



Chapter 1

Inclusive Growth: Meaning, Importance and Timeliness



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1.1 Global setting and the Malaysian context

Malaysia's remarkable achievements in economic growth, poverty reduction and moderation of ethnic disparities, and its transformation from a primary commodities producer to a major world manufacturing exporter have put this small country on the world map. Its performance from 1971, under the NEP, until the 1997-98 Asian financial crises in particular shone the global spotlight on its national programme of growth with redistribution, or growth with equity, as well as its more contentious programmes, including privatisation. The post-Asian crisis era has seen steady but less spectacular growth, increasing concerns regarding the challenge of breaking out of the so-called "middle income trap" (Aiyar et al., 2013). While some inequalities between groups and regions continue to be bridged, disparities continue to persist, and questions remain over continuing forms of social exclusion, economic insecurity and barriers to social mobility.

Patterns and trends in inequality around the world also underscore the importance of inclusive growth and having policy options to achieve them. Recent data show contrasting trends across countries and regions and point out the importance of looking at income disparities between the uppermost extremities and the rest. The 1980s and 1990s were largely characterised by rising inequality in most countries in the world and in the majority of countries in all regions (UNCTAD, 1997). However, the approximately post-2000 period has witnessed a variety of experiences, with

inequality rising in major economies such as the United States and China, and declining in considerable portions of Africa and Latin America (UNCTAD, 2012). Furthermore, robust growth has been sustained in many countries that narrowed inequality, raising important policy implications for complementarities of inclusiveness and productivity in the contemporary world, which is seeing new disputes in the configuration of state and market, and in the dual pursuit of equity and efficiency.

The Malaysian federal government has gone to significant lengths in embracing the inclusiveness agenda. The New Economic Model (NEM) outlined a triangular platform consisting of high income, sustainability and inclusiveness, in order to launch subsequent phases of transformation. Inclusiveness is simply defined as "enabling all communities to fully benefit from the wealth of the country", which translates into growth that is "pro-poor" and "concerned not only with the level but also the effect of persistent inequality on economic growth and poverty alleviation" (NEAC, 2010, p.89-90). The Tenth Malaysia Plan (2011-2015) stipulated 10 major items on its agenda, two of which correspond with inclusive growth: equality of opportunity and safeguarding of the vulnerable, and inclusive development alongside concentration on urban growth poles and high density clusters (Malaysia, 2010).

The issues of inequality and inclusion have also been taken up recently by various scholars and organisations. Faaland, Parkinson and Saniman (1990) provide an overview of Malaysia's successes in growth and redistribution, specifically over the NEP's 1971-1990





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timeline. More recently, the World Bank's (2010) *Malaysian Monitor: Inclusive Growth* broadly outlined the theme, making three principal proposals: 1) Increasing economy-wide income-earning opportunities; 2) Promoting investment in human capital and 3) Providing social protection for the poor and vulnerable. *Affirmative Action, Ethnic Inequalities and Social Justice*, a volume on the NEP, broadly argues that Malaysia's pursuit of reducing horizontal inequalities, predominantly between ethnic groups, has come at significant expense of national integration and economic efficiency (Gomez and Saravanamuttu, 2012).

Khoo Khay Jin's (2012) chapter in *Policy Regimes and the Political Economy of Poverty Reduction in Malaysia* highlights regional and spatial unevenness beneath the remarkable reduction in the national poverty rate. He presents income disparity ratios suggesting that the problem of inter-ethnic disparities is "principally an issue of urban-rural differentials and secondarily of inter-ethnic urban differentials", and questions whether social policy should remain focused on inter-ethnic inequalities or shift to the broader "social inequality, while still addressing ethnic parity where it remains urgent, such as with the 'other Bumiputera'" (Khoo 2012, p.84 & 93). Ragayah (2012) points out the hazards of unequal income distribution on social cohesion, and the possibility that structural inequalities may entrench unequal opportunity across generations, making reference to widening inequality since 1990—although

official household income statistics do not clearly bear this out.

