

Executive summary

Introduction

1. For decades, Malaysia generated economic growth, transformed its profile from a primary goods producer to a manufacturing exporter, reduced income poverty and inequality, raised education and health attainments, and moderated ethnic disparities. Growth has been sustained and shared through consecutive implementation of the three core development policies which began with the New Economic Policy (NEP), followed by the National Development Policy (NDP) and National Vision Policy (NVP). However, socioeconomic progress has slowed down since the 1997 Asian financial crisis. Notably, contemporary Malaysia sees persisting inequalities, especially of regional, gender and ethnic dimensions, and lagging development of human capability, of institutions fostering inclusiveness and of effective governance. Social exclusion, barriers to social mobility and economic insecurity stand in tension against the objective of greater inclusiveness woven through all development visions and plans.

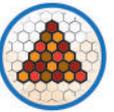
2. The international context lends further perspective to the slowdown in the country's progress. Malaysia's Human Development Index (HDI) score has continuously climbed, but has slowed since the 1990s, somewhat stalling the catch-up process in terms of broader socioeconomic development. The nation is expanding the capabilities of its people on the whole, as reflected in the average income, education and health outcomes that constitute the HDI. However, Malaysia has yet to break through to the upper strata of countries

with very high human development levels, low income inequality, social inclusiveness and equitable opportunities and outcomes.

Inclusive growth in Malaysia

3. This document – Malaysia's first Human Development Report – elects Inclusive Growth as its theme. We define inclusive growth as comprising equitable distribution of benefits of economic growth and of social spending across distinct income groups and 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 and implementation, towards minimising social exclusion and increasing social cohesion. In accordance with the breadth of inclusive growth, we adopt a multidisciplinary and multidimensional approach encompassing economic, social, political and legal elements, highlighting regional, gender, ethnic and aspects of relative deprivation.

4. Malaysia's growth from 1971 to 2012 meets the inclusive criteria outlined above to a considerable degree, although the inclusiveness of policy formulation may be open to question. The evidence includes reduction in poverty rates, high growth rates for low-income households, reduced inequality on a national scale and between regions, diminished interethnic and intraethnic disparities, robust and resilient growth driven by private investments, and lessened unemployment across all ethnicities.





5. However, the work remains unfinished, and new challenges have surfaced. Income and capability poverty among Bumiputera¹ minorities remains high, and pockets of marginalisation prevail, in both rural and urban areas. In addition, the income gap in absolute terms has been increasing while the relative income gap has remained stagnant in the past two decades. Asset inequality shows wider gaps with inequality in asset ownership nearly double that of income. In the labour market, contrasting workforce profiles and preferential practices in public and private sectors indicate that ethnicity exerts influence over employment, posing questions towards inclusiveness in workplaces. Women's participation in the labour market remains exceptionally low even when compared to neighbouring or developing countries of lesser income levels, and gender inequalities overall warrant specific analyses and policy considerations.

Social mobility

6. Inclusive growth entails lifting households out of poverty and facilitating upward, especially inter-generational mobility. The median income profile of the NEP generation improved more rapidly than that of the earlier generation and even the later generation, though the median levels of incomes are higher for the latter. However, the size of the middle class – defined as households falling within 20% on either side of the median income level – is still relatively small, comprising some 20% of total households. This figure has not changed significantly over the last two decades.

7. To shed light on social mobility in ways not captured by national survey data, four national case studies are applied, with

the family as the unit of analysis: the Felda community, Indian plantation workers, coastal fishermen in Terengganu and urban poor Malays, Chinese and Indians. The results are mixed. Felda settlers show limited social mobility in the second generation, which are constrained by limited social capital. There is also low mobility for Indian plantation workers; social capital in the plantation life pertaining to the Indian subculture and Tamil language are not conducive to adapting them to the larger society. The lack of upward mobility is also registered among the coastal fishing community in Terengganu, where those involved in deep-sea fishing experienced upward social mobility, while coastal fishermen and manual labourers actually experienced downward mobility. Case 4, focusing on the urban poor, shows most respondents fall under the moderate mobility level, with the high mobility group overwhelmed by the Chinese.

8. All the three ethnic groups – Indian, Malay and Chinese – exhibit similar patterns of determinants of social mobility in their dependence on the intervening variable combination of human capital, social capital and structural factors.

Composition of Malaysia's growth drivers

9. This study also finds that a number of factors define the growth formula in the Malaysian case as a small, open and resource-rich economy. These include steady and credible GDP and GNI growth in certain periods despite being punctuated by four crisis episodes, bookended by the OPEC-induced Recession in 1975 and the Global Financial Crisis of 2008.

10. The roles of factor inputs,

¹Bumiputera, which literally means "sons of the soil", is a term used to collectively refer to all of the indigenous ethnic groups in Malaysia.

productivity, international trade, foreign capital and government expenditure, coupled with prudent management of the external debt position, have cumulatively supported Malaysia's economic performance through this period. However, a growth diagnostic analysis of the Malaysian economic profile confirms that low-productivity labour and total factor productivity are the crucial binding constraints to sustainable economic growth.

