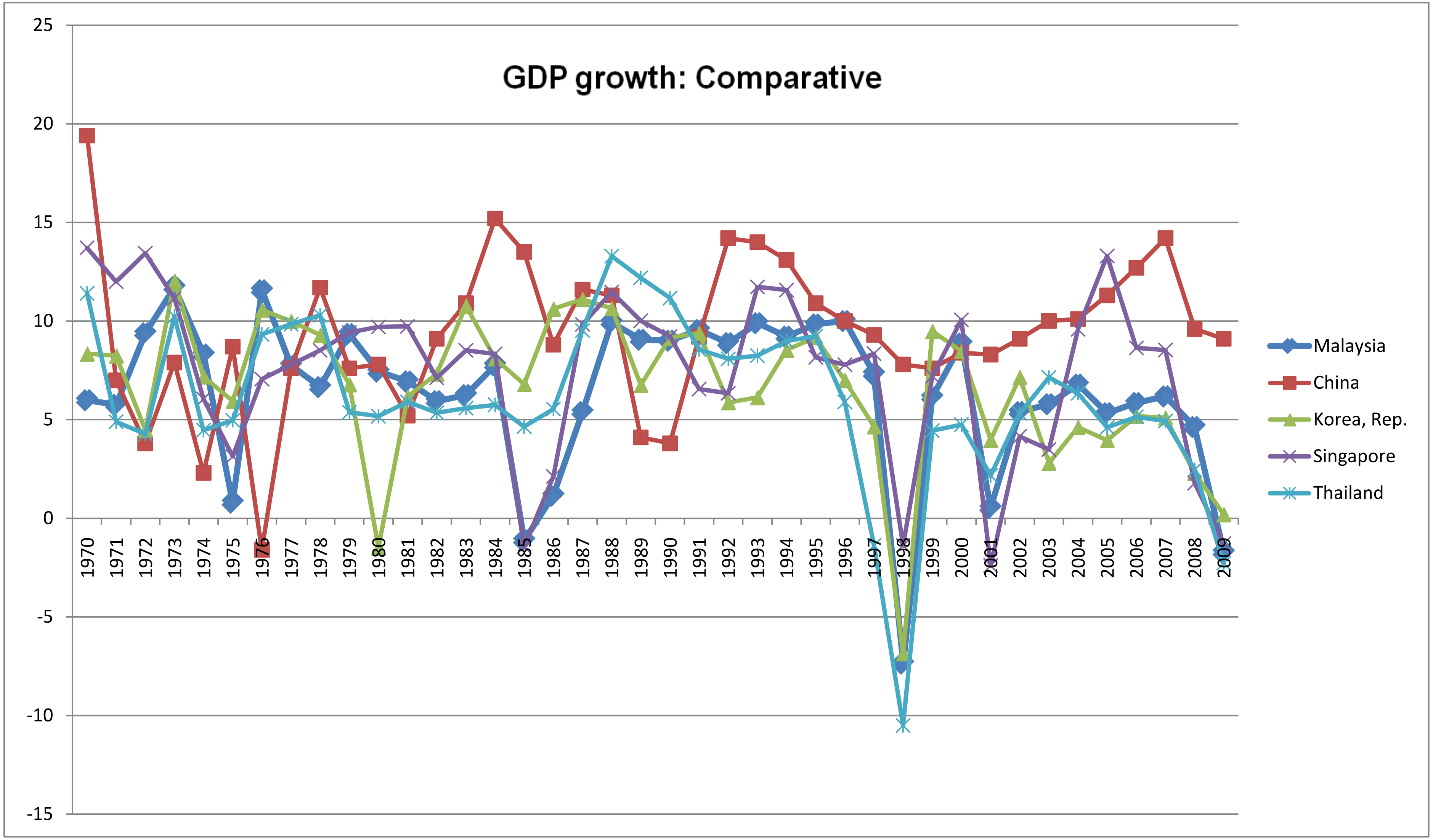


Table 2: Malaysian economic growth by sector, 1970-2007 (%)

	Value added			**Labour productivity**		
Years	Agriculture	Industry	Services	Agriculture	Industry	Services
1971-1979	5.19	7.25	9.07	2.60	1.74	3.50
1980-1989	3.55	5.83	6.32	3.44	5.41	-0.15
1990-1999	0.15	7.43	8.16	1.07	4.08	3.53
2000-2007	2.96	5.20	5.15	4.75	4.81	2.78

Note: Calculated at constant 2000 prices. Industry refers to manufacturing, mining, construction and utilities.

Table 3: Structural change, Malaysia and comparators, 1970-2008

(% of GDP in current prices)

Agriculture

	Malaysia	Singapore	Thailand	Korea	China
1970	29.4	n.a	25.9	29.3	35.2
1990	15.2	0.4	12.5	8.9	27.1
2008	8.7	0.1	11.6	2.7	10.7

Industry

	Malaysia	Singapore	Thailand	Korea	China
1970	27.4	n.a	25.3	26.0	40.5
1990	42.2	34.7	37.2	41.6	41.3
2008	55.4	25.9	44.2	36.5	47.4

Services

	Malaysia	Singapore	Thailand	Korea	China
1970	43.2	n.a.	48.8	44.7	24.3
1990	42.6	64.9	50.3	49.5	31.5
2008	36.0	74.0	44.2	60.8	41.8

Note: Malaysian data for 2008 refer to 2009.

