

**Pacific High-level Policy Dialogue on
“The Role of Macroeconomic Policy and Energy Security in supporting
Sustainable Development in the Pacific”**

8-9 October 2012, Nadi, Fiji

**Jointly organized by
UN ESCAP and Sustainable Development Working Group of the Council of Regional
Organizations in the Pacific (CROP)**

**Session 1 – Stimulating and Sustaining Growth, Building Resilience: the
Role of Macroeconomic Policies**

Stimulating and Sustaining Growth, Building Resilience

by

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Malaysia (Stimulating and Sustaining Growth, Building Resilience: the
Malaysian Experience)

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THE ROLE OF MACROECONOMIC POLICY AND ENERGY SECURITY IN SUPPORTING SUSTAINABLE DEVELOPMENT IN THE PACIFIC

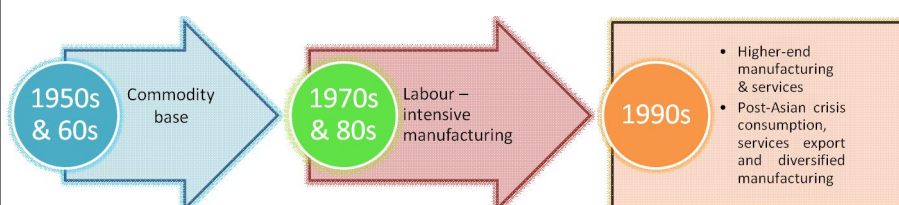
Session 1 – Stimulating and Sustaining Growth, Building Resilience

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The Malaysian Economy : Various Stages of Transformation

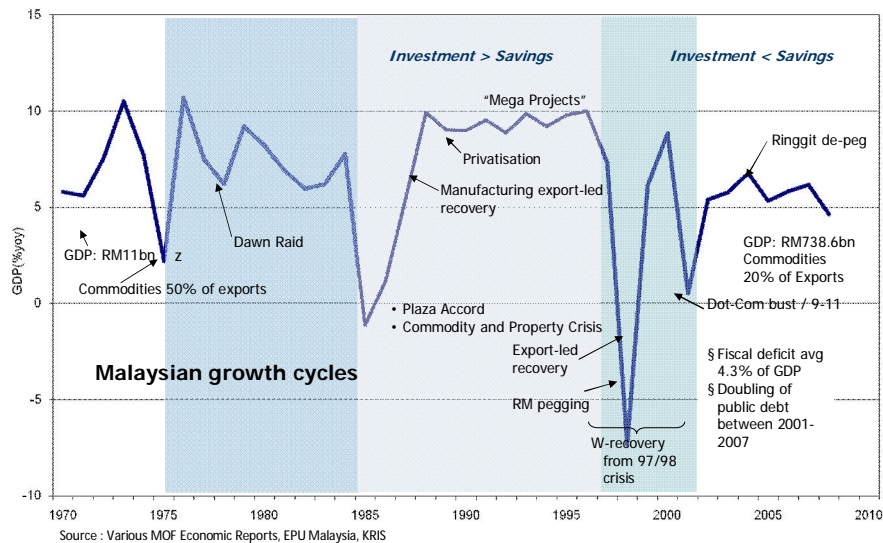


- Industrial policies & liberalisation facilitate structural shift
- Strong investment driven economic expansion raised living standards
- High savings balanced with rising domestic consumption to support growth

| Higher per capita income | | | | |
|--------------------------|--------------------|--------------------|-------------------|-------------------------|
| Year | Per Capita Y (USD) | Average Wage (USD) | Nominal GDP (USD) | External Reserves (USD) |
| 1980 | 2,800 | 310 | 24.5 b | 4.6 b |
| 1990 | 2,800 | 310 | 44.1 b | 10.0 b |
| 2000 | 3,774 | 420 | 90.3 b | 29.9 b |
| 2010 | 9,755 | 600 | 280 b | 140.0 b |