11. But overcoming these constraints only goes part of the way to fostering inclusive growth for Malaysia. In fact, to understand this we have to go beyond growth performance to cover the role of institutions, in particular shortcomings in coordination and dynamism in both the public and private sectors. The roles of small and medium enterprises (SMEs) and the informal economy are critical to inclusive growth in Malaysia.

A New Economic Paradigm: decomposing household purchasing power

12. This *Report* also detects economic vulnerabilities of the average Malaysian. Our decomposition of a purchasing power model shows that most of the lower income households' purchasing power is attributable to disposable income from wages and self-employment incomes, with almost minimal contribution from wealth income or income transfer. The pattern is similar when broken down by ethnicity and strata. It is also revealing that the lower income groups undertake debt for

consumption purposes, and middle and higher income groups use debt as asset generating instruments, with the bulk of credit generated by the financial system accruing to the middle and higher income groups.

13. There are several policy options available to reduce inequality. The *Report* has undertaken several simulations in response to policy interventions, and has found that imposition of a minimum wage potentially improves inequality, based on the changes in the Gini coefficient, by about seven per cent, while compulsory secondary education stands to reduce inequality by up to four per cent. Government transfers, depending on the amount, tend to have marginal effect on overall inequality.

14. Rationalisation of subsidies have impacts at several levels. When shifting to an equity-based scheme in place of the current consumption-based system, our policy simulations show that equity-based subsidy targeting have implications not just on income distribution but also on the cost to government and therefore savings in government expenditure.

Relative poverty and multidimensional deprivation

15. This *Report* explores perspectives beyond income-centric and absolute income thresholds of poverty. In line with growing international norms and conventions, we acknowledge the relevance and usefulness of shifting thinking and measurement from absolute income poverty and a predetermined poverty line to relative deprivation and poverty lines referenced to the median.





We find that setting the relative income poverty line as a proportion – such as 0.50 – of median income provides a simple and effective way to capture inclusiveness, with lower poverty rates corresponding with increasing density of households near the median. We further incorporate the multiple dimensions of household deprivation in addition to income, including living conditions and access to social services, in mapping exercises that visualise relative deprivation and account for differences between Sabah, Sarawak and Peninsular Malaysia.

16. Among our key findings, we observe that the head of household's education, gender and ethnicity correspond with household income. Relative household income deprivation is more acute among households headed by persons with less formal education, especially if attaining primary schooling or less, underscoring the importance of education to inclusive growth. Women-headed households and Bumiputera minorities of Sabah and Sarawak, as well as the Orang Asli of Peninsular Malaysia, are also more heavily concentrated in lower strata, indicating lack of inclusion of these distinct groups in reaping gains of growth and development.

17. Consideration of human capability draws out some insight into the state of inclusive growth. Development attainments across our range of indicators show East Malaysia trailing the Peninsular. Crucially, Sarawak lags behind the Peninsular by much greater margins than suggested by the state's rather low official poverty rate. We also observe that rural areas of Sabah and Sarawak are, in capability terms, even further behind rural Peninsular Malaysia, compared to the corresponding urban-to-urban disparities.

Educational inequality continues to be salient, not just in terms of access and enrolment but also quality of schooling. Our findings raise important implications for policies to uplift capacities, improve outcomes, and provide social protection for the relatively deprived and vulnerable.

Decentralised growth and sustainability

18. Malaysia, being a federation of states, has until recently been ruled from the centre in pursuit of growth and development. The nation went through typical stages physically and socially such as industrialisation, urbanisation, education development and middle class formation. It is suggested that a new inclusive development strategy is introduced by adopting a bottom-up approach of decentralised growth. This would create urban agglomerations by concentrating activities to produce the necessary economic density for rapid and inclusive growth. It was found that per capita GDP growth is accompanied by increased urbanisation, but it would also lead to the spread of economic activities to rural areas. It is interesting to note that a decentralised growth strategy has never been fully tested in this country.

19. Besides addressing environmental sustainability, including the utilisation of natural resources, the chapter seeks fiscal sustainability at the federal level and improvements in the fiscal capacity of states to achieve decentralised and inclusive development in Malaysia.

Contribution and participation of women

20. Inclusive growth also requires analysis of the role of women, focusing on their involvement in national growth and the extent to which they have been rewarded for their contributions. Legal oversight of gender equality, in general and specifically in labour market engagement, has been lacking. Empirical outcomes reflect persisting inequalities. Women's educational attainment has expanded rapidly, and women achieving higher education are more likely to participate in the labour market, although still with substantially more encumbrances than their male counterparts. Less formally qualified women drop out of the workforce at an alarming rate. Women continue to be disproportionately found in services and clerical jobs, and to be steeply under-represented in top-end jobs. Male-female monthly earnings disparities are wider in low- to medium-skilled jobs, such as production line or craft workers, and narrower in higher-skilled jobs like technicians, clerical staff and professionals. However, the gender gap is larger between high-earning male professionals and high-earning female professionals than between lower earners, indicating the prevalence of glass ceilings, perhaps at higher levels.

