**Poverty and Income Inequality in Developing Countries: A Policy Dialogue on the Effects of Globalisation**

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# Globalisation, Economic Policy, and Equity: The Case of Malaysia

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## 1. INTRODUCTION

Prior to 1957, the Malaysian economy was heavily dependent on primary products, specifically tin and rubber, to generate growth and employment. The role of manufacturing was quite minor involving the processing of rubber, tin, timber, foodstuffs and light engineering works. Initially, Malaysia pursued a development strategy that focused on the diversification of agricultural exports as a means to stabilize its export earnings and income. Over the next few decades, Malaysia developed rapidly and experienced a transition from agriculture to industry. These structural adjustments occurred due to the deliberate government policies to industrialize the economy through the import substitution and export-oriented industrialization strategies.

The Malaysian development policies are clearly spelt out in her 5-year development plans called the Malaysia Plan that emphasises growth with equity in the context of multi-racial society. Prior to the 1970s, there was a serious economic imbalance in Malaysia in the areas of distribution of income, employment, ownership and control of economic activity.

After the 1969 racial riot, Malaysia realized the importance of growth with equity and therefore it was decided that the economic development of the country must be equitably shared by all the ethnic groups. Toward this end, Malaysia introduced the New Economic Policy (1971-90), followed by the National Development Policy (1991-2000). The main objective of the two economic policies is to eradicate poverty irrespective of ethnic groups. Those who are poor must be assisted and equipped with training and necessary resources to improve their standard of living.

As a result of successful implementation of the poverty eradication policies, Malaysia was able to significantly reduce the incidence of poverty from 49.3 percent in 1970 to 8.9 percent in 1995. The income share of the top 20 percent of the households fell from 55.5 percent in 1970 to 50.3 percent in 1989 while that of the bottom 40 percent increased from 11.5 percent to 14.5 percent in the same period. Accordingly, the distribution of income among the households improved as indicated by the fall in the Gini coefficient from 0.513 in 1970 to 0.445 percent in 1989. The more equitable wealth distribution coupled with high economic growth spearheaded by the vibrant external sector in the last three decades have been translated into racial integration and political stability. Along this line, IMF argues that policies that promote equity have the ability to reduce poverty because when income and wealth are more evenly distributed, the number of people below the poverty line decreases. Furthermore, equity-enhancing policies, particularly investment in human capital, can boost economic growth in the long run and thus alleviate poverty and reduce political conflicts (IMF, Finance and Development, 1998).

Globalisation has provided several positive and negative effects to the Malaysian economy, particularly in terms of income distribution, employment, and the need for skilled and educated workforce and labour policy and planning. Obviously, globalisation has had positive results on the country's economic growth through trade expansion and foreign direct investment that opened new channels for economic expansion. Thus, during the rapid globalisation periods of 1980s and 1990s, the Malaysian economy became more integrated with the world economy; her share of exports and imports in GNP rose by about 75 percent. This was translated into a buoyant economic growth as Malaysia grew at about 8 percent during the 1987-97 period spearheaded by the exports of manufactures.

The process of globalisation may help only certain groups of people to become richer and this will widen the gap between the rich and the poor. Therefore, the key for success in the era of globalisation is education. If the educational system does not adjust rapidly enough to meet the demand of the labour market it is going to create problems for the majority of workers, especially women and those with only primary education and below. This is because the labour force in Malaysia increased from 3.7 million in 1970 to 9.0 million in 1997 and there was a significant increase in the participation of women in the workforce, especially in the manufacturing sector. The women participation rate in the labour force increased from 37.2 percent in 1970 to 46.7 percent in 1990.

Fortunately, Malaysia has been emphasising human capital as an important ingredient in her development plans. After the racial riot in the late 1960s, Malaysia revised her education policy to allow the primary and secondary school education opened to all races almost free. The policy had improved the quality and access of education to all the ethnic groups both in the urban and rural areas. The skilled and semi-skilled man-power were expanded through the training programs in the fields of vocational, technical, industrial, and agriculture. The tertiary education expanded rapidly in the last 30 years to provide the middle and high level manpower. As the demand for higher education was high, Malaysia started to liberalize her higher education policy in 1990s to make higher education accessible to the public, including the distance learning to encourage life-long education. In the 1990s, Malaysia approved the establishment and operations of a number of new public and private universities, and private colleges to prepare herself toward the knowledge-based economy as a means to reap the benefits of globalisation.

The main objective of this study is to analyse systematically the relationship between globalisation and income inequality in Malaysia. Specifically, by using the available information and empirical evidence, this study analyses the effects of globalisation on poverty and how Malaysia formulates and implements effective development policies to minimize the adverse impacts of globalisation. We would hope that the conclusions drawn from this study will be useful to the policy makers to formulate wise policy actions relating to poverty and wealth distribution in the context of the developing economies.

The study begins with a brief remark, in the introduction, about the Malaysian economy and income inequality, followed by a discussion on economic growth and development policy in Section 2. An analysis on the process of integration of Malaysian economy with the world economy is given in Section 3. Section 4 discusses in detail about the past and present state of income inequality and policy reforms. The basic policies on wealth distribution and poverty eradication in the light of globalisation are discussed in Section 5 while Section 6 summarizes the conclusions and policy implications of the study.

## 2. MACROECONOMIC PERFORMANCE AND DEVELOPMENT POLICY

The objective of this section is to provide an overview of the industrial development of Malaysia and her growth performance. The focus is on issues pertaining to natural resource endowment, ownership of assets, industrial policy, and macroeconomic performance. These issues are interrelated and will be further elaborated in the other sections of the paper.

### 2.1 Natural Resources, Factor Endowment and Ownership

Malaysia has been blessed with natural resources. It is endowed with fertile land and minerals and therefore prior to the 1970s Malaysia was one of the chief producers of natural rubber and tin in the world. In the early 1970s, Malaysia started to diversify its agricultural sector by planting more oil palm in large scale and by now Malaysia is the largest producer and exporter of palm oil in the world. Malaysia diversified further its agricultural sector by growing cocoa in large scale in Sabah but the venture has not been as successful as oil palm. Malaysia also produces and exports oil and natural gas and these have helped ease Malaysia during economic adversities caused by oil price increases in the 1970s.

Prior to the 1970s, foreigners owned most of the large plantations with rubber and oil palm while the local Chinese and the Malays mostly owned the smaller plantations. But in the 1970s there was evidence that the ownership of the large plantations was going into the hands of the locals, including the state and Federal governments (Tan, 1982). The tin mining industry was dominated by the foreigners, mainly the British, but later most of the tin mining companies were bought over by the Malaysian Mining Corporation.

In the 1960s, the ownership of the corporate sector was skewed in favour of foreigners. It was obvious that Malaysian economic activities in the plantations agriculture, mining, manufacturing, wholesale trade, banking and finance were under the control of the foreign limited companies. But in the New Economic Policy, the government set a goal that in 20 years the Malays and other indigenous people (Bumiputra) should manage and own at least 30 percent of the total commercial and industrial activities in all categories and scale of operations. In 1971 the Bumiputra owned 9.2 percent, non-Bumiputra at 34.0 percent and foreigners at 61.4 percent. The New Economic Policy that began in 1971 focused on the mechanism of the distribution of wealth such that races should not be distinguished by their economic functions. As a result, the ownership of the corporate sector improved in favour of the Bumiputra and Non-Bumiputra at the expense of the foreigners. Thus in 1990 Bumiputra and non-Bumiputra ownership increased to 20.3 percent and 46.2 percent respectively, while the foreigners decreased to 25.1 percent.

## 2.2 The Structure of the Economy and Growth Performance

Malaysia experienced high economic growth for more than a decade, after the 1985 recession until the 1997 financial crisis, when it grew, on average, at 7.8

Table 2.1: Malaysian Macroeconomic Indicators

| | 1970 | 1975 | 1980 | 1985 | 1990 | 1995 | 1997 |
|---|---|---|---|---|---|---|---|
| Real GDP Growth (%) | 6.5 | 3.5 | 7.4 | -1.0 | 11.5 | 9.4 | 7.7 |
| Share in GDP(%) of | | | | | | | |
| Agriculture | 30.8 | 27.2 | 22.2 | 20.8 | 18.7 | 15.5 | 11.9 |
| Manufacturing | 13.4 | 16.4 | 20.5 | 19.7 | 20.7 | 32.4 | 35.7 |
| Services | 45.6 | 47.5 | 48.2 | 44.3 | 47.4 | 44.3 | 44.8 |
| Saving and investment Ratio | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Saving ratio (%) | 21.6 | 19.2 | 27.2 | 29.3 | 30.4 | 35.3 | 39.4 |
| Investment ratio (%) | 21.4 | 24.2 | 29.6 | 32.4 | 32.7 | 45.7 | 44.8 |
| Inflation (%) | 1.9 | 2.1 | 7.1 | 0.4 | 3.1 | 5.3 | 2.6 |
| Unemployment (%) | 7.8 | 6.4 | 5.3 | 6.9 | 6.0 | 2.8 | 2.6 |
| Exchange Rate (RM/US$) | 3.08 | 2.26 | 2.28 | 2.58 | 2.72 | 2.54 | 2.48 |
| Current account (% of GNP) | 0.02 | - 1.6 | - 3.5 | - 2.1 | - 4.8 | - 1.0 | - 5.4 |
| Xmanuf/TX (%) | 6.5 | 11.5 | 12.2 | 18.2 | 29.5 | 38.8 | 40.5 |
| TMX/GNP(%) = openness | 77.3 | 82.2 | 103.4 | 95.1 | 143.6 | 182.2 | 169.2 |

Source: Economic Report, Ministry of Finance Malaysia; Malaysia Plans (various issues)

Notes: TMX = imports + exports

TMX/GNP = (imports + exports)/GNP

Xmanuf/TX = exports of manufactures/Total exports

RM = Ringgit Malaysia (Malaysia's currency) percent per annum in real terms spearheaded by a strong performance in the manufacturing sector. The share of manufactures in GDP increased significantly from 13.4 percent in 1970 to 35.7 percent in 1995(Table 2.1) at the expense of agriculture. The Malaysian economy is very open. The share of exports and imports in GNP increased from 77.3 percent in 1970 to 169.2 percent in 1997 indicating that Malaysia has become more integrated with the world economy, especially in the periods of rapid globalisation of the 1980s and 1990s.

In the early 1970s, Malaysia experienced a shortage in capital and therefore the capital-labor ratio and technology level were low. During the period, Malaysia concentrated in agriculture and labor intensive industries such as textiles and garments, and electrical machinery, particularly electronics, to exploit the availability of cheap labor. Most of the products were exported to industrialized nations, especially to the United States and Japan.

As regard to the services sector, it is still not as developed as the manufacturing sector, although the contribution of the sector to GDP was high at 46 percent in 1975 but fell to 44.8 in 1998. The exports of services were low at 5.4 percent of GDP in 1970 which increased to 7.1 percent in 1975. Malaysia  depends too much on the import of foreign services, especially freight, insurance and consultancy services. Thus in 1970, 26.8 percent of the imports were services although it declined to 22.2 percent in 1975

There were significant changes in the factor intensities in the manufacturing sector due to significant investment in machinery and equipment toward more sophisticated technologies. The high rate in capital accumulation and skill development had led to significant increase in labor productivities. The manufacturing sector grew at 26.2 percent in 1970s, coupled with large increases in the prices of petroleum in 1974 and 1979, had led to high economic growth during the period. Consequently there has been significant changes in the structure of Malaysian exports. In 1970, the share of the manufactures in the total exports was only 6.5 percent but by 1995 the share rose to 40.5 percent indicating that the manufactured exports are becoming more important in the foreign exchange earnings.

