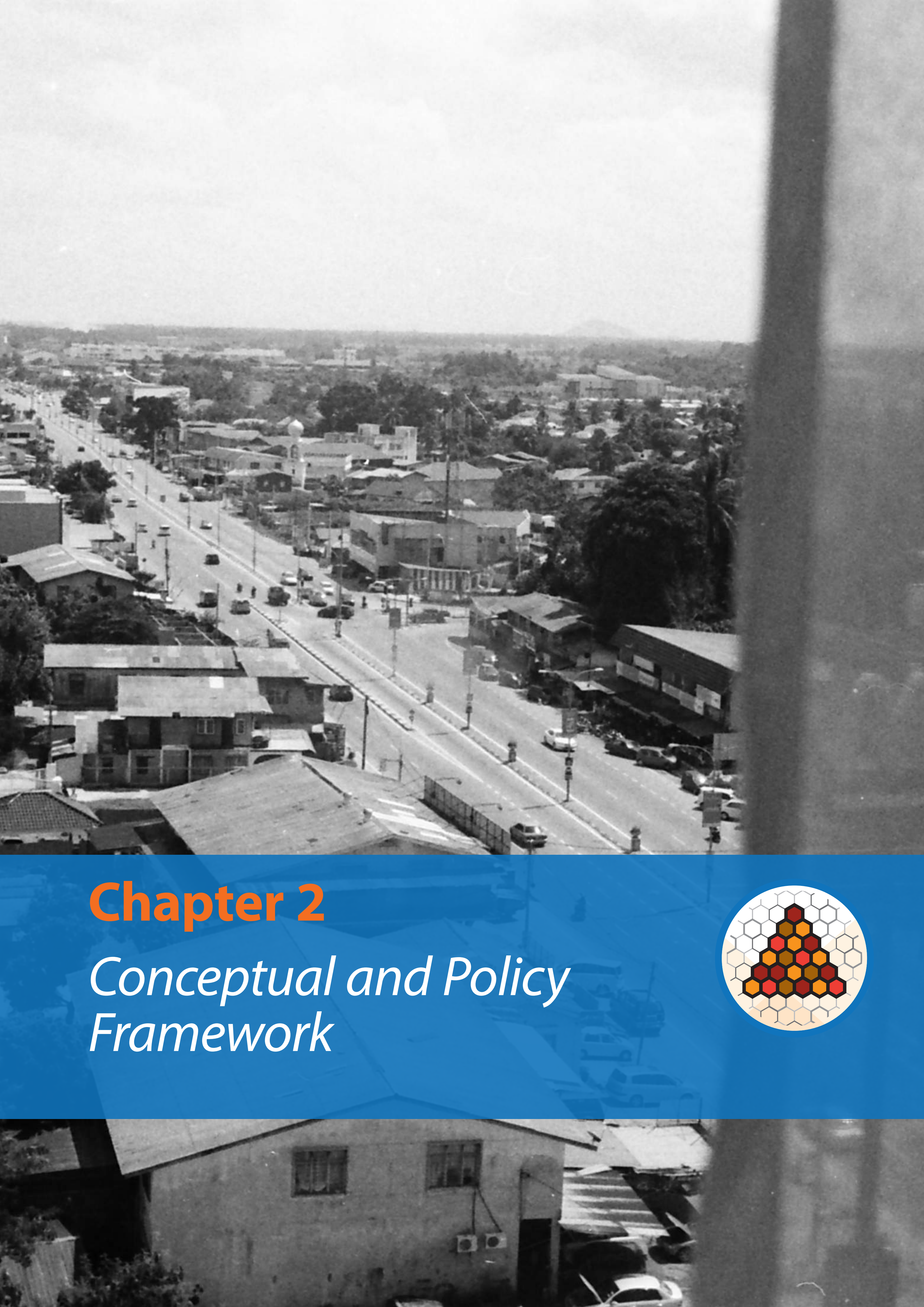

Chapter 2

Conceptual and Policy Framework

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2.1 Conceptualising inclusive growth

In the development process, inclusive growth is understood as both a means as well as an outcome. Commentaries on the inclusive growth approach take a longer-term perspective, with the emphasis on productive employment rather than direct income redistribution as a means of increasing incomes for excluded groups. Inclusive growth conveys a range of meanings, warranting some consideration of its conceptualisation as articulated in both global and Malaysian contexts. Four perspectives will be highlighted and discussed from a survey of international and Malaysian sources to inform this *Report*'s definition of inclusive growth.

2.1.1 Inclusive growth is both process and outcome

Undoubtedly, we pursue inclusive growth as both a means and an end, for its mechanisms as well as its results. It is commonplace to articulate policy formulation and implementation as two stages in development processes, with analyses of policy contents and outcomes as reference points. A more inclusive process, however, begins earlier, with the equitable and active participation of society in setting priorities and designing measures, and the incorporation of such inputs to policymaking. As proposed by the International Policy Centre for Inclusive Growth (IPC-IG), Brasilia: "Inclusive growth is both an outcome and a process. On the one hand, it ensures that everyone can participate in the growth process, both in terms of decision-making for organising the growth progression as well as participating in the growth itself. On the other hand, it makes sure that everyone shares equitably the benefits of growth. Inclusive growth implies participation and benefit sharing. Participation without benefit sharing will make growth unjust and sharing benefits without participation will make it a welfare outcome"[1].

2.1.2 Inclusive growth alleviates poverty and fosters equity among groups

Socioeconomic need constitutes the most basic and important demarcation of exclusion and inclusion. Households and individuals in poverty, especially within an expanding economy, are excluded from receiving the benefits of growth. Inclusive growth overlaps considerably with pro-poor growth, owing to the centrality of poverty alleviation under the former's rubric. At the same time, inequity in participating in and benefiting from economic growth between population groups – identified according to gender, race, ethnicity, region or other category – poses major challenges for socioeconomic inclusion, political stability and holistic development policy.

A more inclusive process begins with the equitable and active participation of society in setting priorities and designing measures, and the incorporation of such inputs to policymaking.

In a similar vein, Stewart (2010, p.3) defines inclusive growth as "growth in which the benefits are well distributed across distinct groups and to the poor irrespective of their group membership." Accordingly, the following are critical criteria for qualifying inclusive growth:

1. Dissemination of the benefits of economic activity and public sector

[1] *International Policy Centre for Inclusive Growth (IPC-IG)."Inclusive Growth". Accessed on November 20, 2012 from http://www.ipcundp.org/pages/newsite/menu/inclusive/whatis inclusivegrowth.jsp?active=1*

provisioning fairly to all major groups in society; and

2. Redistribution of these benefits towards the poor, irrespective of their group membership.

2.1.3 Inclusive growth entails economic participation, social protection and national integrity

In the same manner that human development encompasses economic, social and political advancements, inclusive growth requires making gains across these spheres. Thus, an inclusive growth agenda provides broad and sustained economic participation, protects the vulnerable and needful and fosters meaningful citizenship and political equality.

The Asian Development Bank's Strategy 2020 describes inclusive growth based on three pillars[2]:

- High, sustainable growth to create and expand economic opportunities;
- Broader access to these opportunities to ensure that members of society can participate and benefit from growth; and
- Social safety nets to prevent extreme deprivation.

The European Commission's analogous Europe 2020 platform declared: "Inclusive growth means a high-employment economy delivering economic, social and territorial cohesion[3]."

