

THE STAR

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Stories by SHAILA KOSHY, SHAHANAAZ HABIB, KAREN CHAPMAN, LESTER KONG, TAN SHIOW CHIN, TAN EE LOO, SHAUN HO AND JOSHUA FOONG

The middle income trap

We are now showing signs of being stuck in the middle

It is going to be a challenge for Malaysia to achieve its Vision 2020 goals by that target year.

After two decades of considerable progress at reducing poverty and improving the quality of life in critical areas like housing, transport, communications, health and education, Malaysia is now exhibiting signs of a middle income trap and is in the "danger of being stuck in the middle".

Many factors have contributed to the country's slower growth over the past year - among them is that Malaysia is being supplanted as a low-cost export and services base by emerging economies such as India, Vietnam and China.

These larger emerging economies with their relatively low wage costs and sizeable domestic consumer market have been able to attract foreign direct investments away from more established economies.



The compound annual growth rate of FDI into Malaysia from 2000 to 2007 was only 1% compared to 30% for India, 12% for Vietnam and 10% for China.

In addition, Malaysia's competitiveness has deteriorated and its ranking in the World Economic Forum's Global Competitiveness Index has slipped to 24th place last year from the 21st spot in 2007.

To achieve the goals under Vision 2020, Malaysia would need to grow by 8% per annum until 2020 but

given the current economic and business climate, this would be a huge challenge.

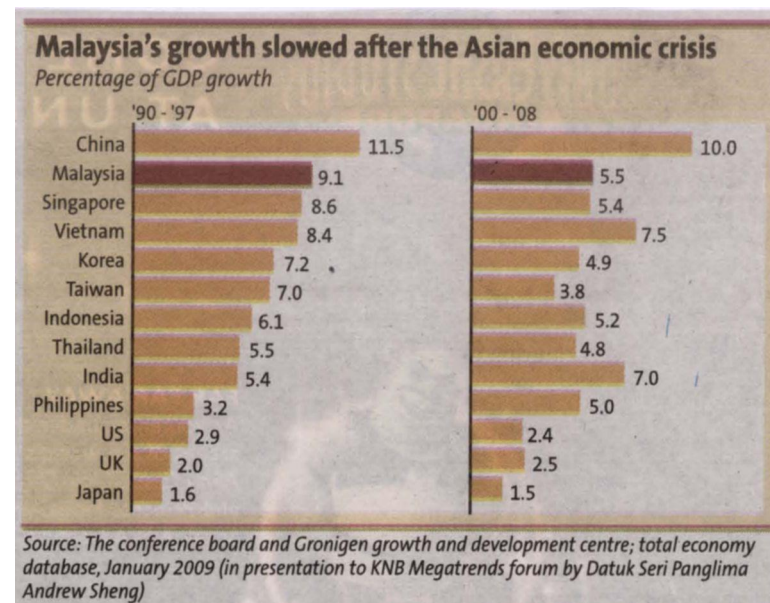
So despite having made the early transition from a low income to middle income nation, Malaysia has not been able to propel itself into the rank of higher income nations.

Instead, countries like Singapore, Japan and South Korea are in fact widening the gap between themselves and Malaysia, which is a phenomenon economists refer to as "the middle income trap".

Malaysia's performance on some key social measures, too, does not bode well of its ability to achieve the social goals of Vision 2020 to be a moral, ethical and economically just society.

Public safety has worsened in recent years with an increase in crime, including vehicle thefts, snatch thefts and robberies.

Corruption in Malaysia is also per-



ceived to be on the rise while in education, the country lags behind country like Hong Kong, South Korea and Singapore.

While Malaysia has made progress in reducing poverty, there are still more than 44,000 hardcore poor households in the country.

Malaysia, too, is in a challenging fiscal position with the public's increasing expectation demanding for high quality public services, stimulus for a recessionary economy and a quick resolution of important concerns like crime and education.

But Malaysia's ability to finance improvements in its performance is limited, given that the country's fiscal position has been worsening

since 1997.

The country too had its largest budget deficit (of -7.4% of GDP) in 2009 in more than 20 years.

In fact, the budget deficit has been deepening consistently since 1997 and this has contributed to historically high levels of government domestic and external debt, which is not sustainable in the long run.

Malaysia therefore faces a dilemma where there is an urgent need to reduce spending and yet deliver big economic and social growth.

Therefore, the Government has to prioritise the allocation of funds to the most important areas, do more with less and roll back subsidies and other distortions in the economy gradually.