Malaysia suffered a recession in mid-70s due to sluggish external demand. But the external demand improved during 1976-80 period which led to higher private investment facilitated by favorable monetary and fiscal policies, higher rates of saving and foreign capital inflows. Private investment was made more attractive by the introduction of export incentives to increase exports, accelerated depreciation allowance on plant expenditure for modernizing production techniques, and increase capital allowance for projects not qualified under the pioneer status.

In the labour market, the labour force increased at 3.9% during the period of 1970-80, from 3.7 million in 1970 to 5.4 million 1980 while labour productivity grew at 3.6% due to better educational and skills of the workforce, adoption of new technology and modern equipment, and the modernization of the administration services of the public and private sectors. Labour productivity measured by the value added per worker increased from RM9280 in 1980 to RM11950 in 1990.

Malaysia suffered the saving-investment gap since 1970s. For example, her saving and investment ratios in 1995 were at 35.3 percent and 44.8 percent respectively. Although saving increased significantly from 21.6 percent in 1970 to 39.74 percent in 1997, these could not match the amount of investment required for the development of the economy. As a result, Malaysia resorted to foreign borrowing to close the saving gap. So far Malaysia has not experienced serious foreign debt service problem and in fact she could raise money from foreign capital markets quite easily.

The position of current account, consisting of merchandise balance and services balance, fluctuated depending on whether the surplus trade balance could compensate for the always in deficit of the services account. The current account deficit has been the trade mark of Malaysia since she has been suffering from the services account deficits caused by the excessive out payments in freight, insurance and investment income stemming from foreign direct investment. This is because Malaysia has been mostly using the foreign shipping lines and insurance companies when she exports and imports goods and services from abroad.  She also encourages foreign investment as a means to industrialize the economy.  As a result, substantial amount of money in the form of dividends and profits are repatriated to foreign multinationals investing in the country.

**2.3 Industrial Development Policy**

Malaysia began to pursue an import substitution development strategy in 1960s and gradually moved toward an export-oriented industrialization strategy in 1970s. A key element of this strategy was to rely on foreign direct investment to achieve high economic growth through industrialization. Thus, investment acts were introduced to attract more foreign participation in the manufacturing and services sectors. Malaysia has also been aggressively pursuing the second round import substitution strategy since 1980s through its Heavy Industries Corporation of Malaysia with full government backing as a means to develop the heavy industries such as the locally manufactured car, cement, and steel industries.

The industrialization strategy began with the introduction of tax incentives offered to pioneer industries in 1958, followed by the imposition of tariffs and quotas in the early 1960s to encourage the development of import substituting industries. Most of these import substitution industries were concentrated in the production of consumer goods for the domestic market and they were mostly owned by the foreigners. In order to protect the infant industries, Malaysia had to erect high tariff wall, import control, offer fiscal incentives such as tax holidays, and tax exemption on capital goods and raw materials imported from abroad. A wider range of incentives were introduced in the Investment Incentive Act 1968 for companies investing in new enterprises or expanding existing ones to attract domestic and foreign investment. These incentives include total or partial relief from payment of income tax and development tax, locational incentives to disperse industries, and labour utilization relief to encourage labour-intensive industries.

In the early 1970s, Malaysia began the export-oriented industrialization strategy. The shift in emphasis from the import substitution to the export promotion was prompted by the saturation of the domestic market and as well as the resultant creation of unbalanced regional development in the domestic economy. This was particularly relevant as most of the import substitution industries were concentrated in the periphery of major towns, where the market of the products were located, and therefore there was a serious migration of population from the rural to the urban areas.  Furthermore, import substitution industries were under high tariffs and non-tariff protection which encouraged them to be very complacent, inefficient and also lack of linkages with the other sectors of domestic economy since they normally relied heavily on the imported inputs.

In Malaysia, most of the manufacturing activities and services industries have been concentrated in the West coast of West Malaysia, especially in the urban areas of Selangor, Penang, and Johor. Therefore, the people in the less developed states in the Northern Malaysia like Kelantan, Kedah, and Terengganu migrated to these urban areas looking for jobs with better wages.  But the costs of living in the urban areas were high relative to their income.  As a result many of the workers who chose to work in the urban centres ended up living as squatters in order to make the ends meet. The rural-urban out-migration of population in Malaysia has been quite serious.  Nowadays it is quite difficult to persuade the youths to work in the rural areas (agricultural sector) as the pay is low and not commensurate with their efforts. As a result, Malaysia now has to depend on emigrant workers from neighbouring countries like Indonesia, Thailand, and Bangladesh to work in the large plantations. These workers have remitted a large sum of money to their own countries. Of course some of these foreign workers came to Malaysia with the intention of staying permanently.

Singer and Alizadeh (1988:72) argue that the import substitution and export-oriented development strategies are complementary since the export-oriented industrialization may lead to the creation of more import substitution industries as a means to reduce the import content of the exports and increase linkages from the export sector with the rest of the domestic economy. This would result in the dispersal of the manufacturing industries. This phenomenon is happening in Malaysia where the export-oriented industries exist along the import substitution industries, including the second-round import substitution industries. Recently the focus of the industrialisation strategy is on the export-oriented industries, but ultimately even the import substitution industries have to export their products as the domestic market is small.

In 1977 the export refinancing facilities was also introduced to provide credit facilities to the Malaysian exporters of manufactured goods at preferential rates. The government also expanded expenditures to increase physical infrastructure for industrial development, especially the establishment of industrial estates and Free Trade Zones in the designated regions of the country. Export incentives was also introduced to provide export allowance based on export sales and tax deductions for promotional expenses in the overseas markets. The generous investment incentives offered to foreign investment had resulted in large investment inflows in the manufacturing sector.

Malaysia experienced a recession in 1985 when its GDP recorded a negative growth at 1 percent. As the foreign direct investment fell sharply, Malaysia introduced the Promotion Investment Act 1986 to replace the Investment Act 1968 to extend more attractive incentives to investment in the manufacturing, agriculture and services sectors. The incentives, among others, include allowances for building, expansion, and modernization of hotels, incentives for R&D, and as well as the creation of Investment Guaranteed Agreement to avoid the non-business risks, such as the nationalization of companies, and to liberalize the inflows and outflows of capital.

## 3.0 INTEGRATION OF THE MALAYSIAN ECONOMY

Malaysia has a relatively open, market-oriented economy since independence. The economy has exhibited sustained growth and increasing diversification over the past decade, led by strong performance in the foreign and domestic investment together with an increase in manufactured exports. Hence, in the 1980s, Malaysia had set its goal to acquire an industrial status by the end of the 1990s, besides being a vibrant commodity-exporting country. This section discusses the process of economic integration as Malaysia moves from being a producer and exporter of commodities to a country that is an exporter of manufacturing products. The discussion focuses on trade and financial liberalisation that accelerated the process of globalisation in the 1980s and 1990s.

### 3.1 Trade Liberalisation

### 3.1.1 Exports, Imports and Terms of Trade

Malaysia remains an open trade oriented economy despite the profound structural change throughout its post-independence period. The economic position was strong in the 1960s to 1970s and this basic strength came from the merchandise account which was consistently in surplus during the export boom years during the periods (Sheng, 1985). The exports and imports accounting made up a substantial proportion of its GNP. Such an open economy like Malaysia has always been vulnerable to the swing in market sentiment. In the pace of its growth in world trade, its economy is heavily influenced by the economies of its major trading partners particularly USA and Japan.

As Malaysia also relies on a few major primary commodities such as rubber, tin, oil palm, and petroleum. A downswing in the prices of these commodities has far reaching repercussions on the economy. The prolonged global recession of the 1980s and the 1990s dampened the demand and prices for all Malaysian major export commodities. When export earnings of these commodities fall government revenue consequently declined and hence, development programmes had to be trimmed down according to the available financial resources. For instance in the 1960s the economy recorded a strong growth despite sharp fluctuation in the prices of its principal exports which led to a decline in the terms of trade by almost 20 percent.

Despite the decline terms of trade, the quantum of export earnings improved substantially, that is from US$0.842 billion in 1961 to US$1.368 billion in 1970 due to significant expansion in the volume of export of rubber, palm oil and timber. However, such high export earnings were not translated into high rate of investment. The 1970s saw sustained improvement in the export sector due to the increasing importance of petroleum and gas as the export earner. In consequent to that, gross national savings rate improved to about 30.6 percent. Hence, the country was able to sustain relatively high levels of public investment, without sustaining deficit in the current account or resorting to huge foreign borrowings.

In the 1980s however, the prices of the major export primary commodities continue to show a pervasive downward slides. For instance receipts from export of rubber declined from US$1215 million in 1980 to US$976.84 million in 1981. The unattractive price of rubber continued through the 1990s. As the price of rubber continued to be unremunerative, planters' and smallholders' confidence weakened and it had discouraged tapping activity especially among the smallholders which made up of almost 80 percent of the country's rubber producers. Tin faced a more pathetic situation with a sharp fall of export earnings in the commodity from US$0.421 billion in the 1985 to US$171.05 million in 1986. This was because of the price of tin fall from US$7.81 per kg (1985) to US$4.05 (1986). Earnings in sawn timber also fell in the 1980s despite being able to fetch higher price per cu. meters. This was because production in the two commodities slowed down and both tin and timber suffered increasing depletion of the natural resources

The palm oil price exhibited rather erratic movements in response to the world market price movements. The price dropped from an average US$423.95 per tonne in 1984 to US$289.47 in 1985. During 1986 the price had dropped further to about 47 percent below the 1985 price, thus, badly affecting the income of the smallholders in the settlement schemes. Nevertheless, Malaysia's dependence on palm oil continued to increase, as the returns from the commodity have been rather favourable compared to other industrial crops. Its annual value-added increased by 7.9 percent in 1998 reaching US$1394.74 million, securing a position as the single largest contributor to the total value-added in the agricultural sector.

Where petroleum is concerned, the export volume actually increased 12 percent in 1986 to US$4.92 million tonnes. The collapse in world prices had caused the average weighted price of the crude oil to fall 46 percent in 1986 to US$14.82 per barrel compared to US$27.60 in 1985. Thus, the oil export earnings had fallen more than US$0.789 billion in 1986. Proceeds from petroleum fell from US$2299.2 million in 1984 to an estimated value of US$1436.05 in 1986. Another important primary commodity, liquefied natural gas, also suffered a decline in price. After experiencing an increase in the proceeds from US$218.7 million (1983) to US$0.605 billion (1985), its export value dropped to US$0.5 billion (1986). Despite a significant rise in volume of exports from 4.5 million tonnes in 1985 to 5.2 million tonnes in 1986, the fall in price by 29 percent had caused its income from export to decline from US$134.47 to US$95.79 per tonne in 1986. Whilst the export value of primary commodities declined relatively, export earnings of manufactured goods showed positive signs. This is mainly due to the expansion of exports of electrical and electronic products. Being an open economy, Malaysia could not avoid but faced the difficult world trade environment of the growing protectionism of the industrialised economies. This was reflected by the slower growth of the sector which "indirectly these effects can be translated into domestic demand contraction." (Osman Rani, 1987)

In the 1990s export of agriculture products declined further due to the softening of prices of the major primary commodities; palm oil, rubber, saw logs and sawn timber. However overall, with higher increases in the prices of exports compared to import prices, the terms of trade improved for the period 1990 and 1995. The higher rise in exports prices were due to favourable export prices for manufacturing products and this led to higher export earnings during the period. Over the period, there was a 1.3 per cent improvement in the terms of trade.