These assessments and recommendations, while varying in approach and conclusion, share a common perspective: inclusiveness remains lacking in Malaysian society, economy and polity. Much progress has been made in narrowing income gaps between groups, yet overall household income inequality remains high, and segments of society may be excluded from actively participating and receiving an equitable share of benefits. International evidence suggests that the country's socioeconomic development and capability expansion relative to other countries has remained static for almost two decades, and the momentum of progress has waned. Malaysia's Human Development Index (HDI) score has increased, but at a slower pace in the 2000s than in preceding decades (Figure 1.1). Performance has also plateaued, compared to both developmentally similar and more advanced countries. As noted in Figure 1.1, Malaysia's HDI registered flatter growth in the past decade, relative to the average HDI of countries classified as attaining high human development as well as those of very high human development. Based on consistent time series data, average annual HDI growth slowed down from 1.21% in 1980-1990 to 1.15% in 1990-2000 and subsequently to 0.64% in 2000-2012. Lack of progress in HDI, and thus equality, is hazardous, as a study has shown that a lack of progress in human development will have a negative impact on economic growth and development (Boozer, Ranis, Stewart and Suri, 2003)¹. The link between inclusiveness and economic growth will be discussed in more detail in Chapter 2.

¹Boozer, Ranis, Stewart and Suri, 2003. "Paths to Success: The Relationship Between Human Development and Economic Growth", Working Paper 874. Economic Growth Center, Yale University.



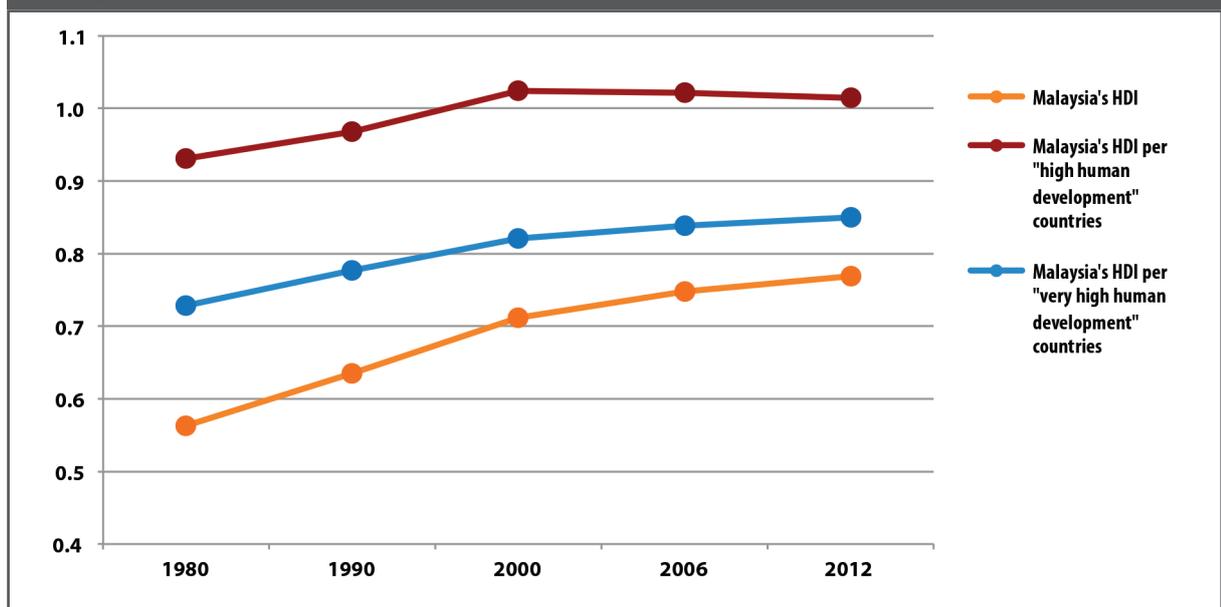
Inclusive growth resonates with particular relevance and timeliness, and constitutes the theme for this inaugural *Malaysia Human Development Report* (MHDR). We conceptualise the term more broadly and systematically than in existing national discourses, and surveying global and local literature and considering country contexts has led us to define inclusive growth as comprising:

1. Equitable distribution of benefits of economic growth and of social spending across distinct groups and to the poor irrespective of their group membership;
2. Robust generation of broadly accessible opportunities for economic participation and safeguards for the vulnerable; and
3. Inclusion of the people in policy formulation and implementation.