Perceptibly, salient points in these pronouncements – in particular, high growth in Asia and high employment in Europe – reflect general policy priorities of the regions for the foreseeable future. Setting it against the country's development record, likewise, can enhance the pertinence and efficacy of Malaysia's vision of inclusive growth.

2.1.4 Inclusiveness potentially feeds back into countries' growth paths

To a large extent, growth precedes inclusive participation and distribution. However, while equity in realising the benefits of growth follow from production, which provides the incomes to be allocated, the two potentially – though not necessarily – interact in a mutually feeding loop. More equitable growth outcomes may in turn spur and sustain further economic growth. Malaysia's New Economic Model offered a definition of inclusive growth as "pro-poor" and "concerned not only with the level but also the effect of persistent inequality on economic growth and poverty alleviation". The causal channels through which inclusiveness affects economic growth, however, are not clearly specified. Indeed, the strategic thrusts for inclusive growth include programmes for promoting growth that are rather disjointed from redistributive programmes (NEAC, 2010, p.89-90).

Positive effects of inclusiveness in economic growth are more aspirational and highly contingent on supportive factors, whereas inclusive outcomes can more decisively be facilitated out of growth scenarios. Hence, we frame inclusive growth preponderantly with growth as a premise and inclusiveness as an outcome. However, the relationship in the other direction – specifically, more inclusiveness and robust economic growth – cannot be denied as a development objective, and

[2] Asian Development Bank. "Inclusive Growth." Accessed on November 20, 2012 from http://www.adb.org/themes/ poverty/topics/inclusive-growth.
[3] European Commission. Europe 2020. Accessed from http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/priorities/inclusive-growth/index_hr.htm

to some extent requirement, in order to sustain development. Hence, while the effects of inclusiveness on growth do not feature in the definition, their implications are undeniably important.

2.1.5 Inclusive growth defined

In view of the approaches and conceptualisations above, and mindful of Malaysia's condition, inclusive growth in this *Report* constitutes:

- Equitable distribution of benefits of economic growth and of social spending across distinct groups and to the poor irrespective of their group membership;
- Robust generation of broadly accessible opportunity for economic participation and safeguards for the vulnerable; and
- Inclusion of citizens in policy formulation.

The case for inclusive growth fits any situation where inclusiveness is lacking. Economies and societies structures, past and present, have been characterised by various structures of inequality and exclusion. Capitalist economies are defined by ownership, power and livelihood disparities between capitalists and workers, which are instrumental to the system's functioning and are internally reproduced. Capitalist systems are inherently unequal and exclusionary, and lack impetus to foster more inclusiveness. Orthodox economic theory, in giving primacy to allocation of resources through competitive market mechanisms as the overriding basis for production and consumption, discounts the possibility that markets are characterised by power, asymmetries and structural barriers to mobility, which perpetuates inequality and exclusion. The stress on the process of exchange, based on an amoral stance toward initial endowments and deference to price signals and willing buyers and sellers, assumes away the difficult problems of persistent inequality and precludes grounds for redressing unequal opportunity and access (UNCTAD, 2012, p.31-32). The case for inclusive growth is, in a sense, timeless.

> **Neoliberalism and market fundamentalism have been further discredited in the wake of the global financial crisis and growing cognisance of increasing or persistently high inequality, economic insecurity and vulnerability of the poor to shocks and downturns.**

2.2 The growth-inequality-poverty nexus

Nonetheless, inclusive growth resonates at the turn of the 20th century and in the wake of the 2008 Global Financial Crisis. Neoliberalism and market fundamentalism, exposed by the 1997 Asian financial crisis as flawed and detrimental, have been further discredited as ideological premises for pursuing development in the wake of the global financial crisis and growing cognisance of increasing or persistently high inequality, economic insecurity and vulnerability of the poor to shocks and downturns.

While recent trends in the global economy have bred these conditions, some systemic roots run deeper. Stiglitz (2012) offers a framework for outlining the problems arising from high inequality. High inequality corresponds with sluggish or negative real wage growth, which attenuates consumption growth and cause aggregate demand deficiency as well as spurring debt accumulation. Situations of high inequality also tend to correspond with concentration of power and "rent-seeking" behaviour, which diverts resource away from productive activities and long-term interests. Markets are never devoid of rents, and strategic allocation of rents can play an effective role in development. However, when elites overpoweringly exert influence over policies, the economic system begins to revolve around securing their interests, saliently through deregulation and privatisation, tax breaks and subsidies, and the promotion of short-term interest and financial gains over long-term improvements in real productivity. Financialisation and labour market "flexibilisation" – among the mainstays of neoliberalism – are factors that have further decoupled finance from the real economy, widened gaps between management and the workforce, and promoted economic insecurity as a premise for setting policy.

The post-2000 period has witnessed a variety of experiences, with inequality rising in major economies like the United States and China, and declining inequality in much of Africa and Latin America.

Persistence of inequality across generations entails diminishment of social channels of upward mobility and notions of fairness. Chronic social exclusion of poor communities – in terms of access to and quality of education, health and infrastructure, job opportunities and democratic voice – confounds their capability to move upward, and raises questions about the fairness of the system. More generally, societies may experience widening mistrust of institutions and a sense of despondency toward the status quo and the prospects of positive change.

Patterns and trends in inequality around the world also underscore the importance of inclusive growth and offer policy options for achieving it. The 2010 World Social Situation Report highlighted that, while income poverty has declined over the past decades, the number of under-nourished persons in the world has substantially increased (UNDESA, 2010). We focus on within-country inequality, as opposed to between-country disparities, which are associated with a broader and more complex set of factors. Over the long term, some of the most outstanding economic performers have sustained both robust growth and declining levels of inequality, most saliently South Korea and Taiwan (Birdsall, Ross and Sabot, 1995). From the 1980s to 2005, inequality increased in 59 out of 114 countries with available data, or 51.7% of the total, and decreased in 40 (35.1%) (UN DESA, 2010).

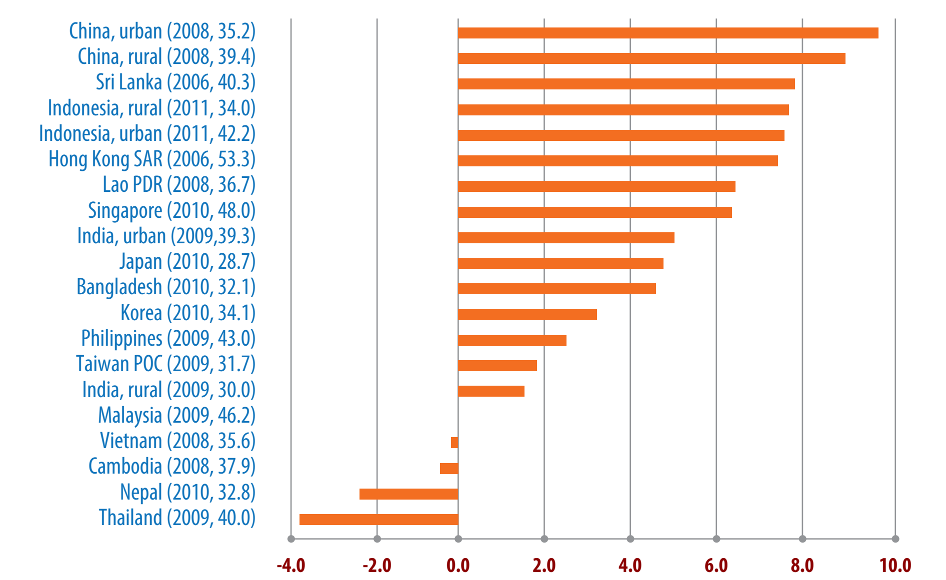
Recent data, however, show contrasting trends across countries and regions, highlighting the importance of looking at income disparities between the uppermost extremities and the rest. The 1980s and 1990s were largely characterised by rising inequality in most countries of the world and in the majority 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 like the United States and China, and declining inequality in much of Africa and Latin America (UNCTAD, 2012).