Before the 1997 crises, the prices of exports were higher than the prices of imports due to the improvements in the quality of exports and a stable exchange rate. The terms of trade continued to improve and thus increased export earnings over the period. During the crises, the highly unstable exchange rate led to the worsening of the terms of trade and this led the government to enforce the fixed exchange rate in September 1998.

### 3.1.2 Trade Liberalisation Programmes

The government has consistently pursued trade liberalisation programmes albeit pursuing it in an ad hoc manner (Okamoto, 1994). Although there was a second round of import-substitution phase during the period 1980-1985 (after the first phase in the 1960s), Malaysia's tariff rates were still low compared to other developing nations (Table 3.1). However, as part of the import-substitution strategy, certain industries were accorded high rates of effective protection such as the tyre, cement, steel and automobile industries. This import substitution phase did not last long as the government emphasised again on the outward-oriented strategy by the mid-1980s due to several reasons.

Table 3.1 Tariff rates of selected ASEAN countries, 1975-1990

| Year | Malaysia | Singapore | Thailand | Indonesia |
|---|---|---|---|---|
| 1975 | 10.25 | 1.32 | 13.80 | 10.02 |
| 1980 | 9.79 | 0.90 | 11.18 | 7.39 |
| 1985 | 9.12 | 0.72 | 13.51 | 5.97 |
| 1990 | 4.78 | 0.34 | 11.58 | 6.92 |

Source: Kawai (1994)

Firstly, this strategy was not able to generate the economic growth as expected and secondly the protected infant industries were not able to be internationally competitive even after many years of protection. As a result, the export sector was liberalised through various measures that include removal of export licensing requirements, elimination of export duties and abolishment of export taxes on some products. Tariff rate on many consumer products was also reduced. Under GATT, Malaysia offered to reduce tariffs for over 1,000 items. As these tariffs are binding, the agreement further reduced the country's tariff rates.

### 3.1.3 Generalised System Preferences

As a developing country, Malaysia was able to benefit from the GSP status whereby the country's exports were given preferential access through GSP to 14 countries. In 1991, the share of exports with GSP status was 11.9 per cent and in 1995, the share increased moderately to 12.5 per cent. Most of the products under GSP were manufactures and semi-manufactures (80 per cent of total GSP exports). In 1997, the USA ended some of the GSP privileges accorded for Malaysia's exports while the EU also ended its GSP scheme in some sub-sectors. Even though this removal had some impact on the export sector, tariff reductions under the WTO helped balanced, to a certain extent, the removal of GSP status.

The government continues to encourage exporters to prepare themselves for increased competition especially with ASEAN Free Trade Agreement taking effect from 2001. The growth of Malaysian exports and expansion of trade in new markets have helped exporters to compete globally in the market place. Local domestic exporters were encouraged to benefit from economies of scale and to increase their use of local content particularly in intermediate and capital in their manufacturing activities.

### 3.1.4 Migrant Workers

The industrial development experienced by Malaysia generated an increasingly greater demand for workforce in the manufacturing and industrial sectors. With this higher demand of labour came the shortage of domestic workers for employment in these sectors. In order to overcome this shortage, foreign workers were employed as they were seen as the most viable solution. According to an estimate by the Ministry of Human Resource (1993), among the 1,461 giant international companies in Malaysia, these companies required 314,955 workers especially semi-skilled (162,480) and unskilled workers (92, 485). Most of these workers came from countries like Indonesia, Bangladesh, Thailand and the Philippines.

The sector employing the largest number of workers has been the services sector with 56.8 per cent of the work force in 1998. The second largest employer is the manufacturing sector (26.5 per cent) and agriculture (16.3 per cent). Between 1980 and 1990, the number of jobs created by FDI was 40,351 and 171,646 respectively. Due to the shift from labour-intensive to capital intensive investments, the number of jobs created declined to 56, 835 in 1997. A survey conducted by Bank Negara (1996) showed that Malaysia-owned companies had a lower share of foreign workers (1:13) as compared to foreign-owned companies.

The manufacturing sector had more than 50 per cent of the total foreign workforce in 1990 where out of 290,000 foreign workers in Malaysia, 144,196 were in the manufacturing sector. However by 1995, the manufacturing sector employed about 14 per cent of the total foreign work force in Malaysia. This decline can be attributed to the structural shift from labour to capital intensive industries. In terms of remittances, the Human Resource Ministry disclosed that about RM2.4 billion was sent home annually by an estimated one million foreign workers.

With continued economic growth and industrialisation of the economy, there will be challenges faced for the demand of labour. With employment creation at 3.4 per cent for year 2000 and unemployment at about 3 per cent, there will be shortages in the workforce (Malaysia, 1999). The flow of migrant labour will continue and a rough estimate of the 1999 migrant labour is about 8 per cent of the total population of the country (Karim, Moha and Mohd Isa, 1999).

## 3.2. Financial Liberalisation

### 3.2.1 Domestic Financial Reforms

During the mid-1980s, falling resource prices led to the temporary worsening of the terms of trade. Combined with the economic slowdown in 1985, this led to a crisis in the real and financial sectors. The contraction of the economy led to cash flow problems of companies and caused high debt problems. Together with rapidly falling share and property prices, the number of non-performing loans for financial institutions increased. The same scenario was experienced during the recent 1997 economic crises. In an open economy like Malaysia, changes in the world markets are bound to have an effect in the economy.

One of the biggest challenges facing the Malaysian economy is the rapid transformation of the global economy and the emergence of the lower cost competitors. Hence, the Malaysian financial system must evolve to play its appropriate role in terms of its ability to position itself to support the economic transformation and to act as catalyst towards becoming a higher value-added and knowledge-based economy (K-economy) for the future sustenance of economic growth

The recent financial crisis demonstrated the vulnerability of the country's banking and other financial institutions because of its fragmented nature and the inadequate risks management process of the banking institutions itself (Bank Negara Malaysia,1999). Thus, it heightened further the need for developing more diversified forms of financing in the economy in order to reduce over-reliance on the banking system. The consolidation and mergers of the financial institutions was also driven primarily by the increase in global presence as well as to maximise the economies of scale and the scope of economic activities.

The globalization process would also bring about the trend towards greater liberalization of the financial system; this would apparently reduce barrier to entry in the domestic financial sector that would intensify competition over time. It is therefore crucial for the financial institutions to be able to manage the international capital flows, particularly the short-term capital flow. A lesson learnt from the Asian crisis, the reversal of the short-term capital flow had complicate the management of the macroeconomic policy. Given a small open economy like Malaysia where the magnitude of the international capital flows was beyond what the domestic financial market could support, such flows thus, resulted in sharp movements in interest rates, exchange rates and assets prices (Bank Negara Malaysia, 1999).

Thus, the domestic financial markets liberalisation in the 1980s and 1990s mainly consisted of internal liberalisation through mergers and acquisitions. Both domestic and foreign entry is restricted and foreign firms are not allowed to open branches or operate ATMs. In addition, foreign participation in domestic banks is limited to 30 per cent ownership and in other financial firms, up to 49 per cent ownership. Thus, for Malaysia domestic financial liberalisation do not directly lead to overshooting and macro economic instability. During the recent 1997 economic crises however, capital account liberalisation has been partly blamed for the macro economic instability experienced during the period.

### 3.2.2 Capital Flows

The 1980s and 1990s were the era of economic globalisation where all economic activities had gone beyond the boundaries of individual economies. Before the 1997 Asian Crisis, Malaysia had managed to weather the third oil crisis reasonably well, particularly in the earlier part of the 1990s.  Despite the crisis, Malaysia gained from the economic globalisation in two dimensions, that is trade and capital flows, which had contributed to the growth of the Malaysian economy.

Capital inflows into the country were actually driven by several external "push" and internal "pull" factors (Reinicke, 1998). In the external scene, decline in international interest rate in 1990 and together with recessions in the United States, Japan and several European countries made investment in the emerging market like Malaysia, attractive. At the same time there was the withdrawal of privileges under the generalised System of Preference (GSP) from the Newly Industrialised Economies (NIEs) which encouraged the outflow of capital from these countries. Malaysia and other Southeast Asian countries had benefited from the outflows due to the liberalised investment and trade policies of the region. Another external factor was the fast development of the institutional investors, such as mutual funds, seeking for long-term profits and to diversify investment risks.

The internal pull factors of FDI inflows into Malaysia were the country's strong economic fundamentals and political stability. The low inflation rate, stable exchange rate and interest rate differentials were some of the attracting factors of foreign capitals into Malaysia. Besides, the Promotion of Investment Act (PIA) of 1986 was enacted for the purpose of stimulating private investment, particularly foreign direct investment (FDI) through competitive packages of fiscal incentives. Under the guidelines of equity ownership, FDIs enjoy the liberalised condition of 100 percent ownership subjected to 80 percent or more of their production, which are produced for exports. As a result, net flow of long-term capital account increased between 1987 and 1992. However, between 1993 and 1995 the corporate investment fell slightly due to the global economic slowdown that checked the inflow of capital to the developing economies.

As the private investment was about to pick up again (in 1996 and 1997), the Asian currency crisis in 1998 badly affected the corporate investment in Malaysia. Consequent to the exchange rate uncertainties and low business confidence, private investment growth had fallen dramatically. Malaysia was hit by a huge fall in the value of its currency (the Ringgit). The economic growth contracted in the first and second quarter of 1998 by 2.8 and 6.8 percent respectively. This was accompanied by a massive rise in the cost of borrowings and the withdrawal of bank lending and credits.

The fall of the ringgit led to the collapse of confidence and investment and the "entire weight of a vicious cycle from which there was no escape, it was believed that all major Malaysian companies would simply go bankrupt; the small and medium scale enterprise would simply die." (Noordin, 1998). The crisis of 1997 had created an unanticipated depreciation of the ringgit by over 35 percent against the US dollar, which further badly affected the financial sector. The Kuala Lumpur Stock Exchange experienced severe contraction of its market capitalisation, while the non-performing loans (NPLs) in the banking system increased with the increase in number of corporate insolvency (Tham, 2000).

### 3.2.3 Exchange Rate Regime

Before the financial crisis Malaysia has adopted the flexible exchange rate. Since the start of the financial crisis the ringgit had been volatile due to the many external and internal forces influencing the exchange rate. Business planning and investment decisions were hard to make since what may seem good business decisions at present may turn out to be disastrous later because of the unpredictable and unfavourable exchange rate movements.