This *Report* expounds on the current states and future possibilities of inclusive growth for Malaysia, in line with the above definition. We evaluate Malaysia's track record, with particular attention paid to aspects of development previously overlooked or underemphasised. We formulate a new perspective – the New Economic Paradigm – as a template for future policy that goes beyond existing frameworks in integrating inclusive growth as a core element. Looking forward, we then consider constraints on the prospects for change, and factors that will make our recommendations feasible and effective.

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Figure 1.1: Malaysia's Human Development Index: score and relative position



Source: UNDP (<http://hdrstats.undp.org/en/indicators>).
 Note: There are four categories of human development: very high, high, medium and low. The values are based on consistent indicators, methodology and time-series data, thus showing real changes in values and ranks over time reflecting the actual progress countries have made.



1.2 Researching inclusive growth

1.2.1 Approach

The empirical portions of this *Report* will evaluate Malaysia's record of growth and development, with a view to critically examine the form and extent of its inclusiveness. A few principles guide this appraisal.

First, in acknowledgment of the manifold forms of inclusion and exclusion, our approach must be multidimensional. Importantly, we provide insights into wealth inequality, differences in quality of social services and pay particular attention to vulnerable and excluded groups. While economic issues are imperative, advocating an inclusive growth agenda demands analysis and policy that go beyond economics and adopt a more multidisciplinary understanding of human development. Thus, on poverty, we go beyond the familiar absolute poverty line approach in locating the problem. We consider household deprivation in a multidimensional framework, and map statistical indicators to show patterns of inequality precluded when data are compressed into single figures or composite indices. In keeping with the theme of inclusive growth, however, we focus on empirical, institutional and policy outcomes and implications of economic growth, and provide some overviews – but not necessarily in-depth analyses – of human development outcomes, especially in education and health.

Second, the principle of inclusiveness further warrants relative measures of development and deprivation to complement assessments based on absolute benchmarks or thresholds. In particular, relative incomes

and relative poverty must be given increasing attention, and instead of mean levels, medians and other thresholds should be referenced (Stiglitz, Sen and Fitoussi, 2009). In the Malaysian context, the boundaries of exclusion must be widened beyond ethnic groupings—although these remain important in view of inadequacies and adversities arising from decades of ethnicity-based political organisation and policy formulation. Various contemporary works, as well as established scholarship on Malaysian political economy, have emphasised the multiplicity in inequality dimensions, especially in spatial, regional, gender, educational and occupational terms, that are vital for identifying development problems and devising solutions.

Third, the qualitative characteristics of economic growth matter as much as the basic rate of growth. Hence, we propose a notion of robust growth to take primacy over high growth. Undoubtedly, robust growth implies a reasonably high rate as well as resilience in the face of change and fluctuation. However, the paramount importance of inclusiveness in participation demands considerations beyond rapid growth—which, if pursued for its own sake, can perilously bias policies toward unproductive expenditures and accumulation. Practically, robust growth translates into growth that is driven by increasing productivity and greater inclusion of society. Our analysis looks for ways to raise the pace of growth by utilising more fully parts of the labour force trapped in low-productivity activities or completely excluded from the growth process. Robust growth is also predicated on spatial, environmental and social sustainability. We therefore give due consideration to issues of sustainable growth, even as we maintain focus on inclusive growth.

1.2.2 Data sources

This *Report* assembles, computes and analyses development indicators from a wide range of sources, as the breadth of inclusive growth as a subject matter and policy theme necessitates broad engagement. We gather inputs from designated background papers and solicit feedback through workshops and discussion with civil society, government and academia.

Evaluation of inclusive growth predominantly relies on official secondary data obtained from Malaysian government surveys and publications. These sources offer nationally representative samples of a range of socioeconomic variables and consistency of format that permits observing change over time.

Raw data of a few national surveys were made available for this *Report* and the data cut-off year was set at 2012. The main data sources and the main information derived from them are as follows:

- The Household Income Survey (HIS), conducted twice in five years on a large sample, informs household income, personal wages and earnings, educational attainment and other aspects of socioeconomic development. The availability of such variables makes the HIS a major data source for this *Report*.
- The Household Basic Amenities Survey, performed concurrently with the HIS and hence obtaining the same sample, contains data on living conditions and access to basic utilities and provisions.
- The annual Labour Force Survey (LFS) enquires on workforce participation, employment status

and personal attributes of the working age population (15-64 years).

