

# Economic Research

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## *New Economic Model – Towards Realising Vision 2020*



**MALAYSIAN RATING CORPORATION BERHAD**  
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the last page of this report*

**The much-awaited NEM was unveiled**

The much-awaited New Economic Model (NEM) was unveiled by Prime Minister Najib on March 30, outlining broad strategies to transform Malaysia into a high-income country, i.e. a nation with per capita income of at least US\$15,000. The NEM is one of the four important pillars needed to achieve Vision 2020 in the next 10 years, with the three other pillars of the national transformation program being: (1) 1Malaysia; (2) the Government Transformation Program; and (3) the upcoming 10th Malaysia Plan.

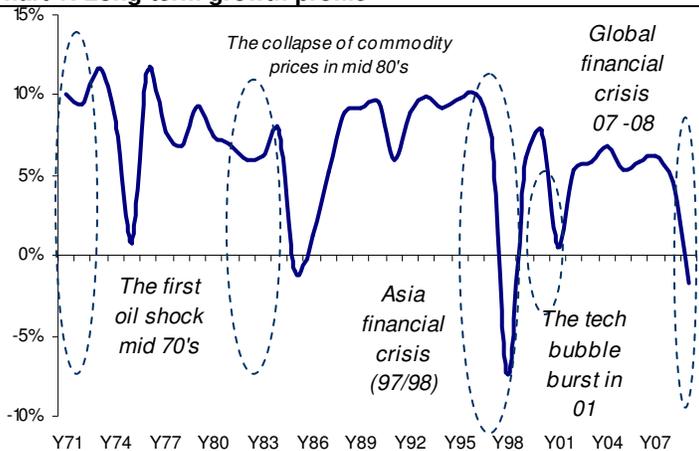
As this is the first part of the NEM, the report only provides a conceptual plan with broad measures that will be further clarified in June this year. The important part of the plan is encapsulated in the eight Strategic Reform Initiatives, namely:

- Re-energising the private sector
- Developing a quality workforce and reducing dependency on foreign labour
- Creating a competitive domestic economy
- Strengthening the public sector
- Transparent and market-friendly affirmative action
- Building the knowledge base and infrastructure
- Enhancing the sources of growth, and
- Ensuring sustainability of growth

**Why is there a need for the NEM?**

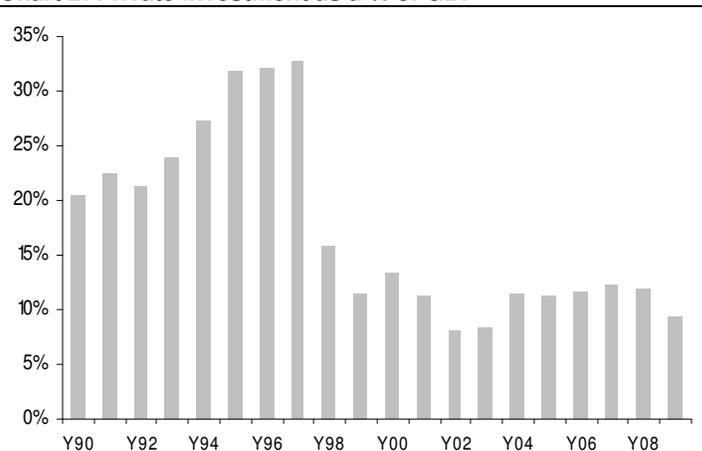
The Malaysian economy is still trapped in the “middle-income” category despite its achievements in the past few decades. For the record, Malaysia was one of the 12 countries that registered an average growth rate of 7% or more per annum in the 25 years or more since World War II. Notwithstanding this, Malaysia’s current per capita income is still around US\$7,600, half of the US\$15,000 needed to be categorised as a high-income country. The deceleration in Malaysia’s economic growth in recent years was attributed to the decline in private investment, a feature that became prominent after the Asian Financial Crisis (AFC) in 1998. As a result, Malaysia’s growth rate fell to an average of 5.5% between 1999 and 2008, compared with 8.8% between 1990 and 1997. Given the amount of capital and assuming a steady rate of increase in the labour force, we estimate Malaysia’s long-term growth potential to be somewhere between 4.3% and 4.5%, almost in line with the International Monetary Fund’s (IMF) estimate of 4.25%.

