

BOOK REVIEW

Hill, Hal, Tham Siew Yean and Ragayah Mat Zin (eds.) (2012). *Malaysia's Development Challenges: Graduating from the Middle*. London: Routledge
by Kee-Cheok Cheong*, *University of Malaya*

In the discussion of economic growth and development, the issue of “convergence” – the ability of countries at a low level of income to catch up, through more rapid growth, with high-income countries – has loomed large. Gershrenkron (1962) was among the first to argue that “catch-up growth” was possible, indeed likely. Since then, numerous studies (for example, Evans and Karras, 1996) have lent support to this argument. However, critics of convergence can muster evidence no less compelling. In the World Bank's *China 2030* (2012) report, a figure shows that out of the 91 middle-income countries, only 13 made it to high-income status by 2008 over a period of 40 years. What prevents countries from crossing income thresholds is the existence of “traps” – the “low-income trap” that prevents low-income countries from achieving middle-income, and the “middle-income trap” which prevents middle-income countries from becoming high-income ones.

The book edited and with contributions by Hill, Tham and Ragayah deals with the issue of the latter “trap” in the context of Malaysia, just over half-way up the middle-income ladder. Achieving high-income status has been the holy grail of Malaysian leaders since Mahathir announced in 1991 Vision 2020, the target year for reaching that goal. However, this call represented little more than rhetoric until the launch of a plethora of initiatives – the New Economic Model (NEAC, 2009), the Economic and Government Transformation Plans, and the Tenth Malaysia Plan (Malaysia, 2010) – at the end of the first decade of the 21st century.

Although the development challenges faced, as discussed in the book, are somewhat generic, its value lies in its attempt to address the issue of the “trap” for Malaysia. While this alarm has also been sounded by the *New Economic Model for Malaysia* (NEAC, 2009), the analyses in the book go considerably deeper and its inclusion of the political dimension makes for more analytical completeness.

An important virtue of the book is its breadth of coverage. Marshaling up-to-date statistics, the authors of the book spoke to both macroeconomic and sectoral challenges. The macroeconomic challenges are Malaysia's role in three economic crises, public sector resource management, monetary policy and financial sector development, and issues related to environmental policy and sustainable development. Sectoral challenges addressed are “microeconomic reform” (a combination of regulatory and governance reform and industry policy), service sector liberalisation, education, poverty eradication, demographic and labor force dynamics, and a case study of the Malaysian electronics industry, the standard bearer of the country's high-tech prowess.

How has Malaysia performed and what challenges lie ahead? Surveying Malaysia's historical performance that qualified the country to be one of what the World Bank

* Faculty of Economics & Administration, University of Malaya, 50603 Kuala Lumpur, Malaysia.
Email: cheongkeecheok@um.edu.my

called High-Performing Asian Economies (HPAEs) (World Bank, 1993), Hill cited structural transformation, consistent openness, prudent macroeconomic management, and social progress as contributing to this performance. Beneath this façade, however, is a story of missteps, including culpability in economic crises (Athukorala), fiscal profligacy (Athukorala, Narayanan), and the subservience of monetary to fiscal policies (Athukorala). Hezri and Dovers also document the difficulty of mainstreaming sustainable development in policy circles.

At the sectoral level, the regulatory and institutional framework remains under-developed while efforts to improve the business climate have met with only partial success (Lee), while the services sector is in need of greater competition (Loke and Tham). Rasiah's chapter also shows that Malaysia's electronics industry has not generated the momentum for technology catch-up to occur. Together, these findings show that Malaysia does indeed possess all the ingredients of falling into a middle-income trap.

It is to the credit of the book that it did not stop at economic analysis. Political analysis has been embedded in the development calculus the book covers. In general, but especially in a country like Malaysia, consideration of political factors that impinge upon, or even override economic decision-making can create distortions that have high economic costs. Two papers address this issue. First, Nelson compares the role of politics in Korea and Taiwan, both of which have made the successful transition to high-income, with that in Malaysia, which began its growth path in the 1960s at about the same income level as these two countries. She finds the subversion of affirmative action to serve patronage networks and the failure to build a vibrant civil society the reason Malaysia has fallen behind. Gomez picks up where Nelson left off, showing how "political business" (a term he uses frequently elsewhere) results in the capture of rent by a small group, leaving truly private enterprises disadvantaged and also most of those affirmative action was supposed to benefit high and dry.