Table 4: Export structure, Malaysia and comparators, 1970-2009

(% of total exports, excluding SITC 9)

Agriculture

	Malaysia	Singapore	Thailand	Korea	China
1970	63.2	46.1	78.6	16.6	n.a.
1990	25.6	7.9	34.2	4.6	16.5
2009	13.4	2.5	19.1	2.0	4.4

Natural resources

	Malaysia	Singapore	Thailand	Korea	China
1970	30.2	25.5	15.7	6.7	n.a.
1990	20.5	19.9	1.9	1.9	10.6
2009	16.4	17.8	6.4	8.5	2.6

Manufactures

	Malaysia	Singapore	Thailand	Korea	China
1970	6.6	28.2	5.7	76.5	n.a.
1990	53.9	72.0	63.9	93.3	72.4
2009	70.2	79.6	74.5	89.5	93.7

Notes: **The following classifications apply.**

Agriculture: SITC sections 0, 1, 2 (except 27-28), 4.

Natural resources: SITC sections 27, 28, 3, 68.

Manufactures: SITC sections 5, 6 (except 68), 7, 8.

Table 5: Major exports, Malaysia and comparators, 1970, 1990, 2009

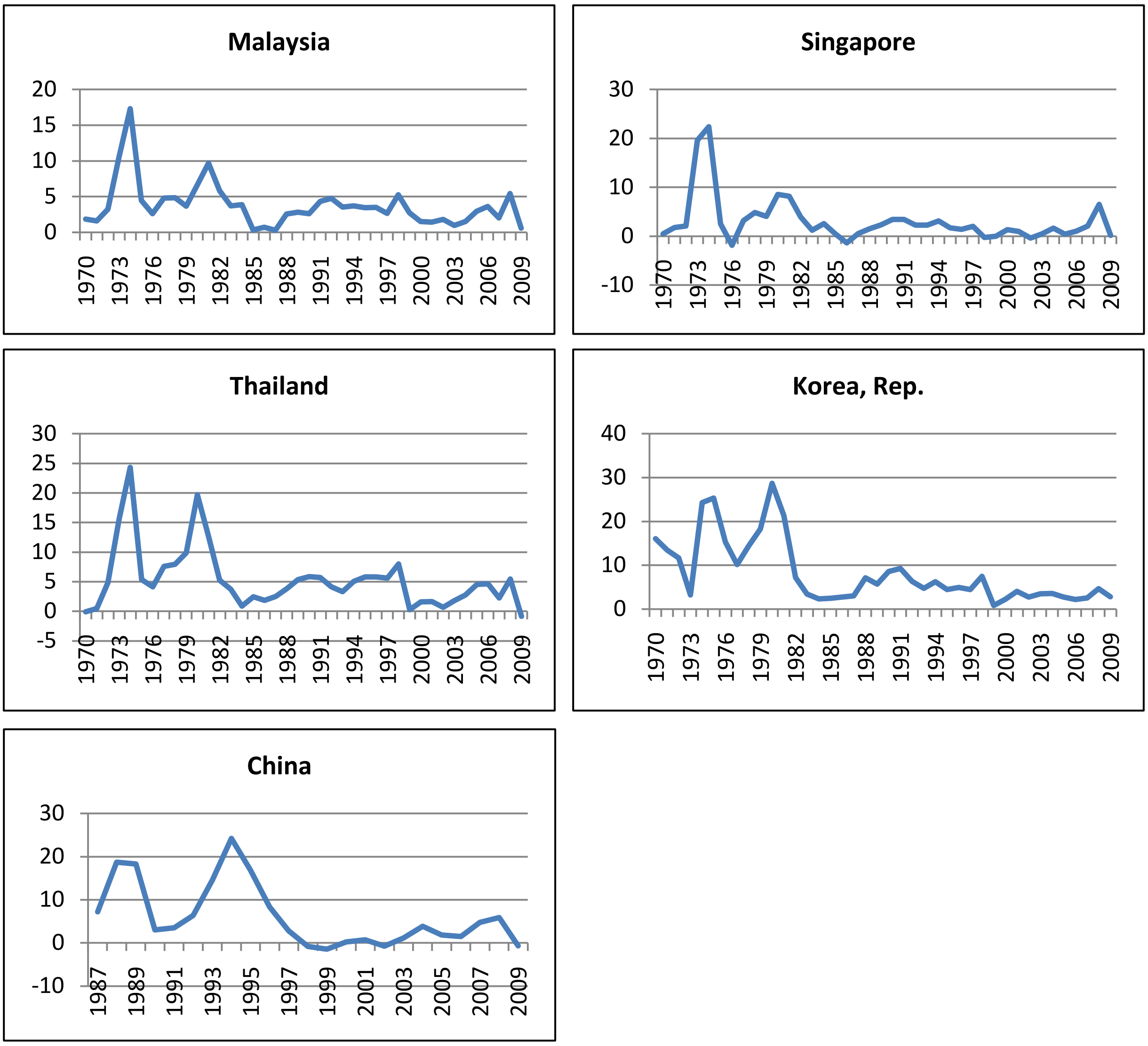
(3 largest items at 3-digit SITC, % of total)

Concentration of exports (3 largest 3-digit SITC as % of total exports)

	SITC	1970	%	SITC	1990	%	SITC	2009	%
China									
	-	n.a.	-	841	Clothing except fur clothing	15.1	714	Office machines	12.2
	-	n.a.	-	732	Road motor vehicles	5.6	724	Telecommunications apparatus	10.3
	-	n.a.	-	331	Petroleum, crude and partly refined	5.5	841	Clothing except fur clothing	8.8
Malaysia									
	231	Crude rubber incl.synthetic & reclaimed	33.4	729	Other electrical machinery and apparatus	15.3	729	Other electrical machinery and apparatus	12.8
	687	Tin	19.5	331	Petroleum, crude and partly refined	13.4	714	Office machines	11.4
	242	Wood in the rough or roughly squared	12.5	724	Telecommunications apparatus	8.6	341	Gas, natural and manufactured	7.3
Korea									
	841	Clothing except fur clothing	25.5	841	Clothing except fur clothing	12.1	732	Road motor vehicles	11.7
	899	Manufactured articles, nes	12.5	729	Other electrical machinery and apparatus	9.4	724	Telecommunications apparatus	10.4
	631	Veneers,plywood boards & other wood,worked,nes	11.0	724	Telecommunications apparatus	7.1	735	Ships and boats	10.0
Singapore									
	231	Crude rubber incl.synthetic & reclaimed	24.7	332	Petroleum products	17.7	729	Other electrical machinery and apparatus	24.8
	332	Petroleum products	23.1	714	Office machines	17.4	332	Petroleum products	15.1
	729	Other electrical machinery and apparatus	2.7	724	Telecommunications apparatus	9.4	714	Office machines	8.7
Thailand									
1970	042	Rice	17.0	841	Clothing except fur clothing	12.3	714	Office machines	9.5
1970	231	Crude rubber incl.synthetic	15.2	714	Office machines	6.8	732	Road motor vehicles	7.4