In the midst of the economic turmoil Malaysia took an unexpected turn of barring ringgit trading with immediate effect to stop the continuous drain to the economy. A more stringent measures in the form of selective capital controls was introduced in September 1998 and the ringgit was pegged at RM3.80 to US$1 and the circulation of the currency abroad had been banned. Such changes in the exchange rate situation had weakened the confidence of both foreign and domestic investors over the ringgit. There was also the fear of emergence of the currency black market causing difficulties in getting access to foreign currencies. The fixed rate gave immediate relief by bringing confidence and certainty back to the domestic business sector.

**3.2.4 Foreign Direct Investment (FDI)**

As stated in the previous sections, Malaysia's development strategy had focused on investment- and trade-led growth. The privatisation and liberalisation program that was carried out following the economic slowdown of the 1980s saw a structural shift towards manufacturing, especially for exports. It had then become the lead sector of the economy. Such leap towards competitiveness had enhanced production for exports and together it was also supported by policies that had actively encouraged foreign manufacturers to locate in Malaysia. The presence of these foreign investors played a role in strengthening the private sector as the engine of growth.

The government continued its commitment further to maintain pro-business policies to woo the multinational corporations for long-term investments in the country. At the same time, stability and certainty of the investment climate was accorded by selective exchange control rules and fixed exchange rate. Subsequently, in 1999 the inflow of FDIs continued to dominate the manufacturing sector, which accounted 47 percent share of the total FDI. About 27 percent went into the service sector and 24 percent was in the oil and gas sector. Although the net foreign direct investment showed a moderate increase in 1999, investment in manufacturing project remained significant. This reflected the commitment and confidence of foreign investors to invest in the country (Bank Negara, 1999).

There are four main characteristics of Malaysia's foreign direct investment (Samuel, Abdul and Ong, 1999). The first characteristic is the flow of FDI is mutually beneficial to both the nation and the investors. Benefits for the foreign investors include generation and repatriation of profits, access to local inputs, increasing their market shares by reducing competition and establishing networks with the Malaysian government. The country benefits from FDIs through increased employment, exports, technology transfer, foreign exchange and linkages with MNCs.

Secondly, the experience of receiving FDI has helped Malaysia in investing in other countries. Thirdly, with FDI, the country's comparative advantage has evolved from agricultural-based to manufacturing-based, from labour-intensive to capital intensive, from import-substitution to export-promotion and from the traditional industries to the information and communication technologies. Finally, the Malaysian government has consistently welcomed FDI with various incentives and co-operation given through various agencies. In 1995, among ASEAN countries, Malaysia recorded the highest flow of FDI with investments of USD 5.8 billion (WIR, 1996). Between the years 1991 and 1997, Malaysia had a growth of 52.6 per cent in FDI.

The FDI in the import-substitution phase (1960s and early 1980s) was to cater for the domestic market. Among the strategy used by the government was through joint venture programmes to encourage both local and foreign participation in the industrial sector. There was a big increase in FDI investment between the periods 1980 to 1995 with a volume of RM120 billion. During the same period, the average growth of FDI was 45.8 per cent while for domestic investment it was 55.2 per cent.

FDI has been attributed as the main engine of growth for the Malaysian economy. As was discussed above, the main benefits from FDI to the Malaysian economy are in creating jobs, technology transfer, linkages, increased exports, output and balance of payments. Foreign corporations have been encouraged to move downstream and upstream in their manufacturing activities to provide for linkages and opportunities for small and medium scale industries.

For the 1990s, Malaysia has encouraged FDI flows in the high-technology industries to promote the Multimedia Super Corridor and to achieve the status of a fully developed nation by year 2020 as stated in Vision 2020. Even as the country was still coping with the economic crisis, in 1998 there were a total of 729 applications for manufacturing projects in Malaysia.

There was a shift in the main source of FDI over the years. In 1980, the biggest source of FDI was from Singapore but by 1995, the main FDI participant was the United States. Other main contributors of FDI between the period 1991-1997 were Japan, Taiwan, Singapore and Korea. These countries accounted for 67.4 per cent of total FDI in Malaysia. Two main sectors with FDI involvement were electrical and electronic products and chemical and chemical products with 73.4 per cent of total FDI.

Through FDIs, Malaysia's manufacturing sector was able to benefit from technology used by the foreign firms. Additionally, with outflows of FDIs by Malaysian firms overseas, the process of technology transfer can be further enhanced. Malaysia's investment in the United Kingdom and EU is mainly for research and development activities and potential technology transfer by the corresponding industries.

Malaysia do not have a clear-cut policy on technology transfer during the early phases of industrialisation and this was true even for joint venture programmes (Ghosh, 1998). During the later phases, however, there was substantial technology transfer from multinational corporations (MNCs). There were at least 601 technology transfer agreements between MNCs and the Malaysia government between 1981-85 (Beaumont, 1990). The transfer of technology usually is at the level of low technology and the transfer of technology was found to be better in American MNCs compared to Japanese MNCs (Narayanan et al., 1994).

### 3.2.5 Domestic Investment

During the 1980-95 period, while domestic investment decreased, FDIs increased from 34.7 percent to 49.4 per cent (Table 3.2). During the 1990-1995 period, domestic investment grew at the rate of 16.6 per cent. The growth of domestic investment was contributed to better economic performance, lower corporate tax rate and the increase in reinvestment allowance. The Domestic Investment Initiative was launched in 1993 to further enhance domestic investments. Most of the domestic investments were in the manufacturing and the oil and gas sectors. The other sector with large domestic investment is the services sector in areas where privatisation projects such as utilities, transport and communications were undertaken.

Table 3.2 Percentage of Investment (Foreign and Local) in the

Manufacturing Sector, 1980-1995

| Year | Domestic Investment | Foreign Investment |
|---|---|---|
| 1980 | 65.3 | 34.7 |
| 1985 | 83.1 | 16.9 |
| 1990 | 37.4 | 62.6 |
| 1993 | 54.3 | 45.7 |
| 1994 | 51.4 | 48.6 |
| 1995 | 50.6 | 49.4 |

Source: Moha (1999)

Real output growth in the economy was contributed to investments in physical infrastructure, R&D, education, skill training and FDI. The Total Factor Productivity (TFP) doubled from 1.2 per cent (1971-90) to 2.5 per cent (1991-95) or from 17.9 per cent of GDP to 28.7 per cent of GDP. Capital however continued to be the main contributor of GDP growth. Between 1996 and 1997, TFP contribution towards growth declined to 1.6 per cent or 19.5 per cent of GDP growth while capital contribution increased to 64.8 per cent and labour decreased to 15.7 per cent. The decline in TFP's contribution was attributed to the structural shift to higher technology and knowledge based industries that in the initial phase required high capital accumulation. Nadiri and Son (1999) found that the contribution of foreign capital towards TFP growth in Malaysia was 0.95 for the years 1960-1990. This was comparatively lower compared to Taiwan (2.89) and Singapore (2.83).

### 3.3. Privatisation

Realising the fact that private sector-led growth would lead to a higher level of economic success, the government begin to entrust a bigger role to the private sector initiative in terms of generating growth. Much emphasis was made on encouraging greater reliance on market forces and improving efficiency in the allocation and utilisation of resources. Less government intervention in the economy will lead to less ascendancy of non-economic considerations into the decision making (Zainal, 1987).

Privatisation programmes pursued by the government was to increase efficiency and competitiveness of the economy. In addition, it reduces the financial burden of the government, enlarges the role of the private enterprise in the economy, increase in productivity and spur further progress towards the objectives of the New Economic Policy (NEP) especially the Bumiputra Entrepreneurship, which has been its main objective (Zainal, 1987). In 1984 great steps on deregulation and privatisation policy was taken up in order to enable private sector participation in economic activities, particularly in the development of infrastructure, which were once the domain of the public sector (Fong, 1989).

The fifth Malaysia Plan had devoted a lot of opportunity for private sector participation in the privatisation projects (Fifth Malaysia Plan, 1986). A massive push was towards the manufacturing activities. The injection of funds into the project was by floatations through public issue, local investors and quite a large part of were also sought from abroad. For instance in 1989 about 649 projects worth US$5.61 billion were privatised and some 50 percent of the monies came from foreigners, majority from Taiwan followed by Singapore (Dean, 1990).

It was perceived that privatisation would enable Malaysians to acquire new technologies and expertise through foreign equity holders, as some of the privatised projects were also being taken up by the MNCs. In line with the definition of competitiveness, it is the capacity of the industries to produce goods and services of world standard quality, for both domestic and external consumption. Such situation will foster increase in the employment of skill level workforce

**4.0 INCOME INEQUALITY AND POVERTY**

Since gaining independence in 1957, Malaysia's growth rate has been growing at an average rate of 6.0 percent per year between 1957 until 1970. The benefits of the rapid growth rate however was not equally distributed among its people. In 1970, the incidence of poverty especially amongst the ethnic Malays was high (65 per cent) compared to other ethnic groups namely the Chinese (26 per cent) and Indians (39 per cent). The May 1969 riots were a catalyst for the government policy makers to layout programmes that strengthen not only the economic growth but ensures that the growth is achieved with equity for the masses. Malaysia's growth differs from many other developing countries as policies for growth and equity were seen to be complements and not substitutes (Bhalla and Kharas, 1992). The government's policy was that only with equitable distribution among the different ethnic groups would growth be sustainable.

This section discusses in depth income inequality and poverty in Malaysia. Various measures of inequality are compared and emphasis is given on the differences in inequality among ethnic groups, region and occupation. Measurement of poverty differentiates between the poor and hardcore poor and this section discusses the poverty line income as it changes over the years. Also discussed is the poverty incidence by ethnic group, region and occupation. The final section discussed the structural transformation of the Malaysian economy as it integrates in the world economy and the impact on poverty and inequality.

### 4.1 Income Inequality

Income inequality or relative poverty is measured using two indicators. The first gives the income share by top 20 percent, middle 40 percent and bottom 40 percent of households and the second measure is given by the Gini coefficient. The most common measure of income inequality in Malaysia is the Gini coefficient.

The overall household income distribution is given in Table 4.1. In 1970, the overall Gini coefficient was 0.513 and by 1995, the income inequality declined to 0.464. As a whole, inequality had worsened initially until the mid-1970s and after that steadily declined.

The income share of the bottom 40% of households has increased from 11.5 percent in 1970 to 14.5 percent in 1989. On the other hand, the income share of the top 20 percent had declined from 57.7 percent in 1970 to 50.3 percent in 1989. The mean and median household income in 1976 was RM514 and RM313 respectively. In the last two decades, there has been a huge increase in household income. By 1989, the mean household income was RM1,163 and the median income was RM808. Malaysia was thus able to achieve a significant improvement in income distribution whereby the incomes of the poor increased by a higher percentage compared to the incomes of the rich.