Malaysia has an open economy

We are affected by global events and external shocks



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Asian Crisis: Sequencing of Package of Macro-economic & Structural Reforms Included Restructure of Banks

| Stage of Crisis Response | Macroeconomic | Structural |
|-----------------------------------|--|--|
| Stage 1 : Jan – Oct 1998 | Stabilisation package : •Monetary policy •Liquidity management •Special funds to Priority Sectors •Counter – cyclical policies | Institutional set-up to restructure banks & cooperatives: •Consolidate finance companies •Set up Danaharta •Set up Danamodal •Set up CDRC •Enabling legislation |
| Stage II : Oct 1998 – mid 2000 | Introduce selected exchange controls | Strengthen governance structures & enhanced bank supervision |
| Stage III : 2001 – 2004 | Gradual liberalisation of exchange controls | Set up deposit insurance, new credit bureau framework |

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Lessons from Malaysian Experience During Asian Crisis

1. Sequenced financial sector reforms- appropriate mix between foreign banks & domestic banks; core strong domestic banks to meet economic development needs " lending to priority sectors; Mix of foreign banks for technology, international links, investor needs for globalised operations
2. Align banking sector reform with economic transformation objectives & deregulation of current & capital accounts in the balance of payments
3. Focus on Financial Sector infrastructure " build strong institutions to manage K flows, implement MP, improve intermediation " support economic growth with FS stability
4. Liberalise capital flows " underpinned by stronger banks to manage flows & risk management framework on foreign currency exposure & currency mismatches
5. Institutional building precede liberalisation
6. At all times:
 - ✓ Build capacity at BNM " strengthen supervision
 - ✓ Ensure sound macro-policies
 - ✓ Prudential rules on lending & foreign currency exposure imposed on individuals

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Commodity and Property Crisis of 1980s

- Adjustments during this period can be more relevant to current state of development in PICs
- Crisis in Malaysia was not contagion; external shock exposed macro-economic imbalances in domestic economy; resolution required adjustments to correct domestic instability, no requirement to respond to external environment.
- Crisis response different on both fronts of macro-economic adjustments and restoring economic growth; domestic policy adjustments and liberalisation of economy led to rapid correction in BOP and Fiscal Accounts.

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Responses to 1980s and Asian crises were significantly different—correct diagnosis of root causes is critical for effective adjustment measures

Commodity, property crisis in 1985

- External shock, but imbalance from inappropriate domestic macro-economic policies to hasten economic development—large fiscal and CA deficit, higher inflation which limited counter-cyclical policy adjustments
- Common thread in banking sector—large lending to property sector
- Recovery conditional on strong macro-economic adjustment policies—reduce fiscal deficit, liberalise interest rates; supply side policies for economic recovery, adjustment policies were mainly in the real sector
- Special funds to promote new investments, SMEs, export credit facilities
- Extensive fiscal incentives to attract FDI, liberalised ownership structures in manufacturing sector—watershed in making Malaysia integrated into global economy
- Banking sector regulation was changed post-crisis period

Asian crisis, 1997-98

- External shock, but sound macro-economic position with low inflation, policies responded to instability in forex and financial markets—fiscal surplus, market-based MP, strong BOP—support counter-cyclical macro-economic adjustments
- Common thread in banking sector—large loans to property sector, asset inflation
- Measures focused on expansionary macro-economic policies, adjustments in exchange rate regime and significant strengthening of financial sector
- Regional cooperation for cross-border liquidity support, monitoring capital flows
- Gave rise to financial sector surveillance and cooperation within ASEAN + 3.

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Malaysia built resilience to shocks over time

10 examples:

1. Diversified supply side GDP growth;
2. Balanced consumption with investment on demand side;
3. FDI for innovation, export markets;
4. Low debt/GDP, manageable short-term liabilities;
5. Addressed maturity mismatch in financing—developed capital market for long-term financing;
6. Took significant measures to build sound banking system—strong capital, low NPL, observed international prudential standards;
7. Reformed financial sector regulation with good corporate governance;
8. Ensured macro-economic fundamentals support exchange rate and overall financial stability;
9. Put in place process for strict monitoring of capital flows, foreign presence in financial markets;
10. Need to continue measures to restore strength in fiscal position.