		& reclaimed							
1970	044	Maize corn unmilled	12.6	031	Fish,fresh & simply preserved	5.5	729	Other electrical machinery and apparatus	6.6

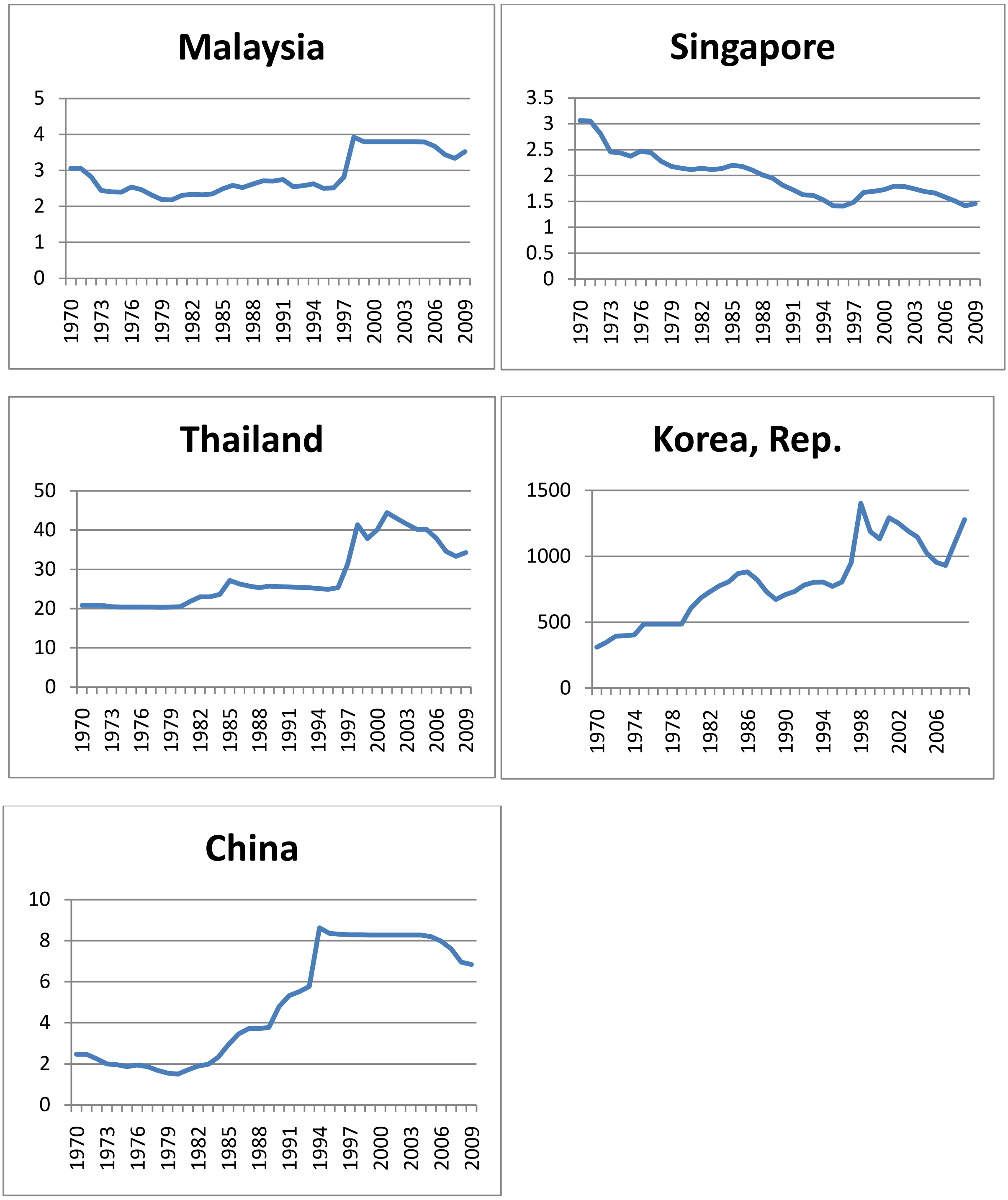
Figure 3: Inflation rates, Malaysia and comparators, 1970-2009 (%)



Note: Data refer to annual percentage change in the consumer prce index.