Table 4.1 Distribution of Household in Peninsular Malaysia,1970-1989

| Strata by income level | Income Share (in percentage) | | | | | |
|---|---|---|---|---|---|---|
| | 1970 | 1976 | 1979 | 1984 | 1987 | 1989 |
| Top 20% | 55.7 | 57.7 | 55.8 | 53.2 | 51.2 | 50.3 |
| Middle 40% | 32.9 | 31.2 | 32.4 | 34.0 | 35.0 | 35.2 |
| Bottom 40% | 11.5 | 11.1 | 11.9 | 12.8 | 13.8 | 14.5 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Gini coefficient | 0.513 | 0.529 | 0.508 | 0.48 | 0.456 | 0.445 |
| Mean Household Income (RM) | 204 | 514 | 693 | 1,095 | 1,074 | 1,163 |
| Median Household Income (RM) | N/A. | 313 | 498 | 723 | 738 | 808 |

Sources: Ishak and Ragayah (1995)

Households at the bottom of the ladder were found to be involved in small-scale agricultural activities, other small-scale family activities and unskilled labour (Tan, 1982). The study also found that movement into higher brackets of income is related to one's education. The Kuznets' "inverted U-curve hypothesis" was tested for Malaysia in two separate studies. Using cross-sectional data, Anand (1983) did not find evidence to support the hypothesis while Perumal (1989) used time series data from 1957/58 to 1984 and found support for the hypothesis.

Among the states in Malaysia, the lowest Gini coefficient in 1989 was recorded for Johor with 0.386. The highest coefficients were for the East Malaysian states of Sabah and Sarawak with 0.459 and 0.448 and surprisingly for the rich states of Selangor and Terengganu where the Gini coefficient were 0.448 and 0.457 respectively (Malaysia, 1989). Among the reasons for the higher coefficients for these richer states (in terms of

GDP) is the migration of workers to these states in search of higher paying jobs and development projects undertaken by the government did not directly benefit the poor.

### 4.1.1 Income Inequality among the Ethnic Groups

Due to the disparities in income among the ethnic groups, most of the studies that have been done are on inequalities of income among the ethnic groups. Income disparities in 1970 among the ethnic groups as measured by the Gini coefficient were 0.4553 for the Malays, 0.4542 for the Chinese and 0.5003 for the Indians (Ishak and Ragayah, 1995). Table 4.2 shows the mean incomes among the three major ethnic groups in Malaysia. The mean income for the Malays was half that of the Chinese in 1970. By 1987, the income differential between the two ethnic groups had decreased even though the gap was still wide.

Table 4.2 Distribution of income by ethnic groups, 1970-1987

| | Malays | | | | Chinese | | | | Indians | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Share of income | 1970 | 1973 | 1984 | 1987 | 1970 | 1973 | 1984 | 1987 | 1970 | 1973 | 1984 | 1987 |
| Top 20 percent | 52.2 | 52.8 | 53.9 | 52.0 | 52.8 | 53.0 | 51.7 | 49.0 | 56.7 | 51.6 | 50.2 | 50.7 |
| Bottom 40 percent | 14.8 | 13.8 | 13.1 | 14.0 | 14.3 | 14.7 | 14.4 | 16.0 | 13.7 | 15.8 | 15.9 | 16.2 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bottom 20 percent | 5.2 | 4.9 | 4.5 | 5.0 | 5.3 | 5.4 | 5.2 | 6.0 | 5.0 | 6.2 | 5.9 | 6.2 |
| Mean per capita income (current prices) | 34 | 48 | 179 | 179 | 68 | 93 | 314 | 290 | 57 | 75 | 210 | 218 |
| Mean per capita income (1987 prices) | 77 | 95 | 183 | 179 | 154 | 182 | 321 | 290 | 129 | 146 | 215 | 218 |

Source: Bhalla and Kharas (1992)

The New Economic Policy's objective of achieving equity between ethnic groups was a success as the inequality had declined during the span of 17 years. The real growth in income for the Malays between 1970 to 1987 was 132 per cent while the corresponding figure for the Chinese was 88 per cent and the Indians was 69 per cent.

### 4.1.2 Rural-Urban Income Inequality

The rural-urban income differentials had initially decreased but again widened during the 1990s (Table 4.3). The structural transformation of the Malaysian economy has increased the rural income per capita from RM51 in 1973 to RM260 in 1995. The urban income per capita has also increased but at a lower rate compared to the increases experienced for the rural income.  In 1973, the urban income per capita was RM104 and in 1995, it was RM 519.

Table 4.3 Rural-urban inequality, 1973-1995

| | Rural | | | | Urban | | | |
|---|---|---|---|---|---|---|---|---|
| Share of income | 1973 | 1984 | 1987 | 1995 | 1973 | 1984 | 1987 | 1995 |
| Top 20 percent | 51.4 | 50.7 | 49.2 | - | 55.2 | 52.4 | 51.2 | - |
| Bottom 40 percent | 14.3 | 14.4 | 15.5 | - | 13.4 | 13.9 | 14.6 | - |
| Bottom 20 percent | 5.0 | 5.0 | 5.5 | - | 4.8 | 5.0 | 5.2 | - |
| Mean per capita income (current prices) | 51 | 166 | 169 | 260 | 104 | 327 | 314 | 519 |
| Rural/Urban mean per capita income ratio | 0.498 | 0.509 | 0.538 | 0.500 | | | | |

Source: Bhalla and Kharas (1992) and Malaysia (1996)

Overall, the income differential between rural and urban was large whereby in 1995, the mean capita income of the rural sector was only 50 per cent of that in the urban sector.

## 4.2 Poverty

### 4.2.1 Measurement of Poverty

The frequently used measure of poverty in Malaysia is the poverty line income or PLI. The PLI is a monetary equivalent of expenditure sufficient to meet a decent standard of living to cover basic needs of shelter, food, clothing, fuel, energy, transportation, communication, education, health and recreation. Hence, the PLI is average monthly household income per capita.

The poverty line has been changed over the years where RM33 per capita was used in 1970 and by 1990, the poverty line was RM92 per capita. Table 4.4 gives the poverty line used from 1970 to 1995. Households having incomes less than the poverty lines are considered "*poor*" while those having incomes less than half the poverty line is considered to be "*hardcore poor*". Based on the figures, the poverty line has increased by 136 percent from the year 1970 to the year 1995.

Table 4.4 Poverty Line Income (PLI) for 1970-95

| Year | Peninsular | | Sabah | | Sarawak | |
|---|---|---|---|---|---|---|
| | House hold size | RM | House hold size | RM | House hold size | RM |
| 1970 | 5.40 | 180.00 | - | - | - | - |
| 1976 | 5.40 | 243.00 | 5.40 | 377.00 | 5.60 | 307.00 |
| 1979 | 5.14 | 274.00 | 5.40 | 410.00 | 5.60 | 347.00 |
| 1984 | 5.14 | 349.00 | 5.36 | 540.00 | 5.24 | 428.00 |
| 1987 | 5.14 | 350.00 | 5.36 | 533.00 | 5.24 | 429.00 |
| 1989 | 5.14 | 370.00 | 5.36 | 544.00 | 5.24 | 452.00 |
| 1990 | 5.14 | 384.00 | 5.36 | 656.00 | 5.24 | 469.00 |
| 1993 | 4.80 | 405.00 | 5.10 | 582.00 | 5.10 | 495.00 |
| 1995 | 4.60 | 425.00 | 4.90 | 601.00 | 4.80 | 516.00 |

Source: EPU and Makita (1998)

Another measure of poverty is the "poverty gap" which measures the extent to which incomes fall below the poverty line. Anand (1991) showed that the poverty gap was 4.8

percent of GDP in 1976 while Bhalla and Kharas (1992) suggested a decline in the poverty gap from 4.3 percent of GDP in 1973 to 0.9 percent of GDP in 1987.

### 4.2.2 Incidence of Poverty

Studies on poverty in Malaysia have identified some of its causes. A study by Aziz (1964) found that the main causes of poverty among the Malays who formed the majority in Malaysia were due to low paying jobs in the rural areas especially in the agricultural sector and the exploitation of peasants by middlemen. Salleh (1977) however postulated that Malay poverty is due to unequal access and opportunity. The access to education resources, credit and housing are limited as the Malays usually reside in rural areas.

Education was found to be the most important explanatory variable in the determination of poverty in Malaysia (Visaria 1981). The study also found that the poor households consist of agricultural workers, self-employed and family helpers, paddy farmers, fishermen, and workers involved in traditional manufacturing activities. In Table 4.5, the incidence of poverty between the years 1970 and 1990 is given.

In 1970, the incidence of poverty was 49.3 percent of households whereby 58.7 percent are in rural areas while 21.3 percent in urban areas. In 1995, the incidence of poverty has been reduced to 8.9 percent. The data on hard core poverty is available from the year 1985 whereby it was 6.9 percent. This percentage of hard core poor has been reduced to

2.2 percent in 1995. Overall, there has been reductions in the incidence of poverty for both the poor and hardcore poor.

Table 4.5 Incidence of poverty and number of poor households, 1970-1990

| | 1970 | 1975 | 1980 | 1985 | 1990 | 1993 | 1995 | 2000* |
|---|---|---|---|---|---|---|---|---|
| Incidence of poverty (%) | 49.3 | 43.9 | 29.2 | 20.7 | 17.1 | 13.5 | 8.9 | 5.5 |
| Number of poor households (‘000) | 1606 | 835.1 | 666.1 | 649.4 | 619.4 | 517.2 | 370.2 | 353.4 |
| Incidence of hardcore poverty (%) | N/A. | N/A. | N/A. | 6.9 | 4.0 | 3.0 | 2.2 | 0.5 |
| Number of hardcore poor households (‘000) | N/A. | N/A. | N/A. | 261.1 | 143.1 | 116.4 | 126.8 | 24.5 |

Source: Malaysia (various years) * Estimate

### 4.2.3 Rural-Urban Poverty

As indicated above, the income inequality between the rural and urban sectors were fairly large. This is also true for poverty as the rural-urban poverty comparison showed large but declining incidence of poverty for the two sectors between the years 1970-1995. Most of the ethnic Malays live in the rural sector and were engaged in agriculture-based occupations while the ethnic Chinese who mainly live in the urban sectors were mainly employed in commercial and industrial based occupations.

Table 4.6 shows the incidence of poverty for households grouped according to rural-urban sectors and also gives the households' occupations. In 1970, the incidence of poverty of paddy farmers is the highest with about 88 percent living in poverty. During the same year, 73 percent of fishermen and 65 percent of rubber smallholders live in poverty. It is interesting to note that estate workers fared better as the incidence of poverty for this group is 40 percent in 1970. In 1984, the incidence of poverty was reduced for all categories of workers with marked declines of poverty for paddy farmers (57.7 percent), fishermen (26.1 percent) and estate workers (19.6 percent).

Table 4.6 Rural-Urban Comparison in Incidence of Poverty (%), 1970-1987

| Category | 1970 | 1976 | 1984 | 1987 | 1995 |
|---|---|---|---|---|---|
| Rural | 58.7 | 47.8 | 24.7 | 19.3 | 14.1 |
| Rubber Smallholders | 64.7 | 58.2 | 42.7 | - | - |
| Paddy farmers | 88.1 | 80.3 | 57.7 | - | - |
| Estate workers | 40.0 | - | 19.6 | - | - |
| Fishermen | 73.2 | 62.7 | 26.1 | - | - |
| Coconut Smallholders | 52.8 | 64.0 | 46.2 | - | - |

| | | | | | |
|---|---|---|---|---|---|
| Urban | 21.9 | 17.9 | 8.2 | 7.3 | 4.1 |
| Total | 49.3 | 39.6 | 18.4 | 15.0 | 9.1 |

Source: Malaysia (various years)

As a whole, poverty is primarily a rural problem and as the majority of rural households were Malays, there is a correspondence between rural-urban poverty and poverty among ethnic groups as discussed in the next section.