As the previous paragraph highlights, at the heart of many challenges described above is the New Economic Policy (NEP), an affirmative action program to help the *Bumiputera* (indigenous races). This program, applied through employment and enrollment quotas as well as preferential treatment for government contracts, has experienced success in improving the income and welfare of rural residents but failed in its objective of building national unity (Ragayah). Its application to industrial policy has also produced an uncompetitive heavy industry sector. But arguably its greatest damage is in the arena of education, which will have long-term consequences. Lee and Shyamala are absolutely correct to title their chapter "the crisis in education". This decline in the quality of education affects negatively the productivity of the future workforce and the bureaucracy, and hence the strength of Malaysia's institutions.

In addressing the question central to the book, that is, whether Malaysia has what it takes to "graduate from the middle", Hill posits three challenges. First, partly because of the changing global environment but also because of government missteps, Malaysia's macroeconomic policy challenges are intensifying. Second, Malaysia has found it difficult to upgrade technologically and capture more value-added, both essential for economic catch-up to occur. After all, failure to achieve technological catch-up while challenged by lower labour cost countries is what, according to Gill and Kharas (2007), the "middle-income trap" is all about. And third, the NEP, while narrowing inter-ethnic income gaps,

has damaged the quality of education, and hence the human capital base vital to the transition to high-income.

With the breadth and depth of coverage of the book, are there areas that could have seen more discussion? Four come to mind. First, given the extent to which Malaysia is globalised, greater emphasis could have been given to the regional context. The challenges facing Malaysia are not all domestic. For instance, the fall in FDI is attributable not only to Malaysia's domestic policies but to the greater attractiveness of other countries in the region, particularly Indonesia and Vietnam, as investment destinations. Second, more discussion could have been devoted to the low labour cost model through the use of foreign labour. While this model has served the country well in the past, it will not in the future. Technology upgrading and value addition requires a skilled workforce. Unfortunately, together with the arrival of cheap foreign labour, Malaysia is experiencing a brain drain (World Bank, 2011). The implications of this labour force dynamics need to be better explored. Third, the contrast in the industrial policy outcomes between Korea and Malaysia cannot be sharper. One just needs to compare Hyundai and Proton in the automotive sector to appreciate the gulf in performance. The factors that bring this about should provide major lessons. Fourth, various authors have pointed to policies, especially the NEP, in failing to achieve national integration while civil society voice has been muted. Closely related to the politics that so often dominate the Malaysian landscape, this is a subject worthy of discussion in its own right.

Given all these challenges, will Malaysia be able to avoid the "middle-income trap"? The authors have wisely avoided answering this question. Malaysia's stellar performance in the past has not been entirely of its own making. External forces – the rises of wages in the now advanced economies that led to the need to move production to low labour cost countries, the end of the Cold War that produced a rush of investment capital to "emerging markets", and that China and India had not liberalised earlier – all played their part. Similarly external forces will continue to play a role. The increasingly competitive international environment does suggest, however, that unless the challenges dealt with in this volume are addressed, the road to a high-income country status will be a very rocky one.

No less important is a question Mohamed Ariff alluded to in the Preface – does the achievement of high-income status make Malaysia a developed country? Cursory evidence that Malaysians see no problem breaking traffic rules, jumping queues, etc. as long as they are not caught makes it hard to disagree with Ariff's conclusion that Malaysia is far from being a developed country defined by the rule of law. It is a lot easier to take Malaysia out of the third world than to take the third world out of Malaysians.

References

- Evans, P. and G. Karras. 1996. Convergence revisited. *Journal of Monetary Economics* 37(2): 249-265.
- Gerschenkron, A. 1962. *Economic Backwardness in Historical Perspective*. Cambridge, MA: Harvard University Press.
- Gill, I.S. and H. Kharas. 2007. *An East Asian Renaissance: Ideas for Economic Growth*. Washington DC: World Bank.
- Malaysia. 2010. *Tenth Malaysia Plan 2011 – 2015*. Putrajaya: Economic Planning Unit.

Kee-Cheok Cheong

- National Economic Advisory Council (NEAC). 2009. *New Economic Model for Malaysia*. Putrajaya.
- World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Policy*. Washington, DC.
- World Bank. 2011. *Brain drain. Malaysian Economic Monitor*, Washington DC, April.
- World Bank. 2012. *China 2030: Building a Modern, Harmonious and Creative High-Income Society*. Washington DC.