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Correct crisis adjustment supports stability, BUT does not ensure sustainable growth

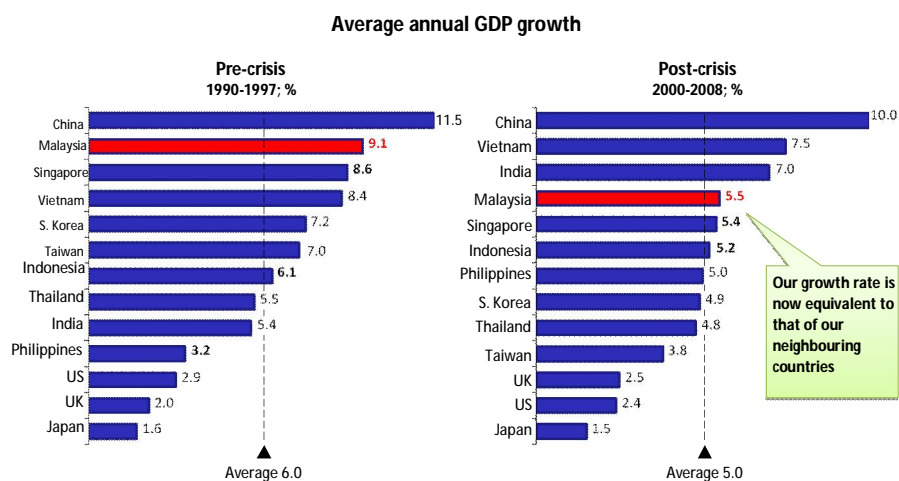
1. The NEM – A Diagnostic of the Middle Income Trap

2. What is the process to achieve fundamental changes?
Ø Leverage on advantages
3. The NEM--paradigm shift towards high income, sustainable growth & social justice



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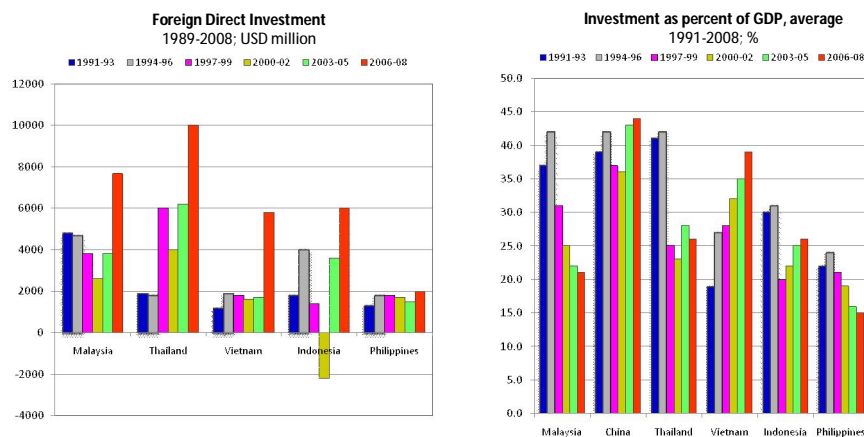
Post Asian Crisis—stronger resilience, but growth momentum slowed, affected regional lead position



Source : BCG, The conference Board Groningen Growth and Development Centre, Total Economy Database 2009

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Investment in Malaysia since the Asian crisis

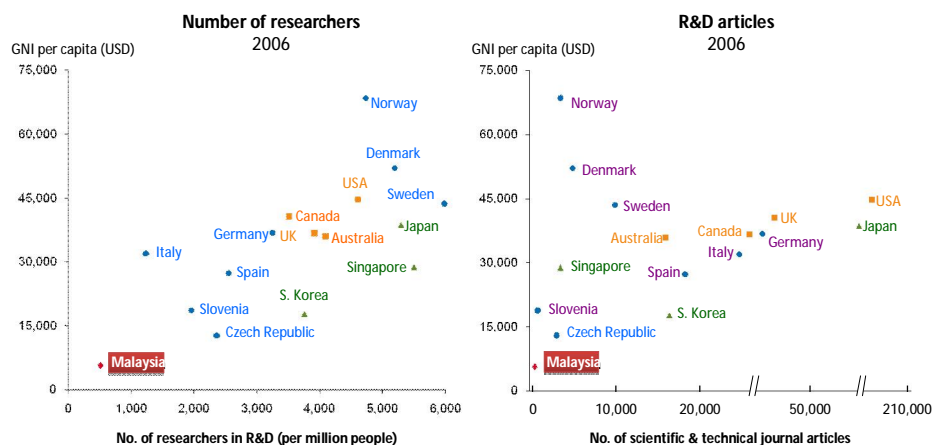


- Countries such as Indonesia have gained notable ground in investment recovery since the crisis
- The rebound of Malaysia's FDI is not as strong as desired, relative to its pre-Asian crisis level

