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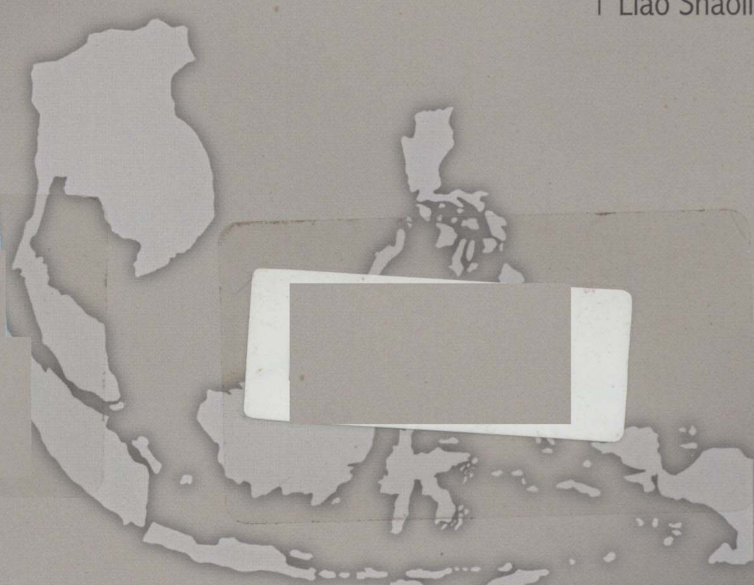
Malaysia and Sino-Malaysian Relations in a Changing World

Edited by
Liao Shaolian



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Foreword

This volume is a compilation of papers presented at the international conference on Malaysia and Sino-Malaysian Relations held on April 6 and 7, 2005. The conference was held to celebrate the establishment of Institute of Malaysian Studies at Xiamen University, China, and to provide a better understanding of Malaysia and explore the impacts and implications of China's rapid development for Malaysia and Southeast Asia as a whole. The conference brought together more than thirty reputable experts and scholars from Mainland China, Malaysia, the Philippines, Singapore, Australia, Japan, the Netherlands, U. K., U. S., China's Hong Kong and China's Taiwan.

The book consists of 14 papers, which touch upon a vast array of topics pertinent to Malaysia and Sino-Malaysian relations. They can be divided into two parts. The first half consists of 7 papers dealing with issues on economy, politics, history and culture of Malaysia. The second half presents 7 papers discussing issues on Sino-Malaysian relations and regional cooperation. The wide disciplinary backgrounds of the contributors to this book have enabled broader economic, historical, political, and international relations aspects of Malaysia and Sino-Malaysian relations to be discussed. The views expressed in the papers of this volume do not necessarily reflect those of the editor or the institution.

Liao Shaolian

Editor

Contents

Malaysian Economic Development in Comparative Southeast Asian Perspective

Hal Hill

Introduction[1]

How might a development economist view the Malaysian economy? What are its key "stylized facts" and its salient features? To what extent does its development record conform to the received wisdom on growth and development? These questions inform the analytical framework which guides this paper.

Starting with the big picture, at least five, and perhaps several more, features stand out in any overview of its development record. The first, and by far the most important, is success. In its almost five decades of Independence, Malaysia's growth record comfortably places it in the top performance decile of developing countries. It is among the tiny handful of countries to have performed consistently well since the 1970s. It was rightly included among the World Bank's (1993) "miracle" economies. It may not have grown quite as fast as China and the four Asian NIEs, but very few countries elsewhere

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[1] Although I have studied the Malaysian economy for about decades, I am obviously not a country specialist. I therefore approach this task with considerable apprehension, and I have attempted to cast the paper in a comparative framework. The references give an indication of some of the material I have found useful in the preparation of this paper. As with most papers I write, I am very grateful to my ANU colleague Prema-Chandra Athukorala, who has written extensively on Malaysia. He kindly allowed me to reproduce Figure 1 and Tables 2 and 3 from Athukorala(2003).

have been able to match its record.

A second feature is the consistency of its performance. Inevitably, as one of the most open economies in the world, external events quickly impact. But its growth record has been impressive virtually throughout the period of Independence. When the economy has experienced difficulty, for example, in the 1997 — 1998 Asian economic crisis and the mid-1980s recession, it has invariably bounced back quickly, testifying to its fundamental strengths and resilience.