### 4.2.4 Poverty among the Ethnic Groups

The above section showed that there is a relationship between rural-urban poverty and ethnic inequality. In Malaysia, there was a concerted effort by the government to reduce this income disparity through the New Economic Policy. Table 4.7 gives the poverty incidence by ethnic group. The incidence of Malay poverty (65 percent) is more than twice that of the Chinese poverty (26 percent) in 1970. Even though there was a marked decline in the incidence of poverty among the Malays (21 percent) by 1990, their incidence of poverty is still more than three times higher than the incidence of poverty for the Chinese (6 percent). Even in the urban areas, the incidence of poverty was found to be highest among the Malays and lowest for the Chinese (Fong, 1984).

Although the absolute poverty for each group has declined, the ethnic disparity among the two ethnic groups (Malays and Chinese) has in fact increased over the years. There was also a marked decline in poverty among the Indians whereby the incidence of poverty in 1970 was 39 percent and in 1990 it was reduced to 8 percent.

Table 4.7 Poverty Incidence by Ethnic Group (%), 1970-1990

| Ethnicity | 1970 | 1976 | 1984 | 1987 | 1990 |
|---|---|---|---|---|---|
| Malay | 64.8 | 56.4 | 25.8 | 23.8 | 20.8 |
| Chinese | 26.0 | 19.2 | 7.8 | 7.1 | 5.7 |
| Indian | 39.2 | 28.5 | 10.1 | 9.7 | 8.0 |
| Others | 44.8 | 44.6 | 22.0 | 24.3 | 18.0 |
| Average | 49.3 | 35.1 | 18.4 | 17.3 | 15.0 |

Source: Malaysia (various years)

## 4.3 Government Policies on Inequality and Poverty

As stated above, the government's policy was that only with equitable distribution among the different ethnic groups would growth be sustainable. Initial efforts by the government to reduce poverty were through a package of rural development programmes as stated in the First Malaysia Plan (1966-1970). However, these programmes were not successful as racial riots erupted in 1970. The riot was attributed to the increasing income disparity between the ethnic groups.

As a result, the New Economic Policy (1970-1990) or NEP was formulated in the Second Malaysia plan with a specific goal of eradicating absolute poverty. This explicit objective of poverty reduction was to be achieved through economic growth as stated in the Mid-Term Review of the Second Malaysia Plan:

*The generation of new employment opportunities at a sufficient pace, the elimination of racial economic imbalances and the creation of the resources to provide the social services and infrastructure to raise standards of living demand that the implementation of the NEP be firmly based on* ***rapid economic growth****. For operational purposes, therefore, rapid economic growth of the country is a necessary condition for the success of the NEP (Mid-Term Review of the Second Malaysia Plan, 1973, p.63).*

The implementation of NEP continued through until the Fifth Malaysia Plan. As given in the Appendix, among the main poverty eradication strategies were employment generation, increase in income and productivity, modernization of rural life, improvement of living conditions among the urban poor, expansion of education and training facilities and creation of commercial and individual community for the Malays.

Most of these programmes were designed for the rural sector and for the ethnic Malays who formed the majority of the poor and hardcore poor. After the NEP, the National Development Policy (NDP) was introduced in 1991.  Similar to NEP, the NDP too focused on eradicating hardcore poverty and reducing the relative poverty. Among the principal strategies of NDP were human resource development programmes, rural urbanisation and non-farm employment development programmes.

Governmental expenditure for the eradication of poverty increased throughout the years until the Third Malaysia Plan (Table 4.8). The start of NEP in the Second Malaysia Plan saw the biggest allocation where 31 per cent of the total development expenditure was for alleviating poverty. By the Seventh Malaysia Plan (1996-2000), the share of expenditure for anti poverty programmes was 22 per cent of the development expenditure.

4.8 Share of poverty eradication expenditure as a percentage of development expenditure (%)

| Malaysia's Five Year Plans | Share of poverty eradication expenditure |
|---|---|
| First Malaysia Plan (1966-1970) | 27 |
| Second Malaysia Plan (1971-1975) | 31 |
| Third Malaysia Plan (1976-1980) | 30 |
| Fourth Malaysia Plan (1981-1985) | 24 |
| Fifth Malaysia Plan (1986-1990) | 26 |
| Sixth Malaysia Plan (1991-1995) | 27 |
| Seventh Malaysia Plan (1996-2000) | 22 |

Source: Malaysia (various years)

Through the NEP programmes, the incidence of poverty was reduced from a high of 49.3 per cent in 1970 to 17.1 per cent in 1990. The significant reduction in the incidence of poverty is an indicator of the successful implementation of the NEP strategies (Bhalla and Kharas, 1992).

**4.4 Economic Development, Integration and Poverty**

In about two decades, Malaysia was able to reduce inequality and poverty and this has been achieved mainly through the New Economic Policy (1971-90). The two-pronged objectives of the NEP of reducing poverty and inequality and restructuring the society had occurred at the same time as the country undergoes trade liberalisation and globalisation. The government formulated the NEP as it felt that the free market system had its limitations and thus to realise a more socio-economic equality, various measures had to be undertaken. Most of the reduction in poverty were mainly due to increased productivity and economic growth and lesser from the redistribution of capital or land.

The objectives of NEP were partially achieved through the government's export-oriented policies (Kamal and Zainal, 1989). One of the important strategies of attaining growth was having an open economy with low tariffs and providing incentives for exports. Krueger (1991) found that unlike other countries, Malaysia's tax on the agricultural sector was not high. This growth strategy enabled a more efficient economy that allowed the effects of growth to be shared with wider sections of the population.

The larger role played by the government was also a factor in ensuring a more equitable economic growth (Bhalla and Kharas, 1992). Development of infrastructure, education and health were emphasised during the NEP period. Education was given special focus especially for the poor and women. By the early 1990s, the educational attainment between male and female for the 12-17 age group was almost equal. The percentage of females enrolled in secondary schools increased from 28 per cent in 1970 to 59 per cent in 1991. The corresponding figures for males were 34 per cent in 1970 and 58 per cent in 1991. Participation of women in the labour force was encouraged. By 1991, women represented 35 per cent of the Malaysian labour force and this is comparable to industrialised countries such as Japan (38 per cent) and Switzerland (36 per cent). Furthermore, better health care programmes especially in the rural areas resulted in reduced infant mortality from 45 per 1,000 in 1970 to 14 per 1,000 by 1992.

The government maintained the economic fundamentals at the right levels during the NEP period. Unemployment and inflation were kept at low levels and the savings rate increased during the period. Domestic investment activities were mostly financed through household savings and not through external borrowing. Malaysia's savings rate increased from 20 percent of GNP in the 1960s to 30.5 per cent of GNP by 1990. Factors that contributed to the high savings rate were the expansion of unit trust schemes, lower consumption growth relative to expansion of national income, increased contribution rate of the Employees Provident Fund, introduction of new savings instruments and the mobilisation of deposits through the Islamic financial systems.

As Malaysia integrates into the world economy, sectoral shifts occurred in the domestic economy. While the share of agriculture towards GDP declined, the share of manufacturing and services steadily increased. The two sectors (manufacturing and services) share towards GDP was about 84 per cent while agriculture's share was 9.4 per cent in 1998. The average annual growth rate of new jobs created in the manufacturing sector between 1985-1995 was impressive at 7.2 per cent.

The occupational structure in Malaysia is similar to developed countries whereby the largest percentage of labour force is employed by the tertiary sector while the agricultural sector being the primary sector has the lowest percentage. As stated above, the majority of the poor in Malaysia tended to be in the rural agricultural areas. Hence, government programmes to reduce the poverty and inequality were mostly concentrated in the rural areas. The structural transformation of the country especially for the labour market was an important factor in the government's poverty alleviation programmes.

Employment creation through the export-oriented manufacturing sector provided opportunities for both the rural and urban poor to increase their incomes and standard of living. In fact, the shift from agriculture based occupations to that of manufacturing, commerce and public sectors were found to be the main source of improved income distribution for the poor households (Bhalla and Kharas, 1992). Even the large unsuccessful public investments during the second phase of import-substitution (early 1980s) were able to provide the structural change needed for the economy.

Table 4.9 provides the average monthly wages by sectors for the periods 1981 through 1990. In 1990, the lowest paid sector was agriculture (rubber plantation) while the highest was recorded in the services (banking) sector. In terms of wage growth, the highest growth between 1981-1990, was in the mining sector (10.7 per cent) while agriculture showed the most sluggish growth during the same period at 3.0 per cent.

Table 4.9 Average monthly wages by sector (RM), 1981-1990

| Sector | 1981 | 1983 | 1985 | 1987 | 1990 |
|---|---|---|---|---|---|
| Manufacturing | 438 | 541 | 639 | 637 | 691 |
| Construction | 471 | 569 | 609 | 590 | 634 |
| Mining | 766 | 986 | 1395 | 1915 | 1731 |
| Agriculture | 273 | 309 | 303 | 334 | 356 |
| Services | 1249 | 1483 | 1678 | 1679 | 1878 |

Source: Malaysia (1993)

Among the factors attributed for these high growths in wages in the mining, manufacturing and construction sectors were the better-educated work force and also due to the total factor productivity growth.

Malaysia’s integration into the world economy was also through the encouragement of foreign direct investment. FDIs had led to the generation of jobs especially in the manufacturing sector. This enabled the rural to urban migration and the reduction on reliance on the agricultural sector as the source of employment. Bhalla and Kharas (1992) found that the uniqueness of the country's growth and equity experience was that, in Malaysia there was an equalisation of the rates of return between investments in human (11.5 per cent in 1987) and physical capital (11 per cent in 1987). The returns to education and physical capital had remained high despite high investments in both sectors. An important implication of this is that resources were being efficiently allocated across the sectors and thus producing sustainable economic growth.

## 5. GLOBALISATION AND GOVERNMENT POLICIES

As globalisation can bring in benefits and costs to a country, Malaysia has to be ready to participate in the process of globalisation and exploit this opportunity to her advantage the maximum possible. In order to participate fully and meaningfully, Malaysians must be educated such that they can adapt themselves to the changing needs of globalisation. To meet the challenges of globalisation, Malaysia has begun to develop its human resource to produce a productive, disciplined, and skilled labour force to meet the needs of the industrial development to increase productivity and equitable distribution of income. This section explains the basic strategies and policies which have been undertaken by Malaysia, especially in the 1990s, to minimize the negative impact of globalisation on the economy. The discussion focuses on education and knowledge-based economy, the small and medium size industries, hard-core poverty, food production, and science and technology.

### 5.1 Education, Training and Knowledge-Based Economy

Malaysia emphasizes education to achieve its development goals. Its education policy changed dramatically in the early 1970s as a result of the racial riot in 1969. The total student enrolment from pre-school to tertiary levels increased from 3.7 million in 1985 to 5.1 million in 1995. The primary and secondary education in public schools in Malaysia are open to the children of all the races or ethnic groups almost free. During the1985-90 period, the enrolment in primary and secondary schools increased by 11.7 percent and 2.4 percent respectively while preschool enrolment increased by 10 percent in the same period (Table 5.1). The children of low-income families would also get free textbooks loaned by the government. The qualities of education, access, and opportunities have improved to all strata of the society to provide manpower requirement to the nation.