**Chart 1: Long-term growth profile**



Source: CEIC

**Chart 2: Private investment as a % of GDP**



Source: CEIC

## Our View

There are numerous plus points about the NEM. Amongst others, the Model:

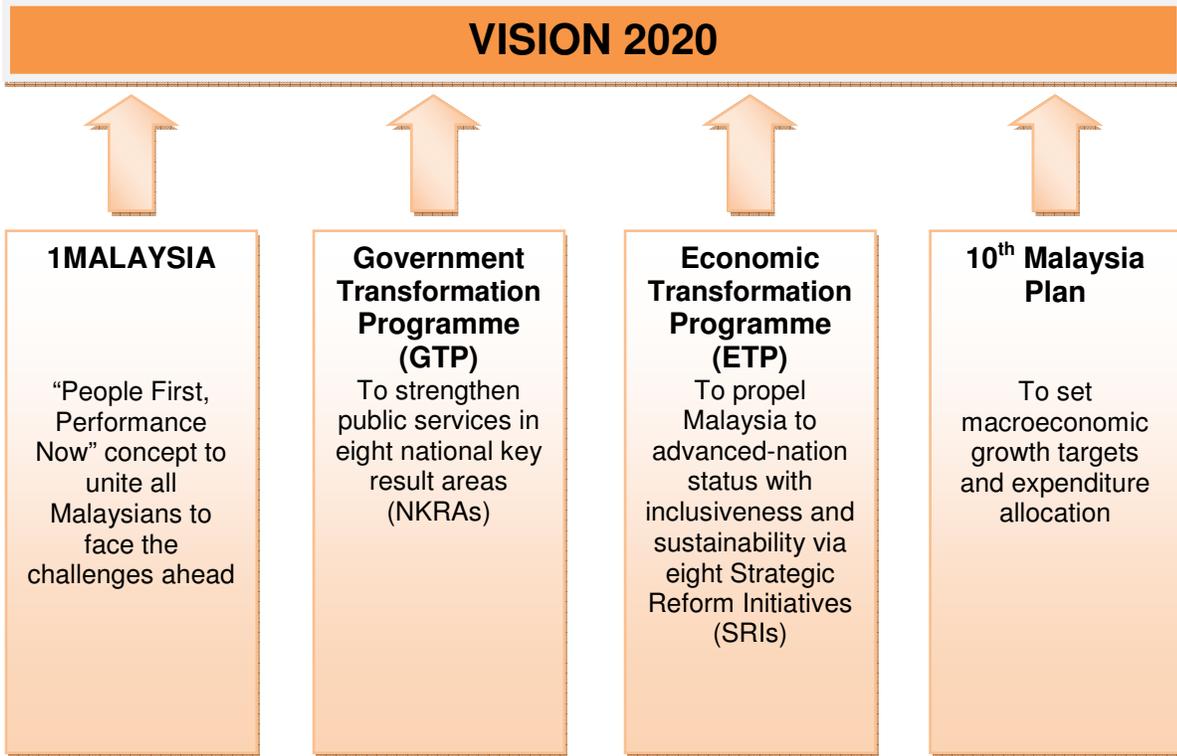
- **Acknowledges current weaknesses and identifies solutions.** Admitting problems that need to be addressed is already half of the battle won. Chief among the issues is the need to revive investments, which is clearly emphasised in light of the substantial decline in private investments since the AFC, as reflected in the present ratio of private investment to GDP of only 9.4% in 2009, compared with 33% in 1997. While the consumption-led growth has enabled the economy to keep on humming at an approximately 5% to 6% clip per annum in the past few years, it cannot continue to spearhead the economy without causing further strain on already-overstretched household budgets. Visible signs of fatigue in consumer spending have emerged after the recent global financial crisis. Other macro weaknesses as mentioned in the report are rising income disparity, high dependency on foreign labour, high subsidies and persistent budgetary deficits.
- **Focuses on producing a superior workforce.** Besides revitalising private investments, enhancing and nurturing the quality of the workforce is also the centerpiece of the NEM. To this end, the NEM will review the present education system, re-skill the existing labour force and retain and attract foreign talents. Such initiatives are very much in line with the development of National Key Economic Activities (NKEA), of which research and development (R&D) is the backbone of key economic sectors.