Furthermore, growth has been sustained in many countries that also narrowed inequality. Growth does have an impact on poverty reduction, but those in the neighbourhood of the poverty line are vulnerable to cyclical growth, and new forms of poverty emerge even during the expansionary phases of an economy.

A study of Latin American countries (Lustig, N, Luis F. Lopez-Calva and E. Ortiz-Juarez, 2013) showed that economic growth does have impact on income distribution in the first decade of the millennium, especially in Brazil, Argentina and Mexico. In Brazil, for instance, they found that "During 2002-2009, the income of the bottom 10% grew at almost seven per cent per year, nearly three times the national average (2.5%), while that of the richest 10% grew only at 1.1% a year. Depending on the poverty line, between 50% and 60% of the decline in extreme poverty can be attributed to the reduction in inequality. For the same reduction in extreme poverty, Brazil's overall per capita income would have needed to grow an extra four percentage points per year" (Barros et al., 2010). This result was largely attributed to increasing skills premium and progressive government transfers.

Even the International Monetary Fund (IMF), in a recent paper by the institution's economists, studied how pro-poor and inclusive Asia's recent growth has been, and what factors have been driving these outcomes (Balakrishnan, Steingberg and Murtaz, 2013). It found that while poverty has fallen across the region over the last two decades, inequality has increased, dampening the impact of growth on poverty reduction (Figure 2.1). As a result, relative to other emerging and developing regions and to Asia's own past, the recent period of growth has been both less inclusive and less pro-poor. Their analysis suggested a number of policies that could

Figure 2.1:
Asia: change in Gini index, last two decades (in Gini points, since 1990)



Source: World Bank; national authorities and IMF staff calculations.
Note: For Malaysia the official Gini coefficient in 2009 is 44.1 (income-based), or 34.7 (consumption-based).

help redress these trends and broaden the benefits of growth in Asia. These include fiscal policies to increase spending on health, education and social safety nets; labour market reforms to boost the labour share of total income; and reforms to make financial systems more inclusive.

At the same time, many countries, especially advanced economies, recorded growing concentration of income and wealth in the top one per cent or even higher, and the increasing power of finance. The Global Financial Crisis has renewed the world's attention on functional distribution – wage and profit shares of national income – with concerns that declining wage shares and expanding profit shares correspond with the skewing of economic conditions toward serving short-term financial interests. Inclusive growth warrants attention to the balance of power between elites and masses, and between financial and productive economies.

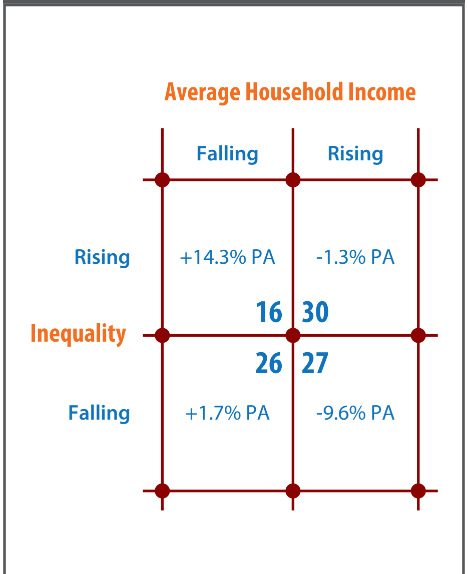
The available evidence suggests that the poor in developing countries typically do share in the gains from rising aggregate affluence, as well as in the losses from aggregate contraction (Ravillion, 2001). But there are large differences between countries in how much poor people share in growth, and there are diverse impacts among the poor in a given country. Cross-country correlations are clouded in data problems and undoubtedly hide welfare impacts, making them potentially deceptive for development policy and highlighting the need for deeper micro empirical work on growth and distributional change. Only then will we have a firm basis for identifying the specific policies and programmes that are needed to complement growth-oriented policies.

Cross-country correlations are clouded in data problems and undoubtedly hide welfare impacts, making them potentially deceptive for development policy.

In a cross-country study of 99 countries, Ravillion observed some patterns of poverty elasticities in different growth and inequality regimes (as shown in Figure 2.2, the countries are divided into four groups, with the number in each shown in the centre of the table). In the countries in which inequality is rising with growth in average living standards, poverty is falling on average. But it typically falls at a much slower rate than in countries experiencing more equitable growth. The median rate of decline in the proportion of the population living below US$1/day among countries with both rising average income and rising inequality was 1.3% per year.

In contrast, the median rate of poverty reduction was seven times higher (at

Figure 2.2:
Poverty elasticities in different growth and inequality regimes



Source: Ravallion, 2001.

about 10% per year) among the countries that combined growth in average living standards and falling inequality. It also mattered greatly among contracting economies what was happening to inequality: when inequality was rising while average living standards fell, the poverty rate was rising by a dramatic 14% per year on average. With falling inequality, the poverty rate rose by less than two per cent.

Ravallion (2001, p.1809) concluded that "(On) balance, the existing evidence using cross-country growth regressions appears to offer more support for the view that inequality is harmful to growth than the opposite view, which was the prevailing view in development economics for decades. That does not imply, however, that any reduction in inequality will enhance growth; indeed, it can have the opposite effect if it comes at the expense of other factors that are also known to matter to growth. Reducing inequality by adding further distortions to external trade or domestic economy will have ambiguous effects on growth and poverty reduction."

It is clear then that the relationship between growth and income distribution is not always straightforward in its impact on poverty reduction. While poverty reduction and growth holding income inequality constant is positively correlated, the impact of income distribution policies can go both ways on both growth and poverty reduction. The interaction between these policy variables is mediated through socioeconomic and political processes that are still not properly understood. The Tenth Malaysia Plan Targets (2011-2015), for instance, has made explicit the objectives of the New Economic Model: 1) Reduce the incidence of poverty from 3.8% in 2009 to two per cent in 2015; 2) Increase the mean income of the bottom 40% households from RM1,440 in 2009 to RM2,300 in 2015; 3) Improve overall income inequality by reducing the Gini coefficient from 0.441 in 2009 to 0.420 in 2015; and 4) Increase the percentage of bottom 40% households with SPM qualification and above from 30% in 2009 to 45% in 2015.

But these remain targets; the impact of economic growth and its development programmes on the nexus of growth-income distribution-poverty remain cloaked in mystery. At best, we have to rely on the experiences of specific country cases.