The private sector has begun to play more role in education and training, as education is an important ingredient for socio-economic development of a community. In order to provide quality education comparable to that available in the urban areas, Malaysia has built more residential schools in the rural areas so that the rural students would be at par with their urban

Table 5.1 Student Enrolment, 1980-1995

| Level of Education | 1980 | 1985 | 1990 | 1995 |
|---|---|---|---|---|
| Pre-school | n.a. | 162,980 | 188,840 | 362,400 |
| Primary | 2,008,587 | 2,191,680 | 2,447,210 | 2,808,210 |
| Lower Secondary | 812,065 | 922,210 | 943,920 | 1,126,450 |
| Upper Secondary | 277,373 | 333,060 | 368,500 | 589,580 |
| Post-secondary | 31,498 | 52,390 | 75,140 | 82,460 |
| Teacher Education | 13,247 | 16,560 | 21,580 | 27,300 |
| Certificate | 2,603 | 6,880 | 9,180 | 18,290 |
| Diploma | 12,262 | 25,050 | 28,000 | 44,230 |
| Degree | 21,944 | 37,840 | 60,010 | 89,680 |

| | | | | |
|---|---|---|---|---|
| TOTAL | 3,150,095 | 3,748,650 | 4,142,380 | 5,148,600 |

Source: Malaysia Plans (various issues)

counterparts. In addition, more rural clinics were made available to the rural communities to provide readily available basic health services to the rural people. All these programs were to address both absolute and relative poverty problems. As it is impossible to eliminate relative poverty, efforts have been made to reduce income gaps among and within ethnic groups whether in the rural or urban areas.

During the1970-80 period, there was a rapid expansion in tertiary education to overcome the shortage in high and middle level manpower. In 1970 there were only two universities which increased to five in 1975, but the places in the universities were still limited. As a result, admissions to these institutions were based on merits and those who were unable to enter the public universities would continue their higher education in private colleges. The enrolment in the degree program in the public universities increased by 59 percent in the 1985-90 period.

The facilities and courses at the college level also expanded as a step to increase the middle level manpower. But the degree programs at the university level were biased toward arts and humanities which resulted in the shortage of manpower in the scientific and technical fields. To increase the skilled and semi-skilled manpower, the public sector had also expanded its training programs in the areas of vocational, technical, industrial, and agriculture. The private sector was asked by the government to provide the on-the-job training programs for their employees. Now Malaysia has 11 public Universities and 5 private universities. Malaysia has also liberalized its education policy to open access education to the public. Since the places in the public higher education institutions were still limited, the government approved the establishment and operations of private colleges in the form of twinning programs of local private colleges with local and foreign universities, branch campuses of foreign universities, and also allowed the establishment of local private universities to improve human resource development, productivity, and competitiveness. As the cost of education was getting more expensive, Malaysia established a higher education fund to extend financial support in the form of education loans to students pursuing higher education in the public and private universities, including the private colleges.

The future of Malaysia depends largely on the manufacturing and services sectors. As these two sectors are more information, skilled, and knowledge based, Malaysia has developed a strategic planning in education to supply the required skilled labour force and that the labour market should be more efficient in transmitting information to reduce skill mismatches, improve labour mobility, and labour market rigidities. Malaysia has just started to prepare a blue print to transform the present production-based economy to knowledge-based economy. The establishment of the Multimedia Super Corridor (MSC) has provided the technological infrastructure to attract high-tech industry in the new economy which requires appropriately trained human resources to work in ICTs industries. The government has also established a computer education program in an effort to strengthen the foundation for a computer literate society.

**5.2 Development of Small and Medium Scale Industries (SMIs)**

Presently, the small and medium scale industries constitute about 80 percent of the manufacturing establishments in Malaysia and they are mostly owned and managed by the local investors. Their investment is less than half of the total investment while their contribution to the value-added is a meagre one-third of the value added in the manufacturing sector. They have inadequate capital, managerial, marketing, production skills, and low technology and subsequently they produce poor quality products that resulted in low inter-industry linkages in the domestic economy. They are involved in the production of foodstuff, handicrafts, fabricated metal products, wood-based products, textiles and clothing. The medium scale industries focus on the processing of beverage and tobacco, electrical and electronic products, chemical products, and automotive parts and components.

Malaysia realizes the potential of SMIs in the industrialization process and the importance of this sector to generate business opportunities, employment, income and reduce poverty. Therefore Malaysia has decided to improve the capability of SMIs to supply the intermediate inputs to the larger firms and encourage these SMIs to export their products, especially in the light of the establishment of AFTA in 2003. The focus of the activities of the SMIs are in the supportive industries producing parts and components, mould and die, testing and tool making, and high quality casting and forgings. The linkage between the SMIs and the larger firms are done through subcontracting arrangements. The government provides land and infrastructure facilities to SMIs and relocate them from the congested urban areas to the less developed regions by building industrial complexes to promote R&D activities, improve productivity, and competitiveness. This is necessary to increase the local content of manufactured goods and pave the way for industrial expansion through industrial linkages.

**5.3 Assistance to Hard-Core Poor**

Malaysia had introduced a special program called the "Development Program for the Poorest Poor" to eliminate social and economic inequalities and improve the standard of living of the hard-core poor. The poorest households were identified in terms of income, housing conditions, accessibility to basic amenities, education level, and their health status at the district level. In the short-run, the focus was on food and nutritional requirements for the undernourished children and provision of decent shelter, scholarships, textbooks, hostel accommodation, and supplementary food programs. The long-run strategy was to introduce viable economic projects such as planting of cash crops, rearing of livestock, and small business activities as a means to raise their income. The government also provided them the infrastructure facilities such as roads, water, electricity, health and medical care.

The approach undertaken by Malaysia to eradicate poverty was to utilize the inherent skills of the poor or training them so that they could exploit their potential to the maximum and become self-reliant. For example, the government has been extending financial support to the non-government organizations, such as “Amanah Ikhtiar Malaysia”(a non-profit organization to assist the poorest poor), in its effort to create business activities, employment and income to the poor. So far the economic projects implemented by the organization were very well received by the poor and successful.

Since most of the poor are in the rural areas the government continues to develop and improve the agricultural sector by implementing its Integrated Agricultural Development Program (IADP), Land Consolidation and Rehabilitation Authority(FELCRA) to improve farm productivity and marketing of farm products through commercialisation of agricultural activities. Rural industrialization process has also been expedited to provide more non-farm employment opportunities and supplemental income to the farm households.

It is a well-known fact that housing, health, education, social, and the general quality of life of the workers in the plantation sector, which are mostly of Indian origin, are poor. Thus, the government has been cooperating with the plantations owners to provide better basic human needs to these workers. For example, the government brought in public main water pipes and electricity supply to the fringes of the plantations areas so that the plantation owners can draw the supplies into the plantations. The government also encourages the plantation owners to establish housing schemes for their workers.

**5.4 Expansion of Domestic Food Production**

In the 1970s Malaysia had a clear policy to achieve self-sufficiency in food production, especially in rice production. But until now the local food production is low in relation to the domestic consumption and therefore Malaysia relies too much on imported foods in which the supply is uncertain. Any political crisis in the exporting country will adversely affect the supply of imported foods from abroad. The trade balance in foods has been negative and the deficit is increasing. For example, in 1993 food exports and imports were RM3975 million and RM5816 million respectively resulting in food trade balance deficits of RM1843 in 1993 which increased to RM338 million in 1995.

The trend in food trade deficit is very alarming, therefore at the moment, Malaysia is paying special attention to the domestic food production and regards food as national security. Under this situation, there is ground for the government to intervene into the food production and distribution directly to help the small farmers to increase their income and standard of living as Malaysia has potential to be a food growing nation and the surplus can be exported. The poor small farmers definitely can produce foods but for the lack of linkages between the production and consumption has discouraged them to expand their production scale, as they are uncertain whether they can market the products if they produce more than what is required by the markets in the neighbourhood. Thus Malaysia has introduced the farmer and night markets to provide more opportunities for the farmers and small traders to market their products direct to the consumers. The programs have been successful in increasing the income of the small traders.

### 5.5 Development of Science and Technology and R&D

Malaysia considers science and technology as an important vehicle to meet the challenges of globalisation. Toward this end the government has encouraged students to undertake science and technology in the secondary and tertiary education. This is to increase the number of scientists, creates conducive environment for activities in R&D, improve creativity and innovativeness, productivity and competitiveness. The government has also emphasized the technical and vocational training to provide sufficient number of skilled and semi-skilled labour force.  All these steps are undertaken to prepare Malaysia to be a knowledge-based economy in which the information and communications technologies would be essential ingredients to improve the productivity and competitiveness as a means to achieve economic growth, improve the standard of living and the quality of life.

Malaysia has also attempted to integrate the science and technology into the socio-economic planning and development. As an open economy, the Malaysian economic development depends very much on international trade that opens to competition in the international market. She needs to maintain her competitiveness through increasing the productivity afforded by the technological progress.  Malaysia has already achieved satisfactory level of competence in R&D in agriculture such as in rubber and oil palm. But the R&D in the industrial sector is at a low level. Thus, Malaysia has taken the initiative to upgrade the R&D facilities in the universities and science and technology parks to provide better environment for the R&D activities. Fiscal incentives are extended to the private sector to encourage them to participate in education, training and R&D. So far the response of the training and retraining of the employees by the private sector has not been encouraging. They found out that after spending substantial amount of money on training, their employees are pinched by other firms by offering them lucrative salaries.

## 6. CONCLUSIONS AND POLICY IMPLICATIONS

In this final section, we shall summarize the findings from this study with regard to the effects of globalisation to the Malaysian economy, especially on the aspects of poverty, and the strategies and policies adopted by Malaysia to minimize the adverse impacts of globalisation.

### 6.1 Summary of Findings

The post independence social and economic development of Malaysia has been guided by a series of five-year development plans and all these plans were successfully implemented and transformed the economy from an agricultural based to the modern technological manufacturing based economy. The achievement was most evident during the period of the New Economic Policy as clearly indicated by the significant reduction in the absolute poverty level and more participation of the Bumiputra in the modern business sector which have provided political stability and opportunities for further social and economic development. In Malaysia, the aspects of economic growth and equity have always been emphasised in her development plans to ensure a just and equitable distribution of national wealth in the economy. The development strategies focused on the diversification of industrial structure, enhancing human resource development, promote the use of modern technology to sustain growth momentum and balanced socio-economic development. The roles of the government in the economy were gradually reduced through privatisation and the private sector has to play a bigger role in creating economic activities through expanding private investment.

The relatively successful reductions in inequality and poverty can be attributed to the growth of the industrial sector, that was mainly led by the private sector, and the improvement in the ability of the poor to participate in the non-agricultural employment especially in the export-oriented manufacturing industries. This was also aided by the fact that the primary and secondary school attainment increased over the corresponding period and the high female participation rate in the labour force. Education was found to play a significant role in poverty reductions in the rural areas. Even though the agricultural sector showed a declining trend in terms of employment, the government continued pursuing policies that enhanced the earnings of the rural-agricultural workers by increasing the productivity of agricultural sector through mechanisation and better agronomic practices.