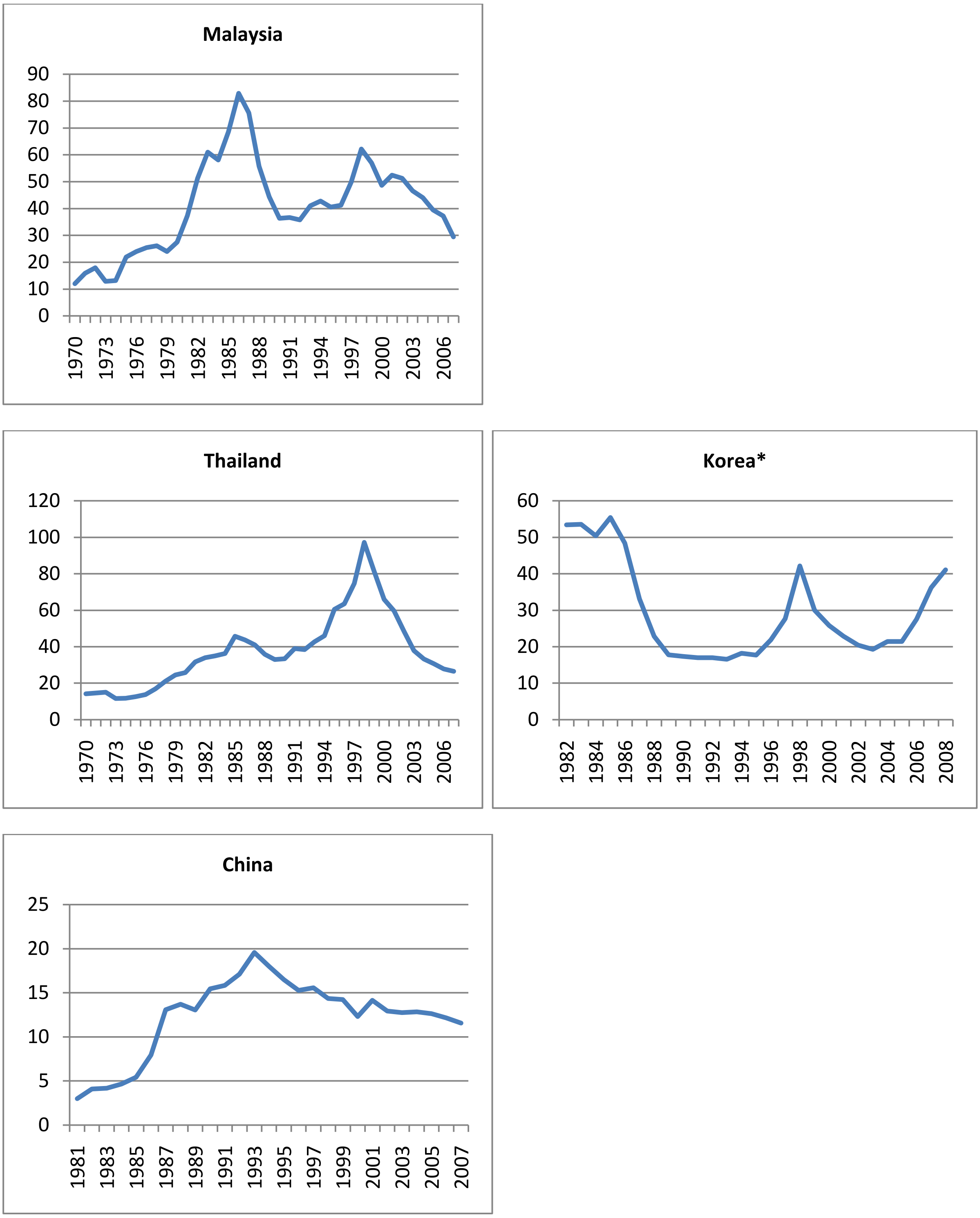
(Beth – for these and following graphs, it's probably easiest to keep them on separate axes, especially when the vertical scales differ. Unless you think it looks silly? They can be small.)

Figure 4: Exchange rates, Malaysia and comparators, 1970-2009



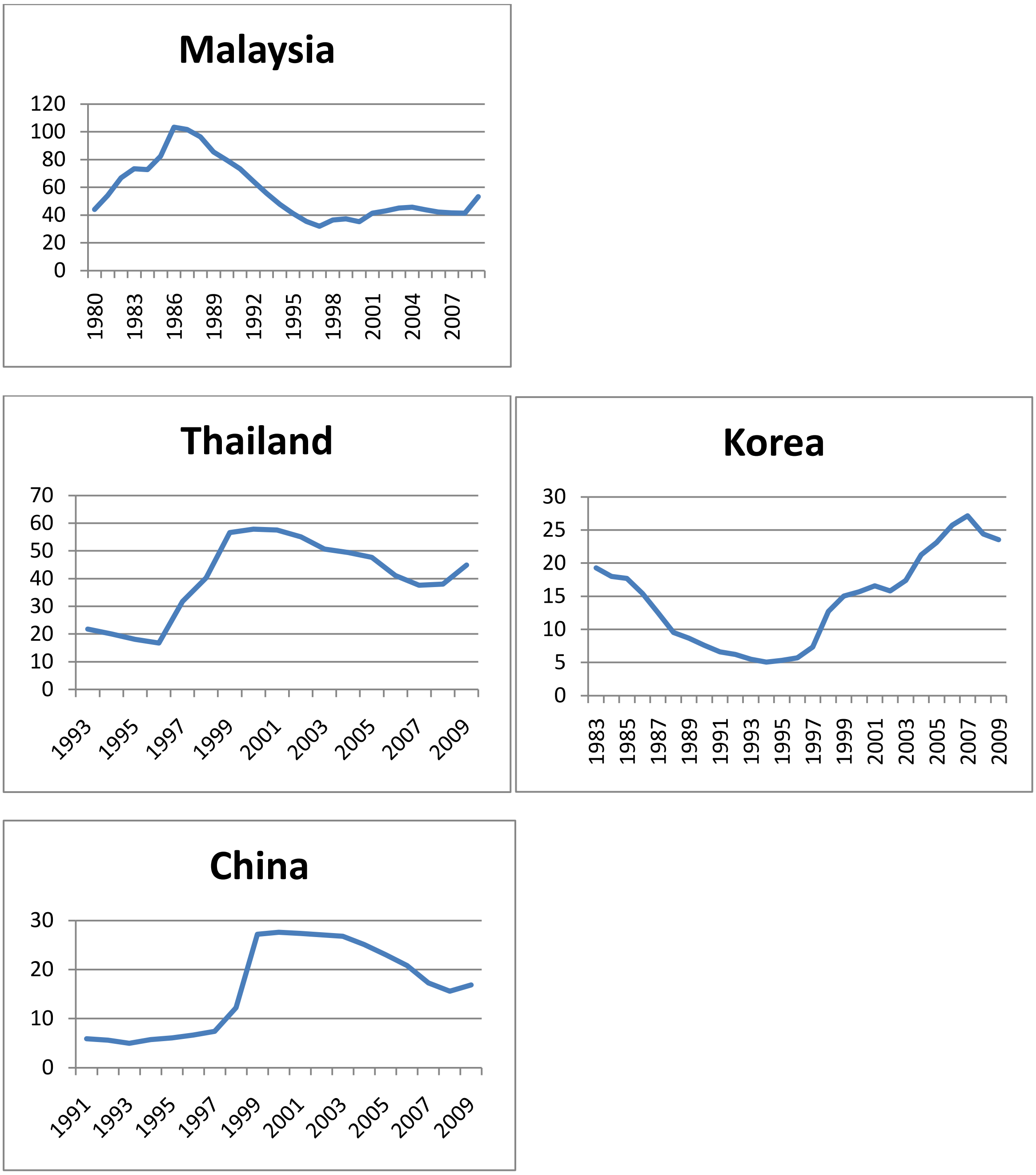
Note: Data refer to annual average official exchange rates of the local currency to the US$.