- **Identifies Malaysia's inherent strengths to leverage on.** Despite facing various challenges, the Malaysian economy has its own strengths, enabling it to stand out among its peers. Malaysia's infrastructure is well developed, following massive investment in the late 1990s. English is a common means of communication and a large proportion of its labour force is relatively educated. In terms of resources, Malaysia is well endowed with crude oil and palm oil. As for financial-market sophistication, Malaysia is highly regarded and renowned as an Islamic finance hub. Malaysia is the world's largest *sukuk* issuer and has in place stringent regulations to enable it to become an important centre for Islamic finance. With all these advantages in hand, Malaysia can continue to excel, provided that core macroeconomic problems are properly addressed.
- **Is a comprehensive outline.** Some of the elements in the NEM had been highlighted previously. However, the desire to move towards a knowledge economy and the need to pay attention to the development of the services sector have been muted since their unveiling in the 1990s. The NEM has now put all the pieces of the economic jigsaw puzzle together in a more systematic and holistic manner. From the pillars to achieve the goals of Vision 2020 to the eight strategic reform initiatives, the NEM is in fact a comprehensive plan on how to take the economy to a higher level of development in the next 10 years.
- **Aims to do more than simply doubling income.** The NEM also focuses on the thorny issue of the widening income disparity. A safety net for the bottom 40% of the income strata will be introduced through the creation of the Transformation Fund and the setting up of the Equal Opportunities Commission. In addition, while it was generally expected that the report will only focus on the need to re-energise the economy and raise the income per capita, it also recognises the importance of the concept of "inclusiveness", or the sense of belonging among the *rakyat*. This, according to the report, can be achieved if no groups of the population are marginalised. Inclusiveness, according to the government, will enable communities to contribute to and share in the wealth of the country. We couldn't agree more.