21. Even in the informal sector, it is less rewarding for women. It is also revealed that women find it hard to re-enter the workforce after quitting to fulfil their reproductive responsibilities. Despite an upward trend of women with tertiary qualifications, nevertheless, the number of women with tertiary education outside the

workforce is also increasing. This could be attributed to the notion that women have responsibilities to the family. Much more can be done to encourage, support and ensure equal treatment to women in terms of contributing and reaping the benefits of national growth which is their due.

Bumiputera minorities

22. Despite momentous attainment in uplifting the socioeconomic status of Malaysians overall, and government carrying out specific programmes to enable targeted groups to participate and receive equitable share of benefits, poverty rates vary markedly among diverse Bumiputera communities, with the ethnic minorities both in Peninsular Malaysia as well as Sabah and Sarawak having the highest incidences. The majority of ethnic minorities are found to have predominated in the lower rungs of the economic ladders where most are self-employed largely in primary and low-income sectors.

23. While there has been an increase in the recruitment of Bumiputera minorities from Sabah and Sarawak in public service at the federal level, the numbers are still disproportionately low. This civil service imbalance can lead to increased racial polarisation and perceived discrimination.

24. From the educational point of view, issues of accessibility and quality of education have long plagued ethnic minority students. This has led to poor academic performances and alarmingly low admission rates to public and private universities, distribution of scholarships and enrolment in professional degree programmes, despite government initiatives. This reflects the dual challenge





of accessibility and need for both the reorientation and improvement in the quality of education. Disparity in attainment remains exceedingly high. In the PISA 2012 creative problem solving test, in which Malaysia ranked 39th out of 44 participating countries, with 50.5% considered low achievers (scoring below level 2 out of a maximum 6). Rural minorities, especially Orang Asli and Sabah and Sarawak Bumiputeras, are presumably among the most acutely lagging. While schooling enrolment and completion rates remain priorities, deficiencies in quality of schooling demand robust action, especially for communities that may become further marginalized if unable to actively participate in Malaysia's quest to become an advanced economy and society (OECD 2014).

25. This study highlights that one of the implications of the continued poverty among ethnic minorities is the high incidence of "statelessness", particularly those living in the interior of Sabah, Sarawak and Peninsular Malaysia. With all these impediments, ethnic minorities are thus said to be lagging far behind the Malays, Indians and Chinese in enjoying the fruits of Independence.

Institutional issues

26. There are institutional issues underlying and influencing the issue of inclusive growth. On fiscal federalism, this study affirms that the absence of decentralised public fiscal allocation has become a point of contention. With excessive centralisation, especially on public fiscal allocation, local aspirations are much more difficult to achieve, giving rise to a "one-size-fits-all" prescription from the centre (federal).

27. This study argues that the implementation of the Government Transformation Programme (GTP) may help the country improve its level of competitiveness and delivery of public services. However, a delivery system for public services will only be effective machinery if it is built upon a good procurement policy, accountability and transparency that can minimise wastage and leakages in public expenditures.

28. The *Report* emphasises that the current mechanism for redistributing income is weak and subject to leakages and wastage, while the contribution of the private sector to private delivery of public goods are imperative and can play a key role in mitigating the social costs that can arise from private development.

29. Finally, the study informs that the rising number of civil society organisations (CSO) over the past two decades and their active role in the decision-making process has accumulatively allowed the marginalised and the less fortunate to actively participate in the socioeconomic development of the country. In this regard, the government has also played its role in providing better access and facilities to less fortunate parts of society, particularly the disabled, as to enable this group to be independent, productive and valued contributors.

30. We assert that these institutional issues need to be addressed in the institutional reform process—mainly to support improvement in income distribution, raise the share of wages in relation to profits in national value-added income as well as to provide social safety nets for the poor and marginalised groups in Malaysia.

Implications of the legal framework

31. Our inclusiveness framework also discusses a number of constitutional and legal issues either directly or indirectly that influence inclusivity. These include Article 153 of the Constitution, and legal protection of women, children, indigenous people, workers and disabled peoples' rights. Overall, Malaysia has significant laws to promote and regulate rights and issues related to the less fortunate and vulnerable people including women, indigenous people, workers as well as the disabled people. There have been several cases testing the application of these laws and their assurance of equality in various issues.

32. However, there are serious limitations that needs to be carefully assessed and improved over time. A cautionary approach should be taken when using Article 153 to establish affirmative action policies and laws. The provision and protection of women's equal treatment also requires firm and sustained judicial support. In addition, there is a need for the legislative affirmation of the child's right to education regardless of the status of their nationality.

33. The rights of indigenous peoples as espoused by the United Nations Declaration on the Rights of Indