

## Malaysia's Slowing Performance

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***There are strong institutional reasons for the lagging performance against its regional neighbors***

In the 70 years since World War II ended, East Asian economies, including Malaysia, appear to have largely got performance right. Malaysia was also one of 13 countries identified by the Commission on Growth and Development in its 2008 [Growth Report](#) to have recorded average growth of more than 7 percent per year for 25 years or more. Malaysia achieved this spectacular performance from 1967 to 1997.



However, since the Asian Financial Crisis of 1997 and 1998, Malaysia's economic performance when compared to previous decades has been lackluster and most macroeconomic indicators are trending downwards. This was confirmed by Prime Minister Najib Tun Razak himself in the publication on March 30, 2010 of the [New Economic Model – Part 1](#). This was a very brave move but a necessary one by the premier as he acknowledged publicly the failures of Malaysia's current economic model in order to demonstrate urgency for reforms.

The New Economic Model identifies domestic factors such as weak investor confidence, capability constraints (weak human capital, entrepreneurial base and innovative capacity), productivity ceilings and institutional degradation and external factors such as a sluggish global economy caused by the global financial crisis of 2008-2009 and the rise of neighbors in the region in contributing to the declining growth trajectory.

If we were to revisit the determinants of growth and agree that proper institutions form the overall structure that determines long-term sustainable growth, then the logical response is to reform Malaysia's institutional set-up, as it must be the deepest determinant of what is hindering economic growth.

This view is further strengthened as Malaysia's other deep determinants, geography and trade, are favorable. The country has abundant natural resources, is shielded from natural hazards and is well-located strategically both geopolitically and economically. Malaysia has also benefitted tremendously from being an open economy, especially in the merchandise sector.

The New Economic Model also reports that regional challenges from China, India and Vietnam, etc. are a cause for Malaysia's declining economic performance. What has changed about these countries? They have all undertaken institutional reforms: China

since 1978, India since 1992 and Vietnam since 1986. They are reaping the benefits while Malaysia has stalled in its institutional reforms since the 1990s, regressed in some ways and is suffering from the consequences.

The above points stress the importance of institutional reforms in Malaysia, something that Najib has ironically neglected in his signature policies – [1Malaysia, Government Transformation Programme](#) and [Economic Transformation Programme](#).

According to the Growth Commission report, "...fast sustained growth is not a miracle; it is attainable for developing countries with the 'right mix of ingredients.' Countries need leaders who are committed to achieving growth and who can take advantage of opportunities from the global economy. They also need to know about the levels of incentives and public investments that are necessary for private investment to take off and ensure the long-term diversification of the economy and its integration in the global economy..."

Michael Spence, the Chairman of the Growth Commission, elaborated on his extensive experience working with developing countries on growth issues in his latest [book](#) by emphasizing two important characteristics for developing countries to ensure long term sustainable growth – the role of political leadership and democratic norms. He suggests four characteristics for governments that are necessary requirements to underpin long term growth:

1. The government takes economic performance and growth seriously.
2. The governing group has values that cause it to try to act in the interest of the vast majority of the people (as opposed to themselves or some subgroup, however defined)
3. The government is competent and effective and selects a viable sustained-growth strategy that includes openness to the global economy, high levels of investment, and a strong future orientation.
4. Economic freedom is present and is supported by the legal system and regulatory policy

### **Manifestations of Malay/Muslim Supremacy**

Malaysia is classified as a non-democratic state by all international indexes measuring quality of democracy. This is also affirmed in academic circles. During the boom years, Malaysians accepted this tradeoff – restricted freedom for economic growth. Since 1997/98, this has changed as expected. The government has not delivered on growth, therefore the natural demand for reforms and by extension freedom.

There is consensus that Malaysia needs extensive economic, political and social reforms. This is all the more evident IF we agree that institutions are key to long term growth. Also, IF we agree with Spence, these reforms must come from a government with the four characteristics identified above.

Astute observers of Malaysia know the reasons why the present administration and the ones before were unable to make fundamental reforms. This has much to do with the ideology of Malay/Muslim Supremacy as defined by the United Malays National Organization (UMNO) and accepted by large swaths of Malaysians, Muslims and non-Muslims alike.

From the literature we can infer that the ideology of Malay/Muslim supremacy has provided the perverse incentives that have manifested themselves in many ways. The more critical ones are:

- Institutional degradation: The deterioration in the quality of Malaysia's institutions, particularly during former Prime Minister Mahathir Mohamad's years, such as the lack of independence between the branches of government; the politicization of the civil service, producing a culture of risk aversion and a lack of creativity; and the expansion of the non-transparent Government Linked Corporations (GLCs):
- Crony capitalism: Affirmative action in the name of Malays has become a smokescreen for crony capitalism. Affirmative action is the instrument for rampant elite-based (from all races, not only Malays) corruption. High levels of income inequality in Malaysia in general but more so within the Malay community prove this.
- Race based affirmative action: Race-based affirmative action in itself is recognized as one of the important reasons for Malaysia's declining economic performance. Malaysia's focus on the ex-post equalization of outcomes across ethnicities rather than ensuring effective ex-ante equalization of access to opportunities has had important direct efficiency implications, affecting growth by distorting incentives and thereby the competitive process.
- Excessive centralization: An interesting institutional feature is the lack of decentralization in the country, which is nominally a Federation and the top-down approach in public policymaking. This is a key disconnect in the reform rhetoric in the ETP and GTP. To strengthen public service delivery, local communities need to be empowered. Fiscal relationships between federal-state-local also demonstrates institutional failure.
- Feedback mechanisms: Related to Malaysia's top-down approaches is an almost complete disregard for monitoring and evaluation. As a result there is little feedback from outcomes into policy design. The obsession with centralizing policy-making is also evident in lack of information sharing both within government and with the public.

### **The need to remove UMNO to create a new "people based ideology"**

In relation to competency, the quality of the human capital base in Malaysia is suspect. This is due to the quality of education from preschool through tertiary and on-the-job training. It is linked with ethnicity issues and is exacerbated by the outflow of high-skill individuals and affected by the inflow of low-skill labor.

There are not only problems on the supply side of the market for skills, but also on the demand side, where firms may not be competitive enough to offer higher wages. The market for skills itself is also problematic in that the price mechanism does not work adequately and this is where wage-setting issues play a role.

A bigger and more important challenge than competency is the question of internal competition. This is quite distinct from external competitiveness, on which front Malaysia has scored relatively well in the merchandise sector given its stage of development and the nature of its manufacturing processes which are still dominated by competitiveness identified by low cost rather than high value.

Internal competition refers to the allocation of certain factors including labor, capital, land and product markets. Internal competition works well when there is good governance, openness and transparency. It relates to the need for deregulation, liberalization and competition policies especially in key areas such as government procurement and the activities of GLCs in the domestic economy.

All of these are also needed to produce effective competition for good ideas and good policies as well as competition in the political arena. This of course challenges the basic idea of meritocracy and affirmative action in Malaysia.

To reform these will ostensibly mean changing Malaysia's embedded incentives and institutions. This definitely means undoing the manifestations of Malay/Muslim supremacy.

### **Can UMNO implement these reforms?**

My hypothesis is that the present leadership in Malaysia within the Barisan Nasional framework is incapable of institutionalizing reforms as the present leadership does not meet the criteria set out by Spence for a simple reason – its ideology. This ideology that overrides and at the same time influences all other norms, rules, conventions, habits and values is the ideology of Malay/Muslim Supremacy.

As the Prime Minister of Malaysia always comes from UMNO it will be impossible for him or her to undo the cornerstone ideology of his/her political party and its adherents in the Barisan Nasional, which includes Malays and non-Malays.

The logic above is discussed extensively in the political science literature. To summarize, the Malay/Muslim ideology provides psychological and material benefits to its adherents. This makes it a potent force for groups that rely on this ideology. However, since it is deeply embedded, it is also extremely difficult to counter when needed. Malaysia's present institutional equilibrium is a reflection of the strength of the adherents of Malay/Muslim supremacy, known by its Malay-language slogan *Ketuanan Melayu*.

There are many examples to illustrate Malay/Muslim supremacy but the one that is cited most often as holding back Malaysia's economic reforms is affirmative action, the most comprehensive in the world. It has by inference been touted as the one of the key reasons for Malaysia's declining economic performance although causality has not been explicitly demonstrated.

Supporters of affirmative action argue that Article 153 of the Federal Constitution provides the Bumiputeras the right to this extensive affirmative action. However this is factually incorrect.

Article 153 of the [Malaysian Federal Constitution](#) states that:

153. (1) It shall be the responsibility of the Yang di-Pertuan Agong to safeguard the special position of the Malays and natives of any of the States of Sabah and Sarawak and the legitimate interests of other communities in accordance with the provisions of this Article.

(2) Notwithstanding anything in this Constitution, but subject to the provisions of Article 40 and of this Article, the Yang di-Pertuan Agong shall exercise his functions under this Constitution and federal law in such manner as may be necessary to safeguard the special position of the Malays and natives of any of the States of Sabah and Sarawak and to ensure the reservation for Malays and natives of any of the States of Sabah and Sarawak of such proportion as he may deem reasonable of positions in the public service (other than the public service of a State) and of scholarships, exhibitions and other similar educational or training privileges or special facilities given or accorded by the Federal Government and, when any permit or license for the operation of any trade or business is required by federal law, then, subject to the provisions of that law and this Article, of such permits and licenses.

In more simple words, the Federal Constitution limits affirmative action to placement in the civil service at the Federal level, scholarships and permits and licences for

Bumiputras and only if necessary and in a reasonable manner by the Prime Minister who advises the Yang diPertuan Agung.

**Does the Prime Minister have the power to revoke or reform affirmative action policies?**

**Yes, he does.** Malaysia is a constitutional monarchy where the monarch reigns but do not rule. Article 153 is subject to Article 40 and Article 40 states that the Yang diPertuan Agung must act on the advice of the Cabinet.

40. (1) In the exercise of his functions under this Constitution or federal law the Yang di-Pertuan Agong shall act in accordance with the advice of the Cabinet or of a Minister acting under the general authority of the Cabinet, except as otherwise provided by this Constitution; but shall be entitled, at his request, to any information concerning the government of the Federation which is available to the Cabinet.

**The decision to continue or reform affirmative action policies and the attendant institutions in Malaysia lies solely at the prerogative of the Prime Minister along with his colleagues in Cabinet as stated in Article 40.**

With power centralized in the Executive (Cabinet), and with the Prime Minister already having six Ministers of 31 from the Prime Minister's Department in the Cabinet, and with the Prime Minister himself holding two portfolios (Prime Minister and Finance Minister I), and legitimised by the Constitution (Article 40), the Prime Minister should on all counts, be able to implement these reforms without much difficulty.

Yet he has been unable to do so for the simple reason that the Federal Constitution may be the law of the land but it is clearly not the supreme power/ideology in Malaysia. The supreme power/ideology is the primacy of Malays/Muslims as defined by UMNO. Hence the Prime Minister may have de jure power to reform, but he does not have de facto power. This power resides among the Malays and non-Malays who support Malay/Muslim supremacy and the current institutional set-up.

Until and unless this supreme ideology of Malay/Muslim supremacy is removed, Malaysian politicians will be constrained in making the necessary institutional reforms to move Malaysia towards long term sustainable growth.

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