A third feature is what one may term "economic policy orthodoxy". Perhaps the most important contemporary challenge for development economics is to understand and explain long term differences in economic performance: why have some countries (like Malaysia) consistently grown more quickly than others; why are there "chronic economic dropouts", and why do some appear to be particularly vulnerable to "boom and bust" cycles? In the search for explanations, empirical verification of contending theories is providing important clues to these questions, while also of course highlighting much that is unknown. As will be argued in Section Ⅲ, I believe that much of Malaysia's economic success can be explained by the more or less continuous adherence to "orthodoxy"—principally openness and prudent macroeconomic management—by all five post-Independence administrations. Malaysia's policy orthodoxy, predictability, and consistency are, I believe, absolutely central to any explanation of its success.

A fourth feature is what may be regarded as Malaysia's "inclusive development" style. Inheriting a highly unequal distribution of income and wealth from the colonial era, successive governments have generally ensured that the benefits of rapid growth have been distributed reasonably broadly. Of course, there are conspicuous exceptions to this generalization. As in all countries, those close to the centres of power, and skilled in the art of rent-seeking, have enriched themselves spectacularly. But by and large, practically every Malaysian has benefited from growth in some measure. The New Economic Policy (NEP) and its successors have of course been central to this achievement, but several other factors are also relevant.

Finally, and consistent with the current predilection of economists to "rediscover" history, initial conditions have shaped Malaysia's development trajectory in important ways. One, already alluded to, was the high levels of inequality generally associated with the colonial-era plantation-based, enclave economy; further complicated in Malaysia's case by the fact that this inequality had an ethnic dimension. While this created great challenges for the newly independent economy, there were also significant positives at the time of Independence: relatively high per capita income, a well functioning bureaucracy and legal system, and reasonably good (though spatially maldistributed) physically infrastructure.

This paper offers a broad assessment of Malaysian economic development over the past quarter century, set against the broader Southeast Asian experience. Section II examines the comparative record according to some key indicators. Section III looks at development achievements in more detail. Section IV considers some key development issues and challenges, while Section V summarizes our principal arguments.

Comparative Overview

Any comparative assessment of Malaysia's development record naturally invites the question, "compared to whom or what"? Since Malaysia is a founding member of ASEAN, the usual comparators are drawn from among its Southeast Asian neighbours, or East Asia more generally. But apart from geographical proximity and policy similarities, there is no obvious East Asian comparator. If Penang were a nation state, it would make sense to compare it to Singapore, but a broader Malaysia-Singapore comparison obviously encounters difficulties. Malaysia and Thailand share many common features, but their initial conditions, institutions and natural resource endowments are also rather different. Malaysia's natural resource abundance invites a comparison with Indonesia, but the countries are very different in so many respects.

In an earlier period, the then Malaya was frequently compared to the West African state of Ghana. The two had a common colonial master, were tropical, and were major cash crop(especially rubber) exporters. Professor Peter Bauer's seminal contributions to our understanding of markets and development over 50 years ago were based on his work in the two countries. Ghana's per capita income was somewhat higher than Malaysia's at the time of Independence, but thereafter Malaysia's record has been so superior that the comparison is now all but pointless, except as a contrasting case study in development economics, of what to do (Malaysia) and to avoid(Ghana). [1]

Another set of comparisons has involved Malaysia and Sri Lanka, countries with somewhat similar colonial histories, populations, ethnic divisions, and cash crop export specializations (see Bruton et al, 1992). Here, too, Sri Lanka had the edge over Malaysia at the time of Independence, with similar per capita incomes but superior human capital. There were of course historical differences between the two in initial conditions, with Malaysia possessing a richer natural resource endowment. But the main point of the comparison is that Malaysia has grown much faster than Sri Lanka for most of the period since the 1960s, owing to better policies (especially before Sri Lanka reformed) and the absence of conflict, to the point where the comparison is now hardly relevant.

Thus, in the absence of anything better, the comparisons might as well be with its East Asian neighbours, recognizing the caveats noted above. Table 1 (See pp. 29 — 34) provides a summary set of indicators for Malaysia and the major East Asian developing economies

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[1] A leading Malaysian economist, Professor David Lim, is in the process of exploring the comparative record. In fairness to Ghana, its recent performance has improved considerably, and it is now considered to be among Africa's better governed economies.

with a per capita income(in PPP terms)of at least \$3,000. [1] We briefly discuss here how Malaysia ranks according to growth, macroeconomic management, openness, human capital, and a range of other indicators.