Figure 5: External debt/GNI, Malaysia and comparators, 1970-2008 (%)



Note: Data refer to total external debt stocks as a percentage of gross national income.

<u>Figure 6: Public debt/GDP, Malaysia and comparators, 1980-2008</u> (%)



<u>Note:</u> Data refer to total public and publicly guaranteed debt as a percentage of GDP.

Figure 7: Current account balances, Malaysia and comparators, 1980-2008 (% GDP)

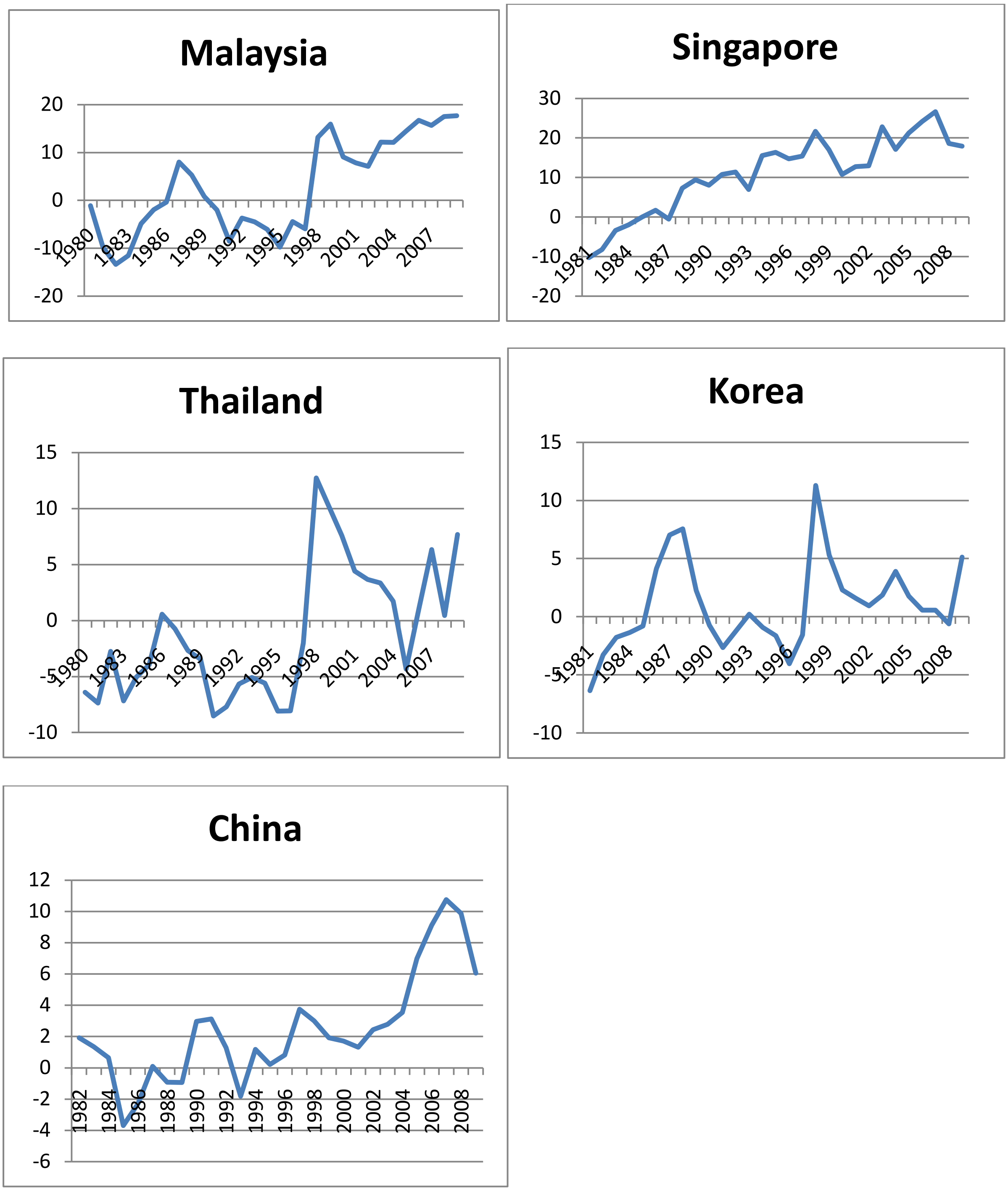


Figure 7 (cont): Fiscal Balances, Malaysia and comparators, 1980-2008 (% of GDP)