2.3 Inclusive growth in Malaysian development policy, 1970-2010

Inclusive growth, defined as the achievement of economic growth with distribution as the twin objectives of development policy, has been adopted throughout Malaysia's economic history since 1970 as can be seen in Table 2.1. The policies adopted with different emphasis on the two goals can be grouped into 15-year periods as alternating between emphasis on growth and distribution. Beginning with introduction of the World Bank report in 1955, the emphasis on a *laissez fair* process of development was adopted, with industrial diversification and rural development being adopted under an import substitution regime through the First and Second Malaya Plan. After the May 13th incident in 1969, the NEP was introduced in 1970 with growth

Table 2.1:
Growth and redistribution policies in Malaysia, 1970-2015

Period	Policy Emphasis	Growth Rate
1955-1970	Growth	6.5%
1971-1985	Distribution	6.7%
1986-2000	Growth	7%
2001-2015	Distribution	5%
2016-2030	Sustainable and inclusive growth	5-6% (target)

Note: The period 1955-1970 includes Singapore (until 1965) and Sabah and Sarawak (from 1963 onwards).

as policy while emphasising redistribution to restructure Malaysian society and reduce poverty regardless of race. It was implemented beginning with the Second Malaysia Plan 1971-1975.

This state-driven development policy was continued until the recession of 1985. Before this recession, Malaysia experienced relatively high GDP growth rate per annum of 6.5%. From the Fifth Malaysia Plan (1986-1990), the NEP was adjusted to accommodate a liberalised economic environment with respect to foreign investment in order to recover from the recession and place Malaysia back in its development path. In 1990, the NEP was replaced by the New Development Policy (NDP) for the next two five-year Malaysia Plans, which saw a 10-year period of high growth until the Asian financial crisis of 1997. From 2000 until the 2008 Global Financial Crisis in the advanced western countries, with Malaysia facing competition from other developing countries in the region, the country faced a relative period of slower growth due to lower investment inflow and crisis in its traditional markets in the west. It was never able to achieve full recovery to its potential growth path of the past 30 years.

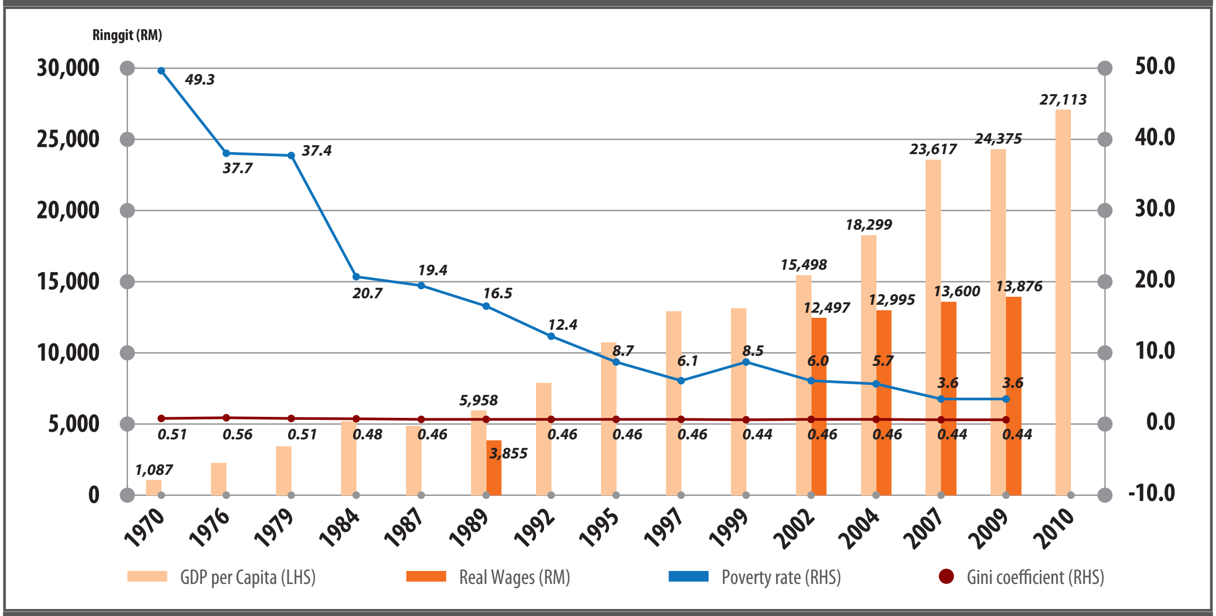
This is the approach adopted in the Malaysian Government's NEM and implemented through the Economic Transformation Programme (ETP) and the Tenth Malaysia Plan in country's quest to achieve developed status by 2020. It represents an extension of the "growth with redistribution" strategy adopted in the 1970s and 1980s, but adapted in the 1990s to a market-led development process that, in combination with state programmes, had contributed to a rise in per capita income and a dramatic reduction of poverty in Malaysia.

Malaysia's achievements are a matter of record, as shown in Figure 2.3 for the said 40-year period from the launch of the NEP, with respect to real GDP per capita, incidence of poverty, Gini coefficient, and average real wages. Real GDP per capita is seen to have steadily increased over the period while the incidence of poverty has dramatically declined from 49% of total households in 1970 to 1.7% overall. The Gini coefficient further declined from 0.51 in 1970 to 0.43 in 2012, a drop of 15%, while the average real wages have grown at a much slower pace from 2002 after nearly tripling from 1989 to 2002. It is significant to note in IMF Figure 2.1 concerning inequalities in Asia that the Gini index hardly moved for Malaysia over the last two decades since the 1990s. However, the correlation between these averages need to be analysed from the point of view of the underlying factors where much remains to be fully understood. This is especially true in the area of human development. Nonetheless the analysis could be further complicated by the current state of the world economy that open emerging countries like Malaysia have to contend with.

The NEM (Figure 2.4) has a three-pronged objective of achieving high income, inclusiveness and sustainability. To achieve the first objective, the NEM has a headline target of achieving US$15,000-US$20,000 GNI per capita by 2020 that requires an average growth rate of at least six per cent annually. Such a hard target however is simply not feasible for the other two dimensions of inclusiveness and sustainability. The NEM has defined inclusiveness as "enabling all communities to fully benefit from the wealth of the country" and sustainability as "meeting present needs without compromising future generations" (NEAC, 2009, p.10).

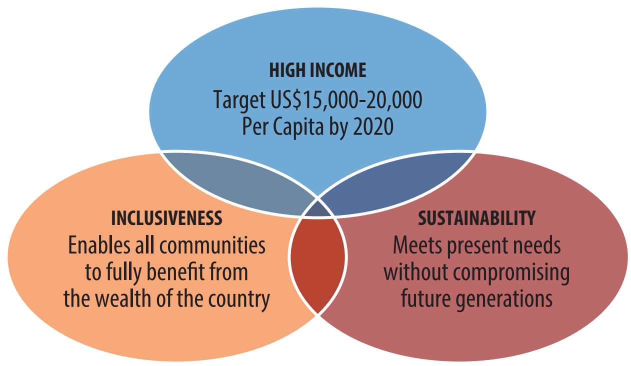
The MHDR seeks to expand on the dimension of inclusiveness in the NEM by considering the entire income distribution rather than just the bottom 40%, and in the Tenth Malaysia Plan by strengthening the analytical and enabling framework for policymaking in support of the goal of enabling all communities to fully benefit from the wealth of the country (emphases ours). The relationship between high income and inclusiveness is not always so straightforward. GNI per capita does not reflect distributive inequalities and increases in GNI do not necessarily result in better living standards.

Figure 2.3:
GDP per capita, poverty rate, real wages and Gini coefficient, Malaysia 1970-2010



Source(s): Economic Planning Unit and Household Income Survey, 1989-2012.