As with other economic blueprints, there are concerns about the NEM. These include:

- **Lack of details.** The immediate concern that strikes almost everyone is the lack of details about the plan. Most of the measures outlined are very general in nature. The NEAC, however, explained that the nitty-gritty of the measures and execution plans will be presented in June along with the 10th Malaysia Plan. Accordingly, there is a need to get relevant feedback about the general outline of the plan from different groups. Only then will the details be worked out by the government. Notwithstanding the fact that relevant feedback is crucial, trying to satisfy all parties will not be an easy task.

- **Execution, execution, execution.** Our immediate question (and almost everyone else's) is whether the NEM will be properly executed. Execution is the most crucial part of any plan. Even the execution of the previous economic plan, the New Economic Policy (NEP), raised concerns, and not the plan itself. In fact, the NEP was a sound policy that had considerable success in reducing the country's poverty level. The concern over the execution of the NEM is understandable as any dramatic changes in policy trends will result in dissatisfaction among some quarters.
- **The government in the leading role.** By this, we are not saying that the government has to be the driver of change, as the NEM clearly stated its intention to see the private sector spearheading the economy in the future. What we really mean is the private sector's desire to see the public sector as an example in driving Malaysia towards the desired goals. For instance, the government may wish to set an example by allocating more resources for research activities to encourage the private sector to enhance its R&D. An organisation like the National Economic Advisory Council (NEAC), for instance, can be made a permanent think-tank that is supported by a considerable number of economic researchers. The previous NEAC (then known as the National Economic Action Council) played a crucial and successful role in pulling Malaysia out of the AFC, but was not given an opportunity to continue to act as an economic intelligence team in the subsequent years.
- **The need for a productivity-based remuneration system in the public sector.** While capital accumulation is critical, it should no longer be a main growth avenue. The smart way to grow an economy is through higher productivity. In this regard, the common argument is that the public sector needs to continue to enhance its productivity. Our concern, however, is that the lack of a productivity-based remuneration system in the public sector may frustrate those who have shown significant improvements in their productivity. It is also worth noting that while the general complaint is the lack of productivity in the public sector, some government agencies have been able to upgrade their productivity levels significantly in the past few years.
- **Political will and public relations are the key factors.** Political will is one of the key enabling factors for the NEM, whereby the government must have the determination to break the log-jam of vested interests and beneficiaries of rent-seeking activities as described in the report. In addition, an enhancement in public relations and communications between the government and the general public will greatly improve the acceptance of any government policy, including the NEM. Admittedly, the whole idea of the NEM should be applauded, and as long as regular updates and information continue to flow to the general public, the spirit of wanting to achieve the goals set up by the NEM will not fade. However, people have to be constantly reminded of the plans outlined by the government to help them improve their income in the future. We are positive that this can be achieved.

## The Four Pillars of National Transformation



## The New Economic Model



## The 8 Strategic Reform Initiatives and Corresponding Policy Purposes

Strategic Reform Initiative (SRI)	Policy Purpose
Re-energising the private sector	<ul style="list-style-type: none"> <li>• Target high value-added products and services</li> <li>• Remove barriers and costs of doing business</li> <li>• Create eco-system for entrepreneurship and innovation</li> <li>• Encourage efficiency through healthy competition</li> <li>• Promote SME growth</li> <li>• Create regional champions</li> </ul>
Developing a quality workforce and reducing dependency on foreign labour	<ul style="list-style-type: none"> <li>• Increase local talent over time</li> <li>• Re-skill the existing labour force</li> <li>• Retain and access global talent</li> <li>• Remove labour-market distortions constraining wage growth</li> <li>• Reduce reliance on foreign labour</li> </ul>
Creating a competitive domestic economy	<ul style="list-style-type: none"> <li>• Improve economic efficiency through competition</li> <li>• Build entrepreneurship</li> <li>• Remove market distortions leading to misallocation of resources</li> </ul>
Strengthening the public sector	<ul style="list-style-type: none"> <li>• Improve decision-making processes</li> <li>• Improve service delivery</li> <li>• Reduce “friction costs”</li> <li>• Provide a safety net to facilitate a smooth transition</li> <li>• Strengthen public finance management</li> </ul>
Transparent and market-friendly affirmative action	<ul style="list-style-type: none"> <li>• Reduce income disparity</li> <li>• Create market-friendly affirmative action</li> <li>• Narrow regional differences</li> <li>• Encourage reward on the basis of performance</li> <li>• Promote equal and fair access to opportunities</li> </ul>
Building the knowledge base and infrastructure	<ul style="list-style-type: none"> <li>• Create an ecosystem for entrepreneurship</li> <li>• Promote an environment for innovation</li> <li>• Establish stronger enabling institutions</li> </ul>
Enhancing the sources of growth	<ul style="list-style-type: none"> <li>• Create value from first-mover and other comparative advantages</li> <li>• Develop greater integration between products</li> <li>• Create new markets</li> <li>• Build scale of industries and production networks for specialisation</li> <li>• Harness innovation potential</li> <li>• Integrate real-sector industries with financial services</li> </ul>
Ensuring sustainability of growth	<ul style="list-style-type: none"> <li>• Preserve natural resources</li> <li>• Leverage on comparative advantages for high value-added products and services</li> <li>• Meet international commitments</li> <li>• Facilitate bank lending and financing for “green investment”</li> <li>• Ensure sound public finances</li> </ul>

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