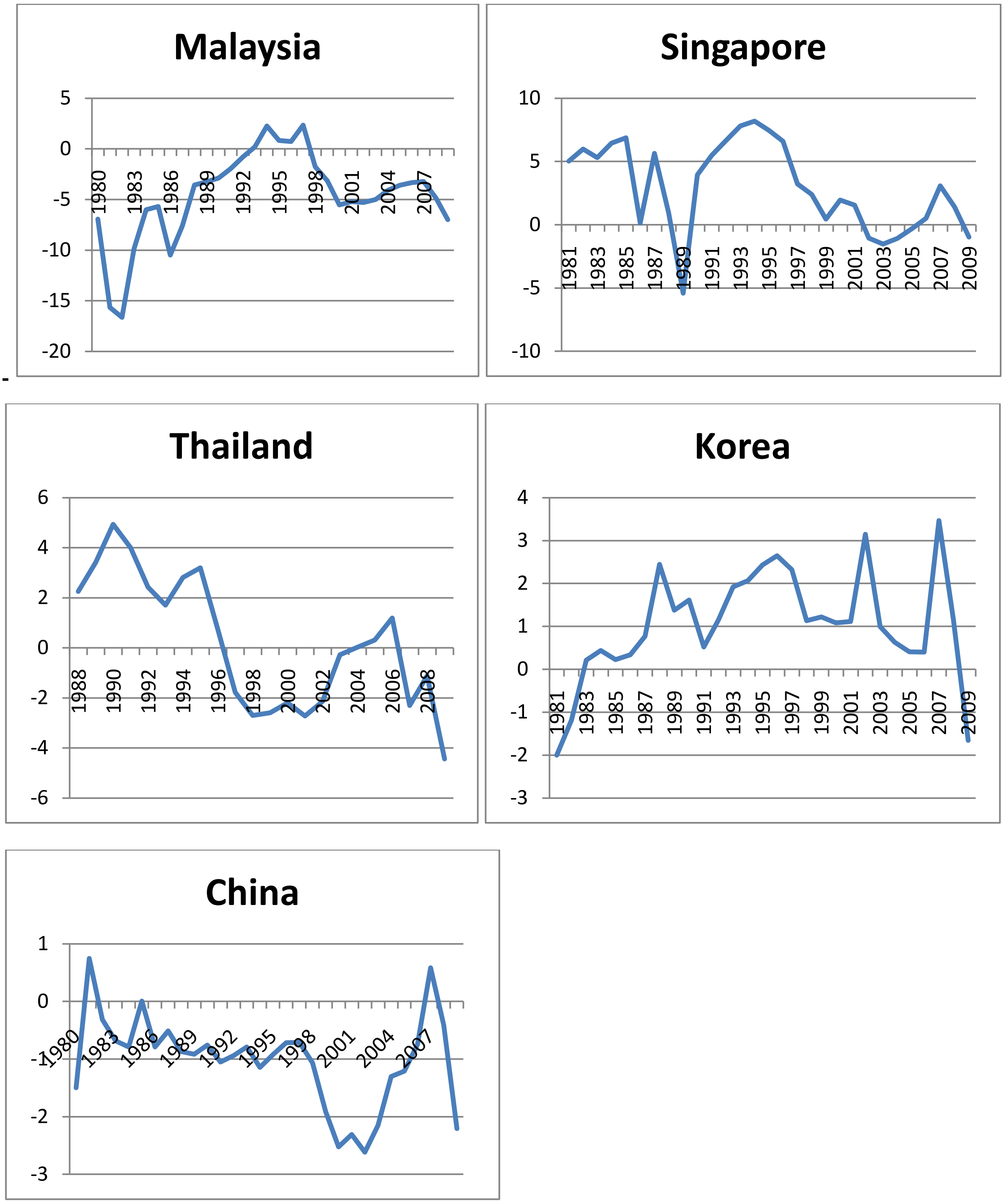


Figure 8: Gross fixed investment, Malaysia and comparators, 1980-2008 (% of GDP)