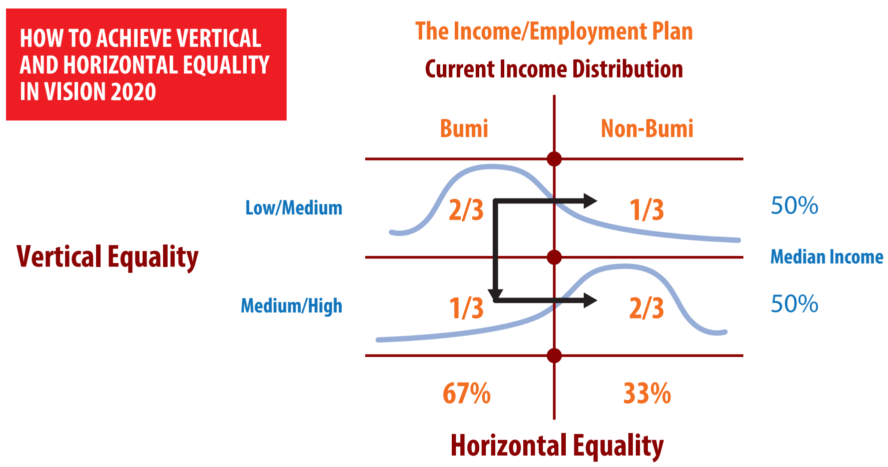
Figure 2.4:
The New Economic Model (NEM)



The issue of income distribution, which is not adequately treated in the NEM but made explicit in the Tenth Malaysia Plan targets, can be handled in a Frances Stewart framework for vertical and horizontal equality in development policy (see Figure 2.5 below). In the diagram, vertical equality was ramified by using the median income to divide the income groups into two, above 50% and below 50%; and horizontal equality by dividing between the Bumiputera and Non-Bumiputera groups (this can be further split into further subgroups). The between group ethnic income distribution is shown for the two (vertical) income groups, which shows the Bumiputera lower income group to be roughly two-thirds of this income class, while two-thirds of the upper income group is represented by Non-Bumiputeras.

In the 1950s and 1960s, much development focus was on infrastructure and poverty eradication programmes (represented by the top horizontal arrow). With the introduction of the NEP in the

Figure 2.5:
The income/employment policies to achieve vertical and horizontal equality In Malaysia



1970s and 1980s, specific affirmative action programmes were introduced to restructure society so that economic activities are not biased in terms of ethnicity and geographic location due to urban-rural disparities, under a regime of accelerated economic growth (represented by the downward-pointing arrow). The post-1998 crisis period was however more concerned with the establishment of a Bumiputera industrial business community with emphasis on privatisation and promotion of private sector investment (represented by the bottom horizontal arrow). The success and shortcomings of policies of horizontal and vertical equality will be the focus of analysis in subsequent chapters of this *Report*.

The *Report* will also emphasise the dynamics of inclusive growth as both an outcome and a process. Substantively, the process and outcome warrant distinct conceptual and empirical attention, as well as analyses of the interaction between them. The analysis looks for ways to raise the pace of growth by fully utilising parts of the labour force trapped in low-productivity activities or completely excluded from the growth process.

The Malaysian case over the 40-year period of 1970 to 2010, constituting a secular trend of reduction in income inequalities and in poverty reduction, is clearly observable. The growth that has accompanied these distributive and welfare developments has also largely been largely resilient through periods of economic crisis, from which the Malaysian economy has recovered buoyantly. Statistical evidence for this will be presented in greater detail in the next chapter of this *Report*.

2.4 Towards a New Economic Paradigm to analyse inclusive growth in the Malaysian context

The Sen, Stiglitz and Fitoussi (SSF) Commission on Measurement of Economic Performance (also known as the Stiglitz Commission), sponsored by the French government, emphasised that economic growth alone is insufficient to ensure sustainable decline in income inequalities. They concluded that performance measures should be more broad-based than the usual GDP/GNI indicators, and should also include other measurements that capture the multidimensional impacts of the growth experience.

The post-1998 crisis period was however more concerned with the establishment of a Bumiputera industrial business community with emphasis on privatisation and promotion of private sector investment.

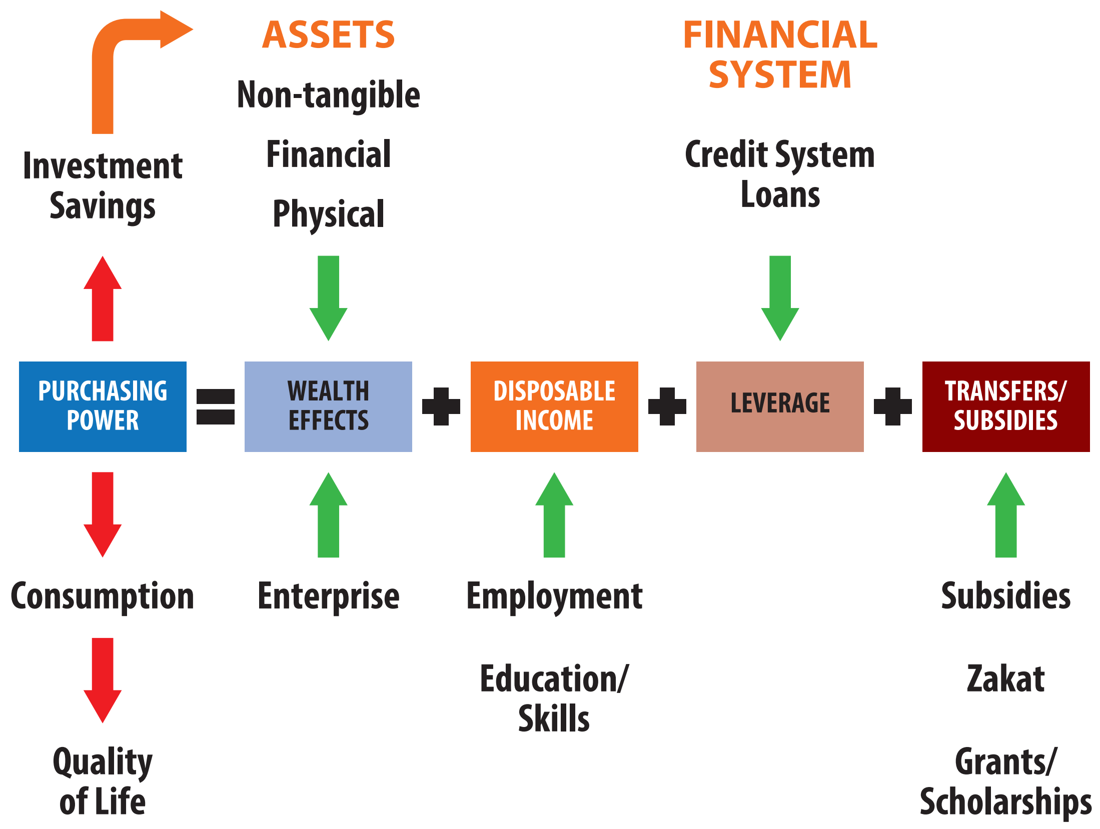
The Stiglitz Commission concluded with the following message and recommendations: 1) Look at income and consumption rather than production; 2) Consider income and consumption jointly with wealth; 3) Emphasise the household perspective; 4) Give more prominence to the distribution of income, consumption and wealth; and 5) Broaden income measures to non-market activities.

The Stiglitz Commission particularly points out that the importance of wealth measures and disaggregation of economic performance to the household level would better capture the development impact of economic growth. The Latin American study by Lustig et al. also emphasised the importance of passive income (e.g., profits, dividend, rent and etc.), or wealth effects in general.