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Low innovation despite fiscal allocations

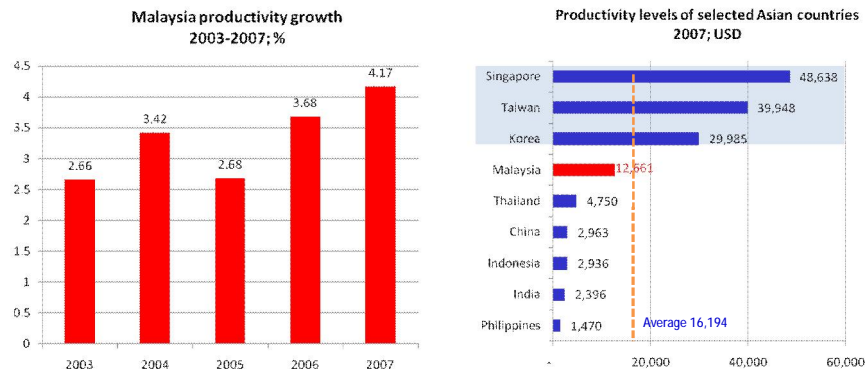
Our R&D capabilities has not caught up with the rest of the world



Source : World Bank Indicators 2008

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Productivity is increasing, but we are still far behind other high income countries

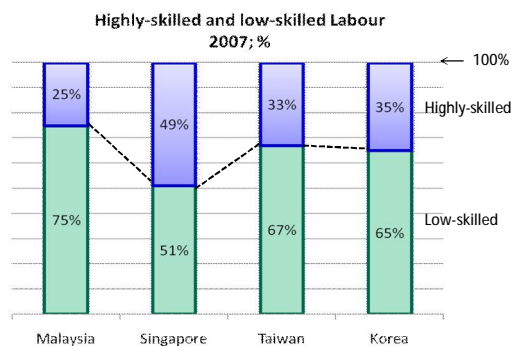


Productivity in Malaysia

- Post-Asian crisis, Malaysia's productivity level and growth has slowed; the service sector has been a major contributor of productivity growth with a 9.7% increase in 2007, whereas manufacturing showed a 2.7% productivity growth
- Malaysia's productivity level continues to surpass that of neighbouring countries, but is still far from OECD levels, where more diversified economic structures, sophisticated technology, higher innovation, and more intensive R&D sectors can be found

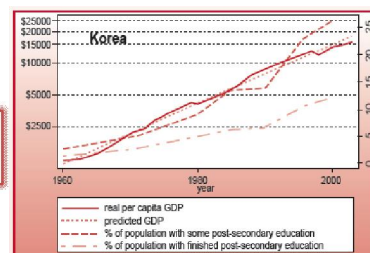
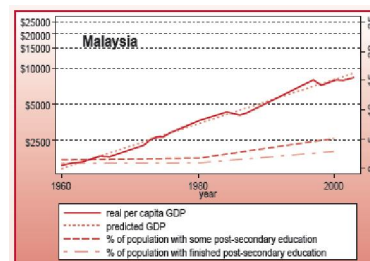
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We have not created enough high wage jobs – skills base is smaller than competing countries



- At present the proportion of skilled labour in Malaysia is low
- The share of labour force with tertiary education for advanced countries is high

Source : Economic Planning Unit, World Bank



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Change is required to retain talent to drive future growth

Human Capital in Malaysia

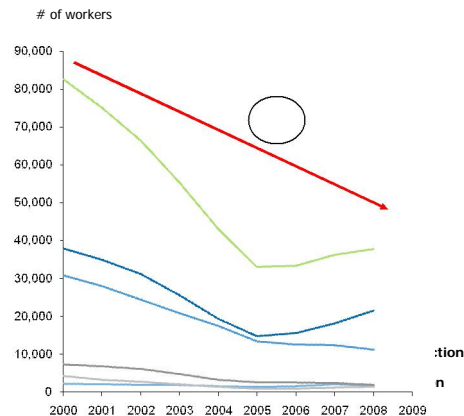
§ Malaysia faces difficulties in retaining talent because new markets offer better opportunities, likewise affecting expatriates working in Malaysia

§ The result is a shortage of dynamic talent needed to push Malaysia into higher value added activities

§ Various programmes to attract skilled talent were introduced, with limited success

Source : Department of Statistics, EPU

Number of skilled expatriates in Malaysia
2000-2008; no. of workers



Source : BCG, DOS, NER 2008

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Institutional structures and processes impede investments, thus weakening our competitive position

Global ranking according to *Doing Business 2010* report – Malaysia losing out on all counts

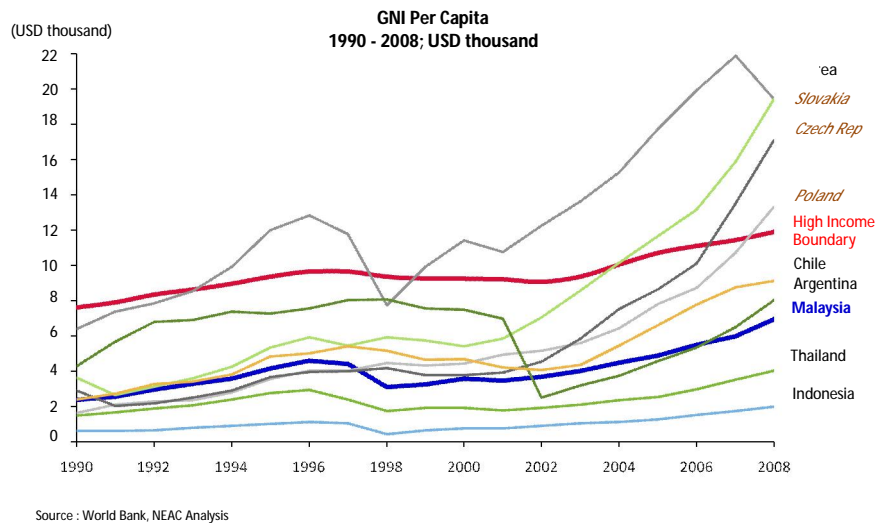
| | Ease of Doing Business | Starting a Business | Dealing with construction permits | Registering property | Trading across borders | Enforcing contracts |
|-----------------|------------------------|---------------------|-----------------------------------|----------------------|------------------------|---------------------|
| Singapore | 1 | 4 | 2 | 16 | 1 | 13 |
| New Zealand | 2 | 1 | 5 | 3 | 26 | 10 |
| Hong Kong | 3 | 18 | 1 | 75 | 2 | 3 |
| US | 4 | 8 | 25 | 12 | 18 | 8 |
| UK | 5 | 16 | 16 | 23 | 16 | 23 |
| Thailand | 12 | 55 | 13 | 6 | 12 | 24 |
| Japan | 15 | 91 | 45 | 54 | 17 | 20 |
| S. Korea | 19 | 53 | 23 | 71 | 8 | 5 |
| Malaysia | 23 | 88 | 109 | 86 | 35 | 59 |

Source : World Bank

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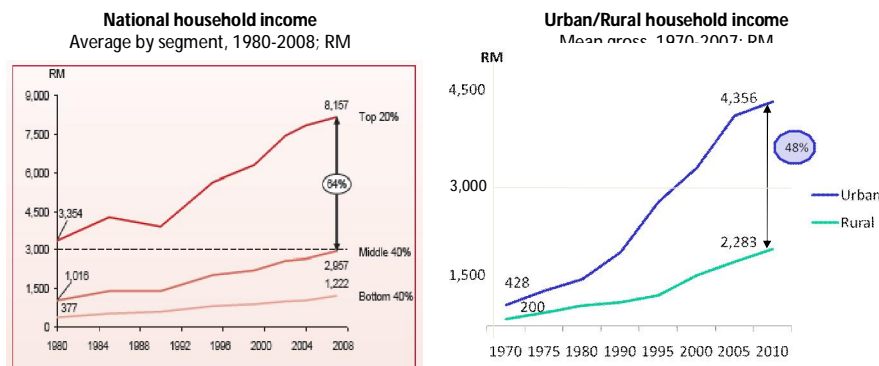
We have been in the middle income trap for a while now

Broad-based change is required to move into high income



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Income growth has been strong for the top 20% of Malaysian earners, particularly since 1990

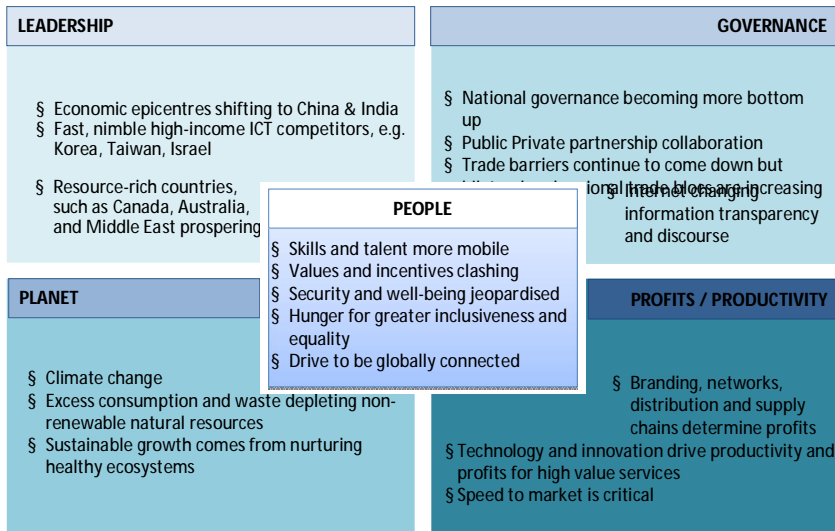


- § The income disparity remains sizable
- § The bottom 40% of household have experienced the slowest growth of average income
- § 58% of households have income of less than RM3,000
- § Although overall income disparity improved (the National Gini¹ coefficient has decreased from 0.459 in 1997 to 0.441 in 2007)

1) The Gini ratio is measure of statistical dispersion of income of wealth. The closer the Gini ratio is to 0, the smaller the dispersion – or the greater the wealth equality.

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Global dynamics: rapid change in global environment post-crisis



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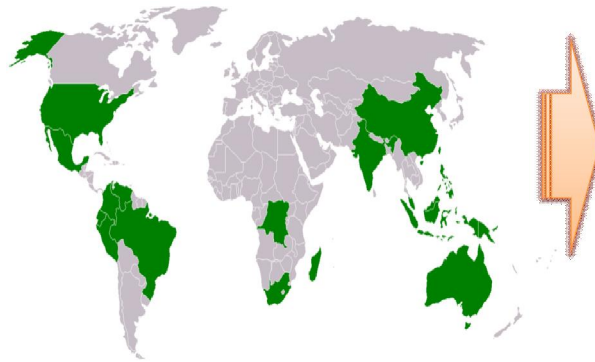
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We are blessed and well bestowed with gifts Rich in culture, biodiversity and natural resources

■ Mega-diverse countries



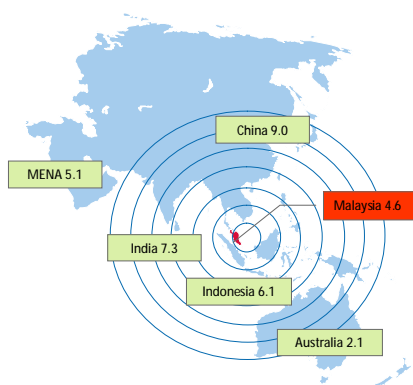
Implication for Malaysia

- § Malaysia has a rich array of **ethnicities, with diverse cultures** spread across the Peninsula, Sabah and Sarawak
- § Malaysia is one of the 17 mega-diverse countries identified by the United Nations Environment Programme (UNEP) as harbouring the **majority** of the **earth's species**. Some 60% of Malaysia remains forested
- § Malaysia is well-endowed with **natural resources** in agriculture, forestry and minerals

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Our country is strategically located in a high growth region Perfectly located as a potential hub with added speed to market advantage

Real GDP growth
2008; %



Implication for Malaysia

- § Bilateral trade between Malaysia and China and Malaysia and India continues to expand rapidly
- § China, India and East Asia are likely to be major sources of new FDI as they seek access to natural resources and niche markets that reinforce bilateral ties
- § Malaysia has inherent characteristics (e.g. language networks) that can develop tourism and industry links

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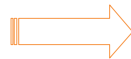


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Require a paradigm shift to restore economic & business dynamism--- The NEM

Malaysia in Middle Y Trap

- Malaysia will remain an open economy
- Sustainability of growth rate of Malaysian economy
- Private investments taking back seat
- Impediments to doing business
- Low skills equal low wages
- Talent is not recognized & utilized → Leaving offshore
- Income gap is widening



**NEM requires
paradigm shift
in economic &
business models**

Old Ways

- Growth thro K accumulation
- Dominant state-led
- Centralized planning
- Balanced reg. growth
- Restrict foreign skills
- Favour specific industries

New Ways

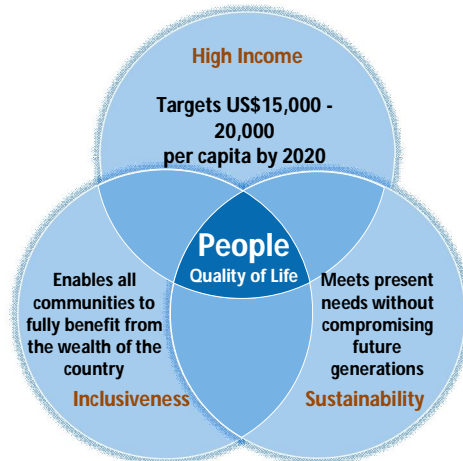
- Growth thro' productivity
- Private Sector led
- Local autonomy & decentralized decision making
- Cluster & corridor -based growth
- Retain & attract talent
- Favour services & technology – industries

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The Goals of the New Economic Model (NEM)

Aspirations of a united and advanced nation in line with the 1Malaysia concept

Goals of the New Economic Model



Characteristics of Malaysia in 2020

- Market Led
- Well-Governed
- Regionally Integrated
- Entrepreneurial
- Innovative

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NEM for the “man on the street”: Inclusive programmes to support the low income and vulnerable groups

Benefits for the People

- § Fulfilling jobs with good wages
- § Attractive homes in safe surroundings with good public facilities
- § High mobility with low environmental impact
- § Excellent health care, accessible by all
- § Access to high quality education in every community in the country
- § Advancement based on merit and effort
- § A better Malaysia for future generations from a sustainable economy
- § Fair and respectful treatment by government agencies, regardless of status
- § Safety net for the vulnerable, especially when impacted by national transformation

Specific programmes are needed to help the bottom 40% in particular



- § Extra effort is needed to ensure the low income group, especially those in rural areas, have access to quality social services –especially education –which will help improve their livelihood
- § A proper social safety net must be created to help the low income group hardest hit during the NEM transition period to cope with changes
- § Extra efforts to ensure small businesses have access to funding

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The enablers for launching the NEM

Actions enabling change

Breaking vested interests

Prepare people for change

Coherent "big push" growth

Strategic Initiatives of the NEM

1. Improve functioning of labour market
2. Increase private sector profile
3. Re-engineer public institutions
4. Improve the national talent base
5. Transform economic structure and technological base
6. Reform fiscal framework.
7. Increase contribution of bottom 40%

Resistance to change

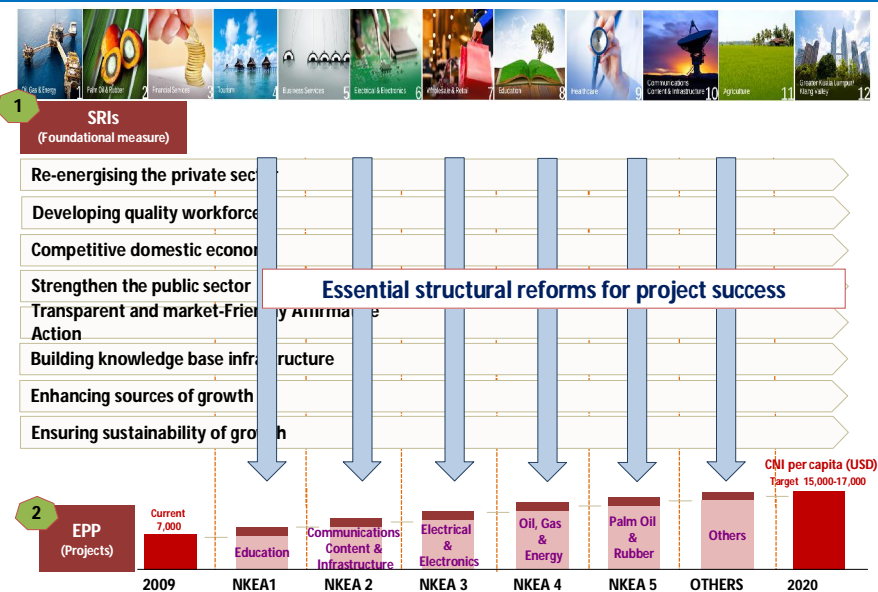
Protected industries, employers of foreign labour, licence holders, subsidised input users and experts at doing business the old way

Peoples' comfort zone of "business as usual"—do not see benefits of the NEM

People who have enjoyed subsidies, government grants, secure jobs and a stable lifestyle

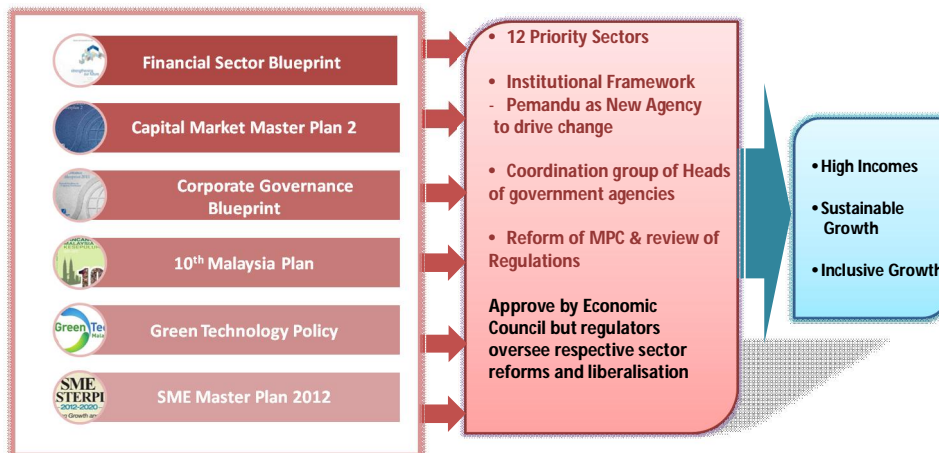
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National Key Economic Areas (NKEAs) Identified as New Growth Drivers for Economic Transformation



* Note: Others - Financial Services, Tourism, Business Services, Wholesale & Retail, Healthcare, Agriculture and Greater Kuala Lumpur & Klang Valley

Strategic Plans : Implementation Programs



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Concluding Remarks

Building resilience to shocks is essential, takes time, correct sequencing on liberalisation of economy

BUT

Resilience alone cannot ensure sustainable growth

NEED

- Dynamism in economy, strong private sector;
- Sound, legal, regulatory and institutional framework,
- Competitive sources of growth;
- Environment that is supportive of consumption and investment;
- Talent and skills management for productivity.

- Sound economic fundamentals--macro-economic balance, strong financial institutions and financial and economic stability +
- Good fundamentals of economic management by institutions practicing good corporate governance

**Resilience to shocks
PLUS**

Viable business model with sound legal, regulatory and institutional framework

For long-term sustainable economic growth

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