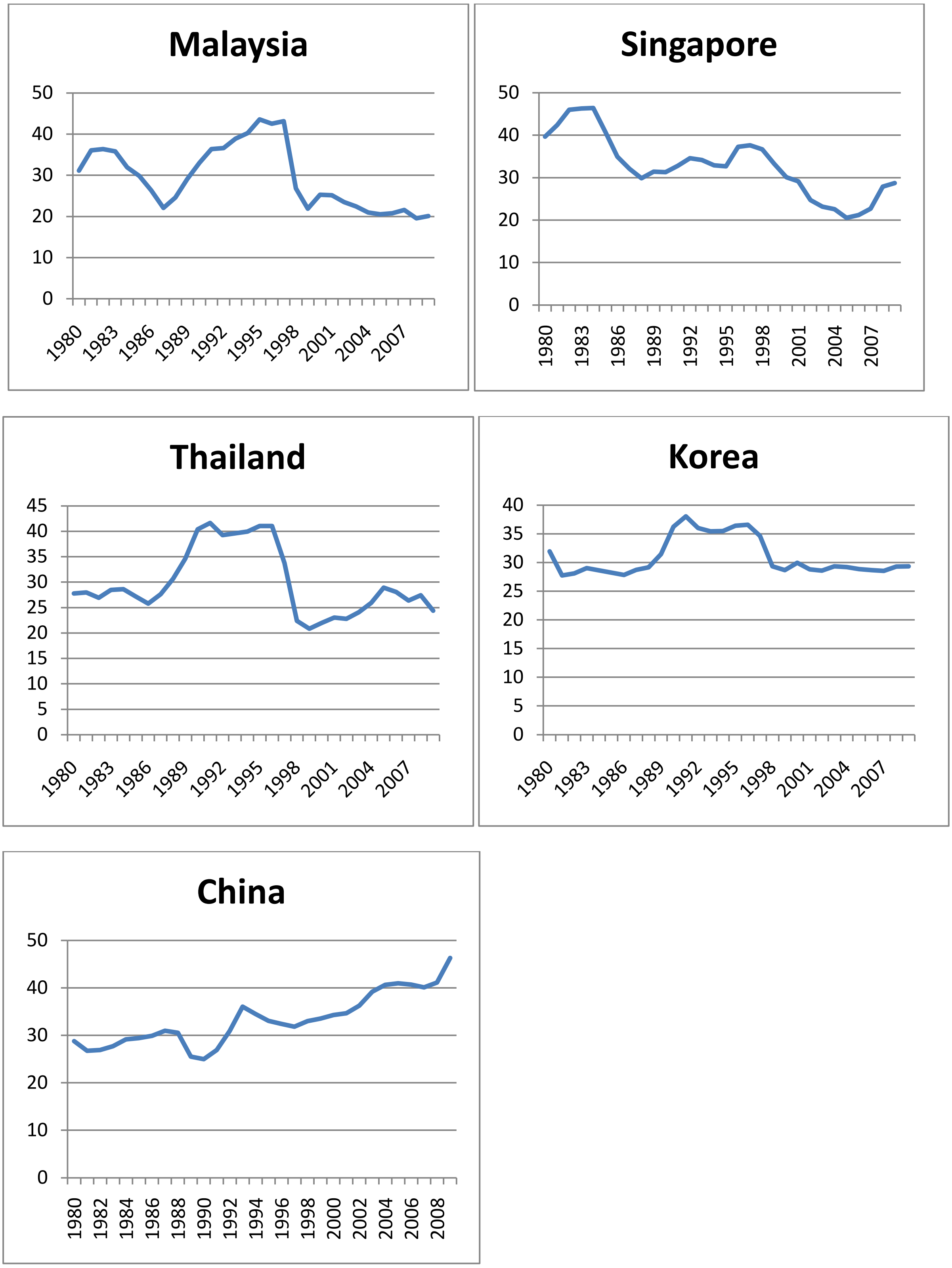
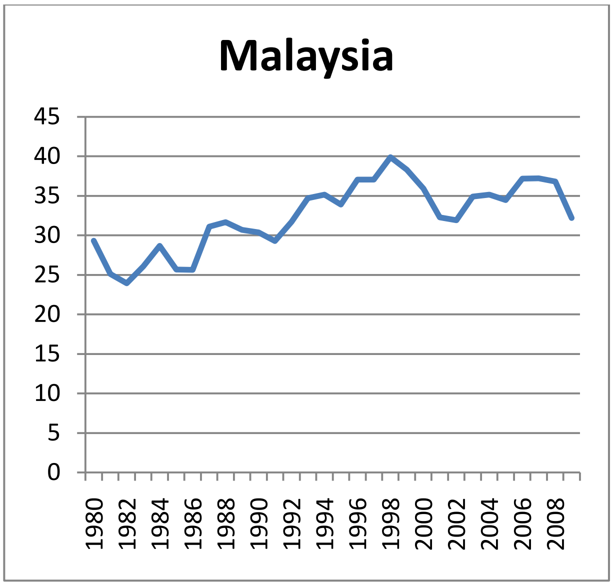
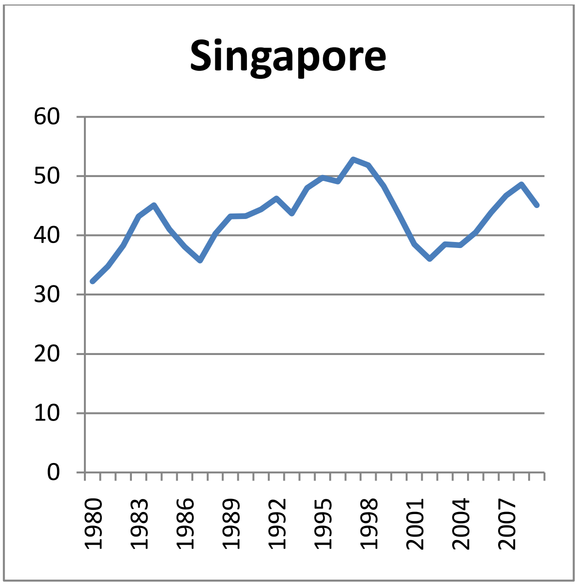
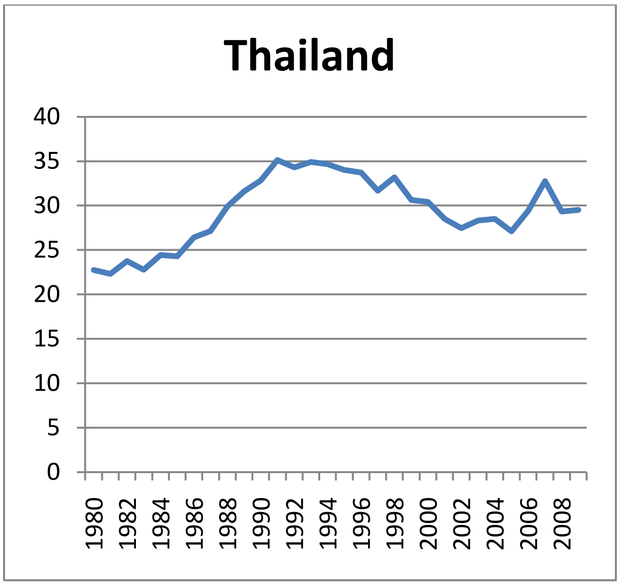
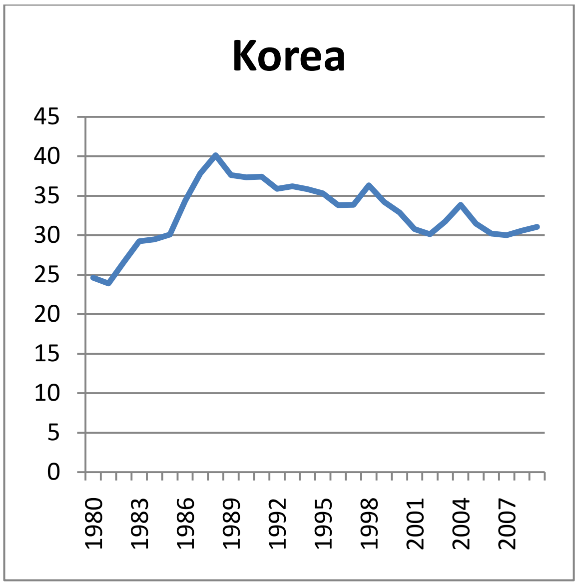