First, Malaysia is relatively rich. Its economy is about the same size as Singapore's, while its per capita income is about three times that of Indonesia and about double China. Since 1980, its per capita GDP has more than doubled, in line with all the major ASEAN economies except the Philippines, but significantly slower than China.

Second, Malaysia's macroeconomic management has been among the best in the developing world. Inflation has never been a problem, in most years falling below 5 percent, and broadly similar to Singapore and Thailand. The country is moderately indebted, as indicated by its debt/GDP ratio. But debt service has never been a problem, owing to its highly outward orientation. Remarkably among developing countries, it has never experienced a serious debt or balance of payments crisis, apart from the special case of the 1997—1998 Asian crisis.

Third, its economy is exceptionally open, with one of the highest trade/GDP ratios in the world. It is one of the half dozen developing economies which Sachs and Warner (1995) classified as "always open", according to a robust set of criteria. Even among the export-oriented economies of East Asia, it has always had by far the highest trade/GDP ratio, apart from the special case of the two city states. In recent years, this ratio has risen rapidly owing to the very large share of electronics in the country's exports(the second highest share in East Asia, after Singapore), owing to the "slicing up"of the production process in that industry, and the consequent thin domestic value added in its exports. But other indicators support the contention that it is a very open economy. Its average tariff rate is low, and there are few non-tariff barriers outside the automotive

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[1] I am indebted to my colleague and co-editor, Professor Chu Yunpeng, Academia Sinica, Taipei, for permission to use this table, which is from the overview chapter of a co-edited book in press(Chu and Hill, eds, forthcoming).

industry and some heavy industries. It does not score more highly on various indices of economic freedom principally because, rightly or wrongly, the various NEP-type commercial restrictions count against it. Malaysia is also very open to foreign direct investment (FDI), with a high FDI stock/GDP ratio, and with FDI generally dominating its aggregate capital inflows. [①]

Malaysia has never deviated from its open economic policy posture, which was rooted in the colonial era, and has never been fundamentally questioned since(Ariff, 1991). It may not have been "made by God for free trade", in the manner that Indonesian geography is some times characterized. It is beyond the scope of this paper to examine why it has always been so open. But for what it is worth, my speculation is that it reflects a combination of at least four factors:

- Entrenched and powerful export interests.
- A recognition that, inevitably, protection would predominantly benefit non-bumiputera business interests, and hence run counter to the spirit of the NEP.
- Owing to sound macroeconomic management, there has never been a balance of payments crisis, which in some countries(e. g., the Philippines, arguably) has been an accidental trigger for the adoption of "temporary" protectionist measures which quickly become embedded in the country's political economy.
- Its proximity to always-open Singapore which, whatever the political realities, has been highly influential in the conduct of Malaysian commercial policy.

Fourth, Malaysia's human capital indicators are generally good but not outstanding. Here, too, history has shaped these outcomes. The country's public expenditure on education is one of the highest

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① See Menon (2000) for further discussion and empirical estimates of Malaysia's openness. Another dimension is of course its labour market, with foreigner workers, legal and illegal, reportedly accounting for as much as 20 percent of the workforce(at least until the recent crackdown), one of the highest figures in the developing world.

in East Asia, but it is still catching up from the colonial inheritance of under-investment. Thus, it is ahead of its lower-income ASEAN neighbours but behind the NIEs on years of schooling and gross tertiary enrolment ratios.[①] Its R&D efforts also follow such a ranking, resulting in some observers characterizing its technology strategy as "passive, FDI reliant"(e. g. , Lall, 2003), in contrast to the NIE economies which have made a more vigorous attempt to develop domestic supply-side capabilities. In fairness, though, Malaysia has recently increased its R&D effort substantially (the figure cited in Table 1 from comparative data is about half the current reported R&D/GDP percentage). Moreover, Malaysia hit the "turning point" of rapidly rising real wages, hence necessitating a greater technological effort, about a decade after the Asian NIEs. From that perspective, its R&D effort has not lagged as much.

Finally, Malaysia scores at least moderately well on a range of indicators which are presumed to be conducive to rapid economic development. Its physical infrastructure is(and always has been)one of the best in East Asia. Its financial system is sophisticated,[②] and its tax rates competitive. Its bureaucratic quality, country risk assessments, and its corruption rating all generally fall within the range of the NIEs. These measures are all crude, subjective and debatable. But they do mostly confirm generally perceptions of Malaysia, that it is a competently governed state, with a predictable commercial policy environment, and reasonably good institutions.

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① The latter figure probably understates Malaysia's ratio, owing to the fact that its large overseas student body is likely to be under-reported in the comparative statistics.

② Indeed, its financial sector may be a bit too "sophisticated". The country has one of the highest stock market capitalization/GDP ratios in the world, a phenomenon which complicated the government's post-1997 recovery strategies, owing to its highly leveraged corporate sector(Athukorala, 2001).

The Development Record

Malaysia has grown very fast, in most years by at least 5 percent per annum, and generally a good deal more. The structure of its economy has also changed profoundly, from one dependent on agriculture and natural resources, to a broad-based economy with manufacturing and services of increasing importance. These two inter-related themes, combined with consistent global orientation and distributional considerations, dominate the development record since the 1970s.

Figure 1(see p. 9)shows economic growth over the period 1965—2000. Growth has been in the range 5—8 percent per annum in most years, with significant dips occurring on average once per decade. There were only two major departures from this record of rapid growth. One was the mid-1980s, when Malaysia experienced a brief and mild recession, while the other was the more serious crisis of 1997—1998. In both cases, a mixture of external and domestic factors caused the problem, and in both the response by the authorities was reasonably sure-footed and swift. In the mid-1980s, the sharp decline in commodity prices combined with expansionist fiscal policies (partly related to the heavy industry and NEP objectives) explained much of the downturn, which for varying reasons affected all of Southeast Asia. Yet by the end of the decade, the economy was growing strongly again. The causes of and responses to the 1997—1998 events are more controversial, but the key point to note is that economic recovery was surprisingly strong and quick. It is important to emphasize that the global orientation, on both the current and capital account, was a factor in both the initial downturn and the swift recovery.

Over the long run, growth has been remarkably consistent, in the sense that, with the possible exception of the period of exceptionally strong growth 1997—1998, no one decade or episode stands out. That is, there has been rapid growth in all three decades since the 1970s. Thus, Malaysia has been more like the NIEs(and

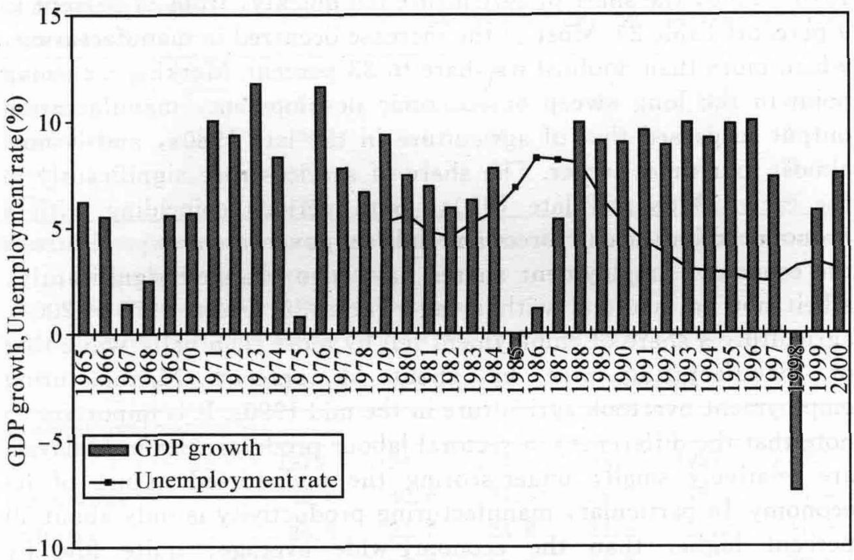

Figure 1 Malaysia: Growth (1965—2000)* and Unemployment (1979—2000), (%)
Note

* Period-average growth rates:
1961—1984 6.7
1986—1997 9.0
1961—2000 6.2

Source: Athukorala (2003), from data compiled from Ministry of Finance, *Economic Survey*, Kuala Lumpur (various issues)

Thailand), as compared to some of its neighbours, especially Indonesia. Nor has there been a "turning point" in its economic fortunes, coinciding with a major policy change, such as for example in China after 1978, India after 1991, Indonesia after 1966 (and again 1998), and Vietnam after the mid-1980s Doi Moi. As a corollary, no one administration stands out in Malaysian economic development, in the sense that all four past prime ministers have generally presided over rapid growth.

As would be expected in a rapidly growing, internationally oriented economy, structural change has been rapid. Over the period