In this *Report*, we introduce a new conceptual framework, dubbed the New Economic Paradigm, which decomposes household capability (or purchasing power) into four components; wealth effects, disposable income, leverage and transfers. This framework informs our analysis of data in this *Report* and enables us to better grasp the policy intervention and their impacts on inclusive growth in Malaysia.

The four components of the New Economic Paradigm are illustrated in Figure 2.6 below which combines not necessarily additively into the household's purchasing power. Wealth effects are essentially derived from tangible assets such as land, property, buildings; financial assets including stocks and shares, savings, and equity in private enterprise including sole-proprietorships; and intangible assets such skills, educational qualifications and patents. Disposable (household) income is represented by after tax income derived from salaries, wages, bonuses, remittances and other forms of remuneration from enterprise, summed over all household members actively employed. Leverage on the other hand includes personal consumption and business loans as well as loans from both banking and

Figure 2.6:
The New Economic Paradigm

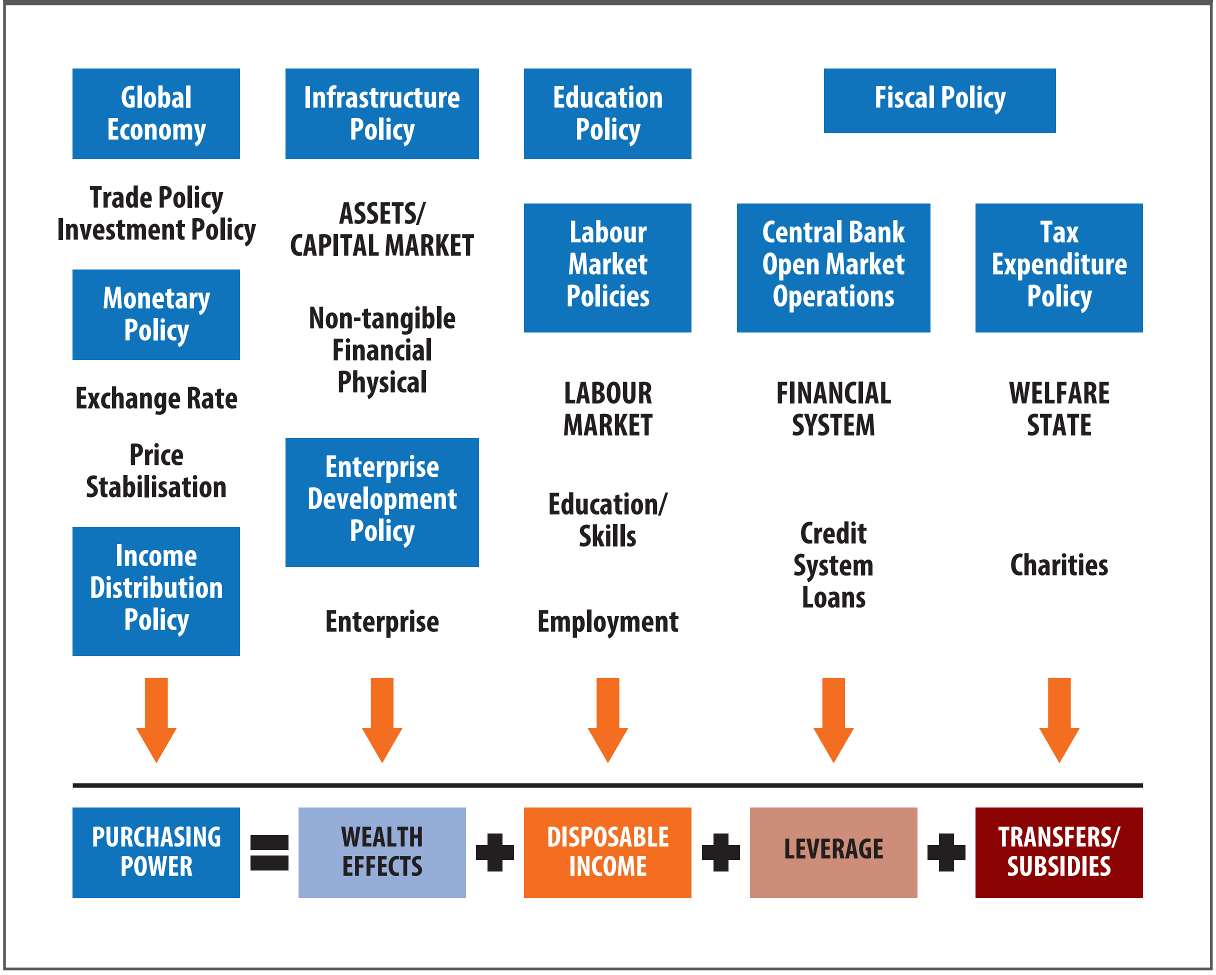


non-bank financial institutions including cooperatives, credit associations and other informal channels of microfinance. Finally, transfers are tax-financed or charitable contributions to the household in the form of grants, scholarships, subsidies, tax allowances, donations and other income-based welfare contribution in both cash and kind, and contributions from other safety net contributions such as unemployment insurance.

Figure 2.7 also demonstrates the possible relationships among social and economic processes at the household level underlying the impact of labour skill premiums through more pervasive education levels of the workforce and the impact of positive transfers in the three Latin American countries studied by Lustig et al. (2013). As another illustration, failure of the prevailing credit system is the inability to satisfy loan demands from the SME and poor sectors of the economy that cannot access formal credit channels or do not have sufficient collateral (essentially asset based financial or physical) against which to borrow.

If the SME sector does not have access to external funds for investment, the capacity to raise investment per worker and thereby productivity and income from wages and self-employment, the economic status of the bottom 50% of households will seriously be impaired.

