



# Challenges for the Next Phase of Malaysia's Development

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On the 11th of July, the Jeffrey Cheah Institute on Southeast Asia (JCI) hosted Dr Jayant Menon from the Asian Development Bank who spoke on the challenges for Malaysia's development in the face of new political and economic circumstances. Dr Menon began his presentation by noting that the change in government was unexpected but undoubtedly positive. He outlined his talk as to answer a number of questions. What are the economic challenges facing this new administration? What key reforms are needed?

## Old Challenges

The first issue Dr Menon highlighted is the premature deindustrialization of the Malaysian economy. Since the 2000's, the share of manufacturing and industry in terms of Malaysia's GDP declined, while services rose in the same period. While this shift to services is to be expected when a country moves from middle to high-income status, the jobs created within Malaysia's service sector are not the high-paying ones typically expected. Jobs in the declining manufacturing sector were also low-paying, of low quality, and mostly concentrated in commodity processing. Dr Menon stated that of all the manufacturing sectors, only electronics offered an opportunity for better-paying jobs.

Another major issue that has plagued Malaysia since the Asian Financial Crisis (AFC) is the fall in Foreign Direct Investment (FDI) as well as domestic investment. Foreign investment was key to transforming Malaysia from an agricultural economy into a manufacturing one within three decades. Domestic investment also saw a slump in the period after the AFC. While it appears that the share of private investment is growing, in reality it could be the result of Government Linked Companies (GLCs) investing in the economy.

Youth unemployment, though more common among wealthier industrialized nations, is a growing concern in Malaysia. The country's youth unemployment rate stands at more than 10%. 25% of Malaysian graduates remain unemployed for 6 months after graduating. At the same time, employers are struggling to find the skilled individuals they need. This suggests a skills mismatch that may have its origins in a broken education system. Dr Menon said that from the outside, Malaysia is seen as a net importer of labour but also a net exporter of skills.

Income inequality measured through the Gini coefficient also shows that our country has made some progress by bringing it below the critical level of 0.4, but it still remains high overall. A piece

in The Edge Financial Daily highlighted the fact that 'half of Malaysians earn below Rm2,000 a month'.

Reforming government institutions remain a challenge for the new administration. Reversing the degradation of key institutions such as the judiciary, police forces, the press and the national anti-corruption agency will need to take place in order for meaningful change. The support from the existing government bureaucracy would be instrumental for reforms to be enacted effectively.

## New Reforms

Malaysian GLCs have played a unique role in our country's enactment of affirmative action through its agenda to create a class of Bumiputera entrepreneurs. While they have allowed for the rise of Bumiputera corporate ownership, it has however fallen short of its 30% target. Furthermore, Dr Menon opined that this economic arrangement has also resulted in crony capitalism, state dependency, the crowding out of the private sector, and an unequal distribution of wealth amongst the Bumiputeras. Prime Minister Dr Mahathir Mohamad suggested recently that Malaysian GLCs have 'lost their original function' and have become 'monsters', referring to their size and wealth. Since the recent general election, evidence has been

uncovered about the role of various Government Linked Investment Companies (GLICs) in helping the scandal-ridden 1MDB service its debt.

for the majority of Malaysians instead of merely for an elite few.

According to Dr Menon, redressing the effect of GLCs and GLICs on Malaysia's economy would first require the granting of institutional autonomy. This would mean removing GLCs and GLICs from under the purview of the Ministry of Finance. The installation of an independent body with operational oversight as well as significant internal managerial reforms would further improve the governance of these companies. Dr Menon suggested that a thorough review of the GLCs be conducted to assess if they operate efficiently or perform a social function. This review should be done in order to determine whether these firms should continue operating or be divested. Such an exercise should be done with care to account for artificial rents generated through preferential treatment.

Dr Menon highlighted that given the reform mandate of the new administration, one glaring issue that must be addressed would race-based policies, as typified in the New Economic Policy (NEP). The lack of any means testing is seen as a major flaw of the NEP's affirmative action programmes. The result of this is that the majority of Malays see few of the benefits while a small minority enjoy 'super benefits'. While a perfect meritocracy is an unattainable ideal, much needs to be done to break the existing system of patronage. Dismantling a system built on racial preference will require leveraging the efficiency gains from incrementally moving towards a more meritocratic system. Reforms in this direction should result in the achievement of a major tenet of the NEP, namely the eradication of poverty regardless of race, as the system would be beneficial