- The National Health and Morbidity Survey (NHMS) enabled us to evaluate access to health services.

Official statistical publications and annual reports also served as important references, notably:

- The Yearbook of Statistics, a comprehensive compendium of summary statistics.
- The Labour Force Survey Reports, which report descriptive statistics of the LFS.
- Annual reports of government agencies or government-linked investment funds.

Data were also provided by government departments on an ad hoc basis in response to requests made specifically for this *Report*. A full list is provided in Appendix A.

The methods for utilising and analysing these data are suited to the issues at hand. Descriptive statistics, econometrics and other statistical analyses are employed to assess inclusiveness in the Malaysian economy and society.

1.3 Overview of chapters

This *Report* is arranged in three parts. The first part analyses inclusive growth, while the second considers dimensions of inclusion and exclusion. The third proposes how we may secure inclusive growth for human development.

In Part 1, Chapter 2 presents the conceptual framework for this *Report* and





situates inclusive growth in the Malaysian context. We define inclusive growth and discuss its foundations in Malaysia from legal, political and development policy angles. Additionally, this chapter discusses the evolution of policy from the NEP to NEM and outlines a New Economic Paradigm based on the decomposition of household capability as the basic unit of analysis and policy targets. The chapter will also make the case that the study of Inclusive Growth and its policy implications cannot be addressed meaningfully by taking an exclusively economic approach—analysis and policy need to move away from income-centric measurements and targets towards social processes and social policy implications, especially in dealing with poor and vulnerable groups.

Chapter 3, on growth and imbalances in Malaysia from 1970-2010, involves a critical review of the historical record of Malaysia's development experience and policy development over the four decades since the implementation of the NEP. The chapter will be based on officially published reports and the Five-Year Plans, as well as secondary data analysis where available. We critically examine achievements, limitations and omissions of Malaysia's NEP, an early version of Inclusive Growth policies through its three-pronged strategy of Growth, Poverty Eradication and Restructuring Society.

Chapter 4 explores social mobility in Malaysia. We survey available studies on the emergence and expansion of the middle class in Malaysia's development, and analyse policy interventions and social processes that enhance social mobility. We also conduct statistical analyses to capture income profiles of mobility by cohort, finding those that can be classified

as the NEP generation – born between 1945 and 1960 – to have experienced greater upward income mobility and, by extension, broader middle class expansion. Case studies of four groups show variation in form and magnitude of social mobility, drawing attention to the broad range of inter-generational experiences, with some communities generally seeing upward mobility and others not moving at all.

In Part 2, Chapter 5 focuses on the analysis of Malaysia's economic growth performance and the implications of inclusiveness. In particular, we examine the major variables contributing to growth, of the national economy in terms of its global positioning as a small, open, resource-rich economy. Besides analysing the issues underlying national competitiveness, the chapter adopts a growth diagnostic approach to identify the possible binding constraints against the future growth of the economy, and to determine the critical intervention that can ensure inclusive growth as Malaysia drives towards developed nation status. The key element is the decline in potential growth due to low investment in the public and private sector. Besides productivity issues, the small and medium enterprise sector (SMEs) including the informal sector is identified as a key focus of policy intervention for inclusive growth.

Chapter 6 assesses and discusses inequalities and imbalances in income and other socioeconomic variables. This chapter will involve a statistical analysis of income distribution and its components using the New Economic Paradigm as a conceptual framework. We decompose household purchasing power fourfold – wealth effects, disposable income, transfers and leverage – and evaluate the

constituents' distribution across social and spatial categories. As expected, inequalities in wealth and disposable income correspond with ethnic, locational and socioeconomic factors. We also simulate the effects of social and labour market interventions geared toward bridging disparities, specifically minimum wage, universal secondary education and social grant transfers. Our investigations find support for the inequality-reducing impacts of these policy measures.