Figure 2.7:
The policy space in the New Economic Paradigm

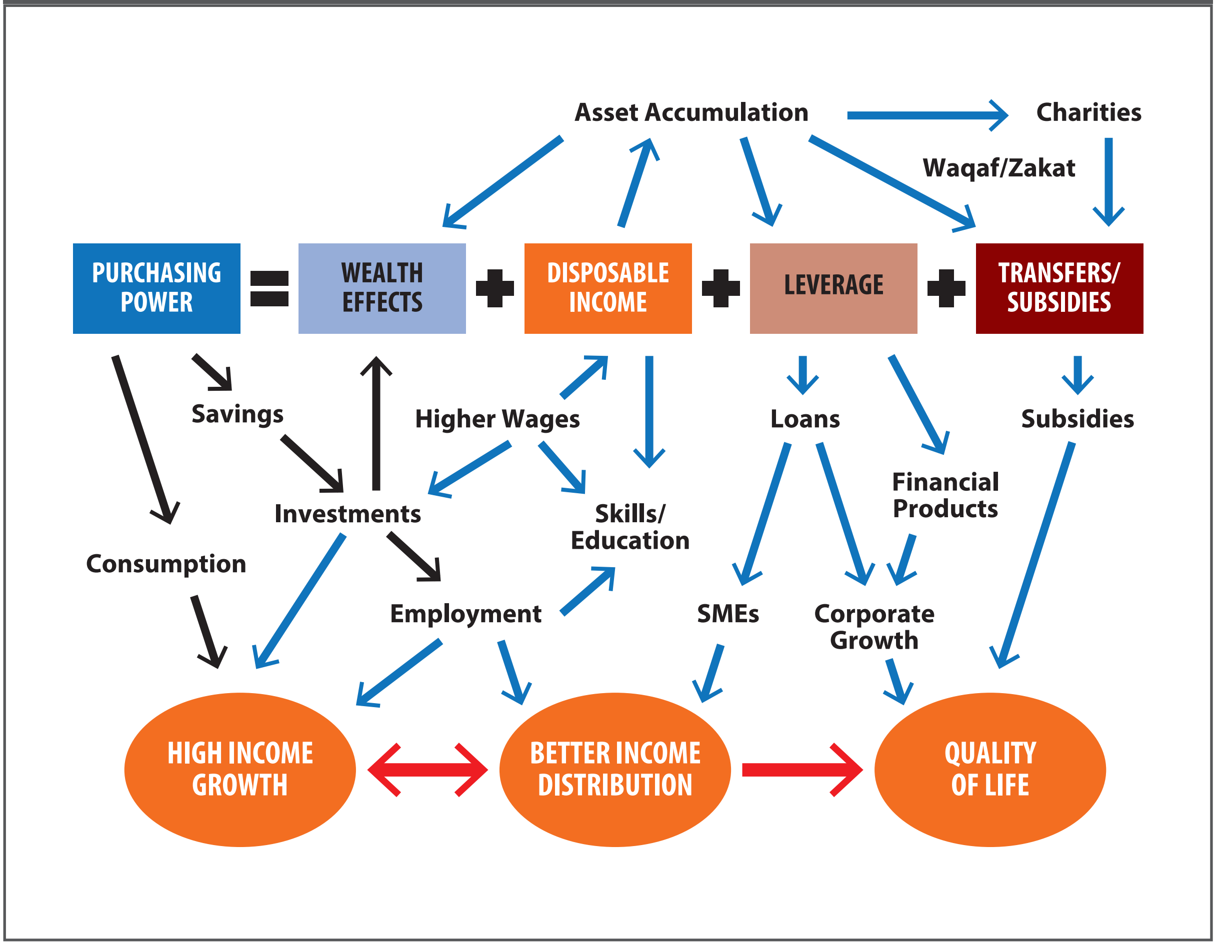


As suggested by the Stiglitz Commission, the New Economic Paradigm we offer above as conceptual and policy framework for inclusive growth must incorporate productive as well as consumption capabilities at the household level and linked to wealth and their distribution in order to properly translate income performance at the national level into its impact on the standards of living and quality of life of the population. This can be heuristically illustrated in Figure 2.9 which shows a stylised income distribution profile of households according to income class consumption power when decomposed according to the four categories of wealth effects (passive income), disposable income, leverage and transfers at the household level.

The share of total purchasing power among income classes is depicted in the vertical stacked bar on the left of the diagram, while the decomposition of purchasing power by income class can be read off the right scale, with the order of the graphs following the class ranking. The vertical sum of each purchasing power component over the four income classes should add up to 100%.

The search for new economic thinking, in the wake of the Global Financial Crisis of 2008 and the revolt

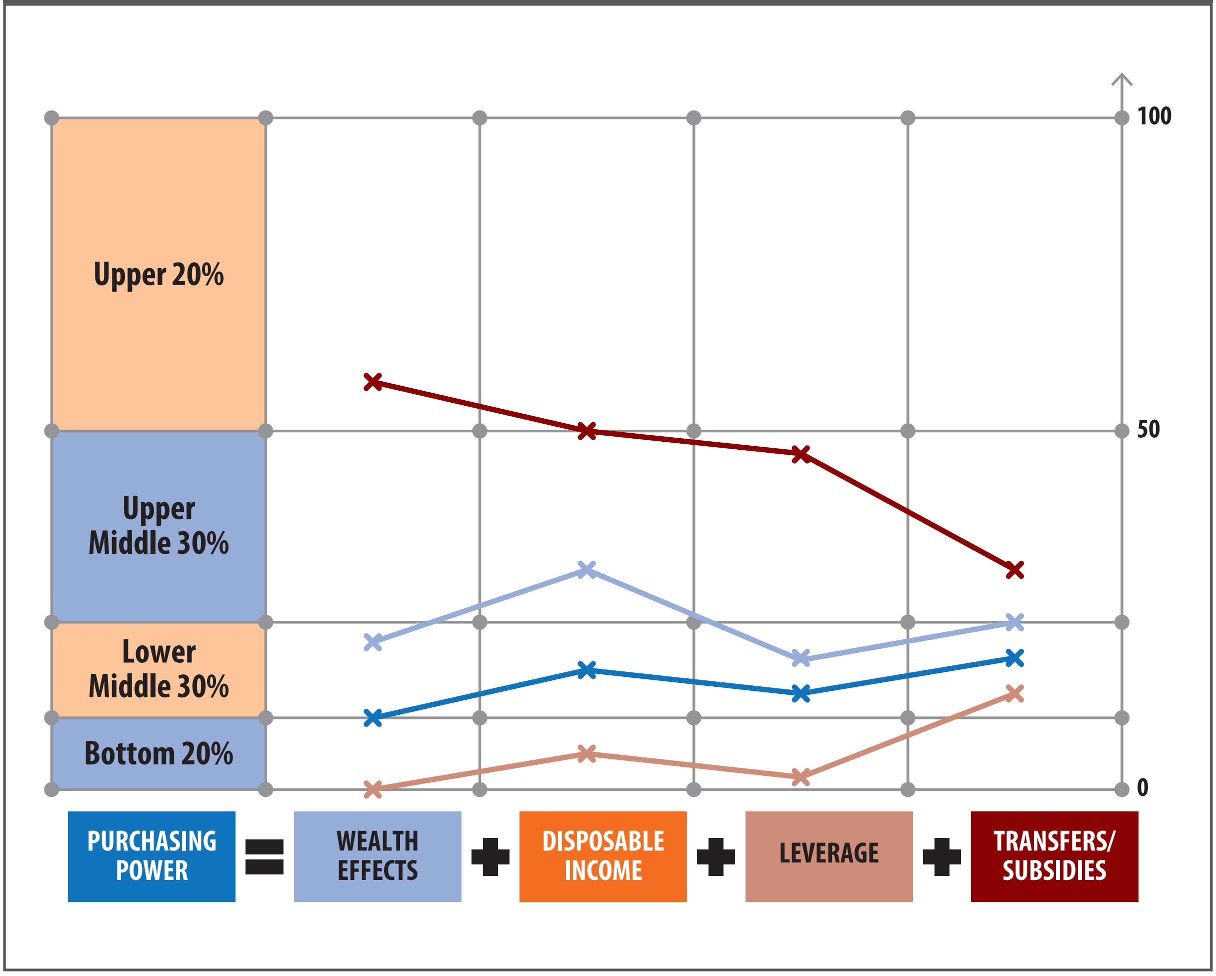
Figure 2.8:
Processes according to decomposition of household capital capabilities in the outcome space of the New Economic Paradigm



against the Washington Consensus in development policy, enables us to explore and redefine traditional concepts and links between macro- and micro-economic foundations of development policy. There is also renewed concern and disquiet regarding the imperialism of economic ideas in development thinking, and a shift towards other social science contributions in development policymaking process (Fox, 2013).

In this *Report*, we recognise the need to go beyond a purely economistic articulation of development processes and policy, as such an approach will not capture the full dynamics of social processes that link between growth, inequality and poverty. In this regard the household approach, which encompasses the kinship structure and processes, and social organisation of production, asset accumulation and allocation, and consumption in the household economy, play an important role in the development experience and the multidimensional facet of the quality of life of its members. At this level, three units of analysis may be recognised: 1) The individual member of the household as agent; 2) the household unit itself; and 3) The generation (as represented by the head of household) as a unit of analysis.

Figure 2.9:
Stylised share of purchasing power by components and income class (%)



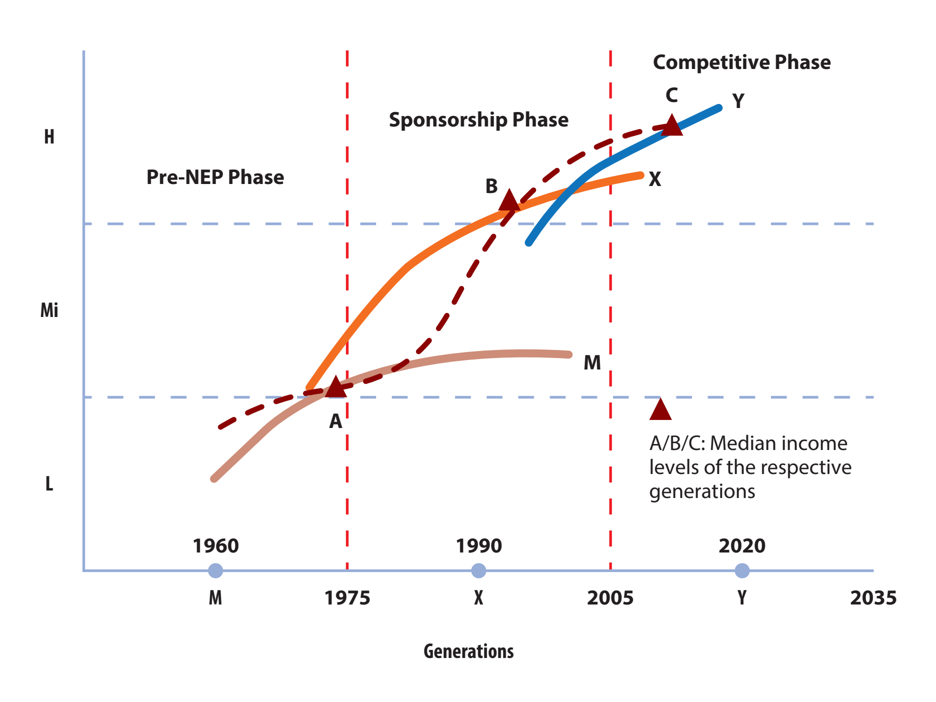
2.5 A Social Mobility Model for Malaysia

The third level i.e. generational analysis is particularly interesting in light of Birdsall's suggestion that inclusive growth is concerned with "the expansion of the middle class" and that policies concerning macroeconomic stability, business development and social policies such as education and government transfers contribute to the wellbeing and living standards of the lower income classes. This study adopts a model of social mobility relevant to the Malaysian case as shown in Figure 2.10, which will serve as a basis to explain the Malaysian development experience and its social impact.

The model recognises the evolution of three generations of Malaysian society since the end of the war in 1945: The M Generation (Merdeka = Independence) which is equivalent to the Baby Boomer generation in the western nomenclature; the X Generation; and the Y Generation. The periodisation is consistent with the phasing of development policy beginning with the NEP in 1970.

This model shows the median income trends of the respective cohort over the three periods. It is suggested that the period between 1970 to 2000 covering the X Generation, dubbed the "sponsored" period on account of the social engineering programmes under the NEP, represent the most rapid expansion of the Malaysian middle class, and that the next two decades coinciding with the Y Generation as they come into maturity will be a slower period of upward mobilisation the account of liberalisation and a competitive era post-Asian financial crisis and the 2008 Global Financial Crisis. The long S-shaped trend line combines the median income

Figure 2.10:
A Social Mobility Model for Malaysia



of all three generations by year of birth, intended to describe the 65-year transition from 1945 to the present.

In Chapter 4, some statistical evidence of this generational transition in median income according to age cohorts will be provided.

This approach will basically show how the poor and vulnerable attend the problem of social mobility against the background of rapid economic development. The rapid changes in the labour market brought about by export-oriented industrialisation since the 1970s created vast employment opportunity for the unskilled and semi-skilled. This largely explains the shift from employment in the primary sector to modern sectors. It also explains why rapid internal migration coincides with the period of accelerated economic transformation. Though the transformation can be explained in statistical terms, the conduit that bridges the vast transformation and the identified group can be best understood by observing the identified group's social and economic organisation.

The main question posed above will resonate closely in the Malaysian case where social development and intergeneration income mobility is clearly evident as shown in other parts of this *Report*. How does this development correspond to certain poor and vulnerable groups, and more specifically how did these groups experience upward mobility over time even though some subsection among them remain vulnerable? The focus on these groups is not from the statistical strength but on the social and economic processes at the meso- and micro-level that conditions their mobility pattern. By observing the problem of coexistence of the two opposite categories of mobility, the studies undertaken can provide agency dimension of the problems and efforts of the families within their constraints and limitations. We will also be able to better appreciate the analytical line of poverty and how people move up and down the line within their lifetimes and across generations.

In adopting such an approach, we also move away from the common approach that normally compares regional disparities, such as the urban-rural divide or inter-ethnic comparisons in explaining social mobility processes. Instead, we attempt to establish intra-group dynamics in the given context. And as mentioned earlier, instead of focusing on the entire strata of the selected community, the focus will be limited on the two categories and their social mobility trajectory. This approach will give us an idea on the total range of mobility outcome at the meso-level of the selected groups.

The rapid changes in the labour market brought about by export-oriented industrialisation since the 1970s created vast employment opportunity for the unskilled and semi-skilled.

So what are the social and economic processes involved in the "selectivity" that allows or hinders social mobility of the members of the group? Why do disparities exist within the groups and intra-household, in response to the opportunity structure? By posing the question in this manner we hope to explain the existing micro dynamics, especially from a social dimension, and at the same time raise issues useful for policy purposes in dealing with the poor and vulnerable. The subject of the poor and vulnerable attended through selected case studies also avoids the problem of blanketing the poor and vulnerable as an undifferentiated mass.

Using the conceptual framework as outlined in this chapter, we then analyse social mobility processes by accounting for the particularistic, without compromising the generalistic nature of the case. The unit of analysis and the categories of respondents will be tailored to best explain mobility processes from a multidimensional approach. Second, a number of national case studies will be provided in Chapter 4 of this *Report* to illustrate the Malaysian experience in social mobility, the process of "middle classisation" and the vulnerabilities of the poor and lower income groups to the uneven impacts of growth. The conclusions of these findings, as well as our recommendations, will be outlined in Chapter 13.

2.6 Conclusion

The discussion in this chapter, which involves searching the current literature on inclusive growth, is aimed at conceptualising a new analytical and policy framework relevant to the Malaysian case, which we dubbed the New Economic Paradigm. This new framework will inform our analysis of official statistics on economic performance and its quality of life dimension as well as the formulation of new development policies and programmes. The chapters in Part 3 of this *Report* will discuss different aspects of this framework in order to understand the issues of inclusion and exclusion in the development process going forward from the NEM currently being implemented in the ETP and the GTP. From this analysis and policy framework, we hope to define new initiatives to address the issues of inclusive growth in Malaysia.