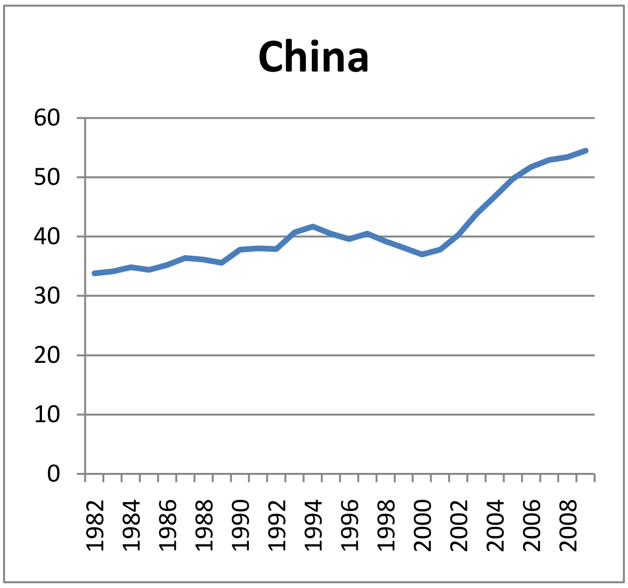
Figure 8 (cont): Gross national savings, Malaysia and comaprators, 1980-2008 (% of GDP)











Sources:

Various issues, on-line and hard copy, of the following publications:

Table 6: Selected Indicators, Malaysia and Comparators

Indicator	Malaysia	China	Korea	Singapore	Thailand
1. Governance & regulation					
Ease of doing business, 2009, rank/181	20	83	23	1	13
Economic Freedom, 2010, rank/179	59	140	31	2	66
Transparency International, 2009, rank/180	56	79	39	3	84
WGI, 2009 (percentiles):					
voice & accountability	31	5	68	35	34
pol stability, absence of violence	47	30	52	90	15
govt effectiveness	80	58	83	100	60
regulatory quality	60	46	75	100	62
rule of law	65	45	83	92	51
control of corruption	58	36	71	99	51
2. Openness					
Trade/GDP, 2008 (%)	212	63.4	107	450	150
Average tariff, 2000-04 (%)	7.6	12.8	9.1	0.2	8.9
FDI stock/GDP, 2008	38.0	10.8	10.2	136	34.2
3. Human capital					
R&D/GDP, 2006 (%)	0.64	1.42	3.22	2.31	0.25
Years schooling, pop aged 15+	6.8	6.4	na	7	6.5
TIMSS, 2007, grade 8:					
Mathematics	474	na	597	593	441
Science	471	na	553	567	471

4. Social indicators

Human Development Index, 2010	0.744	0.663	0.887	0.846	0.654
HDI rank – GDP/cap rank, 2010	-3	-4	16	-19	-11
Q1/Q5 income shares (year)	7.0 (‘04)	8.3 (’05)	4.7 (’98)	9.7 (’98)	8.1 (’04)

5. Supply-side indicators

GCI infrastructure/213	30	50	18	5	35
GCI financial development/213	7	57	83	2	51

Sources and Notes

Governance and regulation:

Ease of Doing Business rankings for 181 countries and jurisdictions are from World Bank, Doing Business 2009, Washington DC 2009. Lower rankings indicate more business friendly environments.

Economic Freedom rankings for 179 countries and jurisdictions are from The Heritage Foundation, 2010 Index of Economic Freedom, New York, 2010. Lower rankings indicate greater economic freedom.

The Transparency International Indicators 2009, Berlin, 2009, rank 179 countries and jurisdictions according to perceived levels of corruption. Lower rankings indicate lower corruption.

The World Governance Indicators are from World Bank, Aggregate Governance Indicators 1996-2009, Washington DC, 2010. Higher percentile values correspond to better governance outcomes.

Openness:

The trade and FDI ratios are from World Bank, World Development Indicators 2010, Washington DC, 2010.

Average tariffs are from A. Nicita and M Olarreaga (2006), ‘Trade, Production and Protection 1976-2004’, World Bank, Washington DC.

Human capital:

R&D expenditure as a percentage of GDP and years of schooling from World Bank, World Development Indicators 2010, Washington DC, 2010.

The data on Trends in International Mathematics and Science Study are reported in Highlights from TIMMS 2007, National Center for Educational Statistics, US Department of Education, Washington DC, 2009.

Social Indicators:

HDI score and rankings are from United Nations, Human Development Report 2010, New York, 2010.

Q1/Q5 ratios refer to the income of the top quintile as a ratio of that of the bottom quintile, as reported in Asian Development Bank, Key Indicators 2010, Manila, 2010.

Supply-side indicators:

Based on rankings of 213 countries and jurisdictions as reported in World Economic Forum, The Global Competitiveness Report 2010-2011, Geneva, 2010. Lower rankings indicate higher quality.

World Bank, World Development Indicators. Global Development Finance.

United Nations, COMTRADE Statistics.

IMF, International Financial Statistics.

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