In Chapter 7, we grapple with issues of deprivation and exclusion in a multidimensional framework. Income poverty continues to be a key aspect of deprivation, but we expand beyond the traditional absolute poverty line approach by conceptualising and measuring relative poverty, benchmarked to a proportion, such as 0.50, of median income. Lower relative poverty corresponds to increasing gravitation of incomes toward the median, which is in line with inclusive growth. The usefulness of measuring deprivation in relative terms is also corroborated by our observation that, as household income increases, living conditions and human capabilities improve on a continuum, and not with a clear cut-off point marking an escape from poverty. The chapter also conducts mapping exercises to summarise and visually present the multiple dimensions of deprivation and capability. We note that considerable disparities persist between Sabah and Sarawak, relative to Peninsular Malaysia, with rural areas of East Malaysia particularly lagging behind. We also observe that capability deprivation, in the form of lower educational attainment, is most marked among Bumiputera minorities.

Chapter 8 considers the spatial economy and environmental sustainability of Malaysia, with an emphasis on regional policy and corridor development. Regional development and urbanisation have been an integral part of development policy and its differential impacts on regional economic growth, income and incidence of poverty. The persistence of inter-state disparities and urban-rural imbalances means that regional development policy – in terms of infrastructure development, investment and fiscal federalism in the distribution of natural resources – will be key to human development in Malaysia. No less important is the issue of environmental sustainability and the protection of our biodiversity for future generations and distressed groups. Policies relating to urbanisation, housing and sustainable energy and water supply are also important issues for human development. A balanced and environmentally and financially sustainable spatial economy is thus integral to the country's inclusive future.

Chapter 9 addresses women and development, with particular focus on Malaysia's persistently low women's labour force participation rate, inequalities in employment and earnings, vulnerable conditions of women in the informal economy and forms of gender discrimination. While recent years have seen rising educational attainment among women and growing efforts to increase women's labour participation, gender disparities prevail in employment and income, and women constitute some of the most excluded and vulnerable in society. A more inclusive future for Malaysia entails legal frameworks, policy designs and social norms that promote and safeguard gender





equality in status and opportunity, and fairness in socioeconomic outcomes.

Chapter 10 explores exclusion and inclusion of ethnic minorities, particularly Bumiputera minority groups of Sabah and Sarawak and the Orang Asli of Peninsular. On average, these communities bear higher income poverty, lagging access to basic amenities and public services, and socioeconomic disadvantages with regards to educational advancement, economic participation, ownership and upward mobility. Beyond these issues of access, opportunity and development outcomes, fundamental policy questions

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also arise on the balance between ethnic minority integration into the mainstream development process and the preservation and protection of their native rights, culture and identity, including

customary land rights. Fuller inclusion of ethnic minorities in Malaysia's development will be a cornerstone to realising national development and cohesion.

In Part 3, Chapter 11 provides a critical overview of institutional issues pertinent to inclusive growth strategies for Malaysia, including the issues of fiscal federalism, governance and integrity in the public delivery system, and the role of the private sector and civil society organisations (CSOs). We focus on access to official service providers, quality of

governance, transparency and integrity in securing participation, and equitability in sharing in the benefits from development. Our observations suggest the need for institutional reforms to address market and institutional failures; specifically, weaknesses in the fiscal redistributive system must be addressed. On the whole, the infrastructure for achieving inclusive growth involves the government, private sector and CSOs working together to ensure fairness and social justice for all.

Chapter 12 will hone in on the implications of the legal structure and its operation on inclusivity of the society. It will look into the effectiveness of the law in protecting rights of the special groups, particularly of women, children, indigenous people, workers and the disabled, and discuss the constitutional provision of Article 153 which allows preferential treatment to Malays in Peninsular Malaysia and natives of Sabah and Sarawak. The chapter will also tackle the concept of "substantive equality", as opposed to "formal equality" and how equality of opportunities can be ensured in the growth process for all.

Chapter 13 concludes this *Report* with a summation of our main themes, arguments and findings, and outlines policy recommendations for deepening and sustaining inclusive growth in Malaysia. This chapter summarises all the findings in the above chapters and identify the key issues in order to arrive at policy interventions to achieve inclusive growth and human development in Malaysia as the country seeks to achieve developed nation status by 2020.