Another important aspect of the eradication of poverty in Malaysia was the restructuring of society by helping the indigenous Malays who form the majority of the poor and hard-core poor. Among the programmes under this strategy was developing a viable Bumiputra and Industrial Community among the Malays. This was achieved through education and training especially in entrepreneurial programmes and the development of commercial and business premises to enable the Malay community to participate in the modern and commercial sectors of the economy.

Foreign investments were encouraged through liberalization of the procedures and rules and maintain liberal policy on foreign equity participation in the manufacturing and tourism sectors. In order to improve the international competitiveness, Malaysia had changed her industrial structure moving away from labour intensive industries into a more high-technology industries to reduce its unit cost of production. And finally Malaysia, to certain extent, has already made progress to develop her financial and capital markets for efficient mobilisation of saving to meet the needs of the private sector long-term investment fund. In fact, the private sector now depends more on capital market to generate fund.

**6.2 Policy Implications**

The followings are our suggestions with regard to the policies and strategies to enhance competitiveness and improving the quality of life in the borderless economy. The suggestions focus on the short-run macroeconomic policy and the long-run strategies relating to the K-economy, human resource development, and agricultural development policies which might also be useful to the other developing nations.

Currently the demand for Malaysian exports is high due to the competitive exchange rates but the internal demand has been weak as Malaysians lost about one-third of their purchasing power during the recent currency crisis. Thus at the macro-level, the government has employed the monetary and fiscal policy to increase domestic absorption, such as the low interest rate policy, as long as it does not fuel inflationary pressure. The policy has been effective to bring Malaysia out of the recession due to the currency crisis as a result of globalisation. On the fiscal side, the government also increased its spending on socio-economic projects such as hospitals, clinics, schools, and roads in the rural areas to improve the standard of living of the rural population.

Malaysia would face new challenges as she moves from the production-based economy to the knowledge-based economy. The government and the private sector must take the necessary steps to promote knowledge creation and skills for the K-economy to stay competitive in the borderless world. One of the determinants of success in the knowledge-based economy is the continuous generation and acquisition of knowledge by the workers to cater for the rapid changes of society demands in the borderless environment. This would mean that Malaysia needs to provide access to education to the population through distance learning besides the traditional on-campus learning such that education should not only confine to school leavers but also workers already in employment with the objective of providing lifelong learning for them.

Malaysia has dualistic agricultural sector, that is the more efficient sector (the plantations) and the less efficient sector (the smallholdings). Agricultural development and food production have now been accorded high priority in the national planning as a means to attain self-sufficiency, improve efficiency, and eradicate poverty in the rural areas. Malaysia has taken steps to expand food production and to harmonize production, distribution and consumption to ensure that the small farmers can sell their produce in domestic and world markets in orderly fashion. When the farmers know that they could sell their products at an acceptable price they will definitely expand their production which will be translated to more job creation, increase income, reduce poverty, and discourages rural-urban migration.

# APPENDIX

Table 4.8 Summary of Malaysia's Five-Year Plans

| | (1) Economic Development Strategy | (2) Poverty Eradication Strategy | (3) Major Programs | (4) Newly-established Development Institutions |
|---|---|---|---|---|
| 1MP (1966-1970) | ■ Employment generation<br>■ Reduction in unemployment<br>■ Promotion of new economic activities<br>■ Human resource development for effective participation in economic and social development<br>■ Diversification of economy (Reduction in dependence on rubber; expansion of timber, palm oil and manufactured goods) | Poverty to be tackled implicitly<br>■ Increase in per capita income and consumption, especially of rural inhabitants.<br>■ Increase in productivity and income-earning capacity<br>■ Provide infrastructure such as electricity, health, low-cost housing, transportation, etc. | RED Book Program, including<br>■ Land development schemes by FELDA<br>■ Land consolidation and rehabilitation by FELCRA<br>■ Irrigation and drainage<br>■ Rubber replanting<br>■ Rubber rehabilitation<br>■ Modernisation of small-scale fishery<br>■ Improvement in marketing system<br>■ Revision of credit facilities | ■ Council of Trust for Bumiputera (MARA): 1996<br>■ Federal Land Consolidation and Rehabilitation Authority (FELCRA): 1966<br>■ Malaysia Agricultural Research and Development Institute (MARDI): 1969<br>■ Agricultural Bank of Malaysia (BPM): 1969<br>■ Malaysian Rubber Development Corporation (MARDEC): 1966 |
| 2MP (1971-1975) | Under the New Economic Policy (NEP)<br>■ Poverty eradication<br>■ Restructuring of society | Under the New Economic Policy (NEP), poverty to be explicitly recognised as a | ■ Land development, consolidation and rehabilitation<br>■ Provision of complementary inputs, | ■ Muda Agricultural Development Authority (MADA): 1970<br>■ Fishery Development Authority of |

| | | | | |
|---|---|---|---|---|
| | ■ Stimulation of investment and consumption<br>■ Promotion of export<br>■ Employment generation through economic growth in the key sectors: agriculture, services, manufacturing, and wholesale and retail trading | ■ Employment generation<br>■ Increase in income and productivity<br>■ Modernisation of rural life<br>■ Improvement of living conditions among the urban poor<br>■ Reduction of inequality in income distribution<br>■ Creation of commercial and individual community for the Malays occupational employment<br>■ Expansion of education and training facilities | infrastructure and services<br>■ Modernisation of fishery through the provision of subsidies and facilities<br>■ National rubber price stabilisation<br>■ Provision of basic facilities and amenities<br>■ Employment expansion in the manufacturing and construction sectors | Malaysia (LKIM): 1971<br>■ Southeast Pahang Development Authority (DARA): 1971<br>■ Southeast Johor Development Authority (KEJORA): 1972<br>■ Kemubu Agricultural Development Authority (KADA): 1972<br>■ Farmers' Organisation Authority (FOA): 1973<br>■ Central Terengganu Development Authority (KETENGAH): 1973<br>■ National Tobacco Board: 1973<br>■ Rubber Industry Smallholders Development Authority (RISDA): 1973 |

| | | | | |
|---|---|---|---|---|
| | (1) Economic Development Strategy | (2) Poverty Eradication Strategy | (3) Major Programs | (4) Newly-established Development Institutions |
| 3MP (1976-1980) | ■ Ethnic balance in employment<br>■ Expansion of education and training facilities<br>■ Use of public enterprise in achieving ethnically balanced employment<br>■ Establishment of trust funds for the Malays | ■ Targets of anti-poverty programs clarified<br>■ Improvement in welfare and quality of life for both the rural and urban poor<br>■ Promotion of agricultural and industrial sectors for the generation of income and employment<br>■ Increase of the Malays' participation in the ownership and control of wealth in the modern sector; reduction of employment in the traditional agricultural sector<br>■ Identification of the poor as target groups | ■ Irrigation and drainage for paddy cultivators<br>■ Replanting for rubber smallholders<br>■ Replanting, rehabilitation and intercropping with other crops for coconut smallholders<br>■ Subsidised distribution of engines, nets and gears, relocation, and promotion of aquaculture and off-shore fishing for fisherman<br>■ Improvement of basic facilities, promotion of small-scale industries, and security of tenure for new village residents<br>■ Land settlement schemes for agricultural labourers<br>■ Special settlement schemes for Orang Asli | ■ Southern Kelantan Development Authority (KESEDAR): 1978 |

| | | | | |
|---|---|---|---|---|
| | | | ■ Promotion of labour-intensive and small-scale industries for the urban poor | |
| 4MP<br>(1981-1985) | Era of economic recession<br>■ Structural adjustment in government expenditure<br>■ Structural transformation of the economy by diminishing the role of agriculture and raising the contribution of the manufacturing, construction, banking and financial sectors. | ■ Introduction of the concept of hardcore poor<br>■ Employment generation in the manufacturing and service sectors<br>■ Improvement in productivity and income<br>■ Revitalisation of agriculture by commercialisation | ■ IADP<br>■ Irrigation and drainage<br>■ Rubber replanting<br>■ Land rehabilitation and consolidation<br>■ Crop diversification and livestock integration<br>■ Modernisation of small-scale fishery<br>■ Land development schemes with the block system<br>■ Provision of agricultural support services | ■ Kedah Regional Development Authority (KEDA): 1981<br>■ Jengka Regional Development Authority (JENGKA): 1983<br>■ Penang Regional Development Authority (PERDA): 1983 |

| | | | | |
|---|---|---|---|---|
| | (1) Economic Development Strategy | (2) Poverty Eradication Strategy | (3) Major Programs | (4) Newly-established Development Institutions |
| 5MP (1986-1990) | ■ Efficient use of resources<br>■ Minimisation of governmental assistance<br>■ Privatisation<br>■ Export-led manufacturing<br>■ Increase in domestic savings<br>■ Promotion of foreign investment<br>■ Revitalisation of the agricultural sector under the NAP | ■ Increase in productivity and income<br>■ Improvement in the quality of life<br>■ Employment generation in the manufacturing and services sectors | ■ Group farming<br>■ Rural urbanisation<br>■ Established rural growth centres<br>■ Promotion of off-farm employment | None. |
| 6MP (1991-1995) | Under the national Development Policy (NDP)<br>■ Economic growth with equity<br>■ Creation of Bumiputera Commercial and Industrial Community (BCIC)<br>■ Reduction in social and economic inequality among ethnic groups | ■ Concentration on the hardcore poor<br>■ Reduction in relative poverty (bottom) 40% of households)<br>■ Minimisation of leakage and improvement in delivery system<br>■ Great emphasis on human resource | ■ Special package for the hardcore poor (PPRT)<br>■ Loan scheme by AIM<br>■ IADP<br>■ Land consolidation and rehabilitation<br>■ Commercialisation of farms | None. |

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|---|---|---|---|---|
| | ■ Promotion of human resource development<br>■ Regionally balanced promotion | development<br>■ Generation of employment opportunities for low income groups<br>■ Improvement in skills and productivity | ■ Economic and commercial linkages of rural with modern sectors<br>■ Growth of value-added activities from agriculture<br>■ Continued provision and improvement of facilities and services for the urban poor<br>■ Employment opportunities in manufacturing, construction and other urban activities | |
| 7MP (1996-2000) | Under the NDP<br>■ Balanced development<br>■ Sustained economic development<br>■ Equitable distribution<br>■ Shift from the input/investment-oriented to the productivity-oriented<br>■ Large-scale production for exports<br>■ Human resource development (increased investment in education and training)<br>■ Private sector-led growth with | ■ Emphasis on the hardcore poor, including Orang Asli ad the urban poor<br>■ Reduction in relative poverty<br>■ Employment and income generation in the non-agricultural sectors<br>■ Improvement in the educational level of the poor<br>■ Development of remote areas in the poorest states and districts | ■ Special package for the hardcore poor (PPRT) to be continued<br>■ NGOs to complement governmental activities<br>■ Participation of the private sector in poverty alleviation<br>■ Provision of better education and training to low-income groups<br>■ Provision of low and medium-<br>■ cost housing for the urban poor | None. |

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|---|---|---|---|---|
| | emphasis on privatisation | | | |

Source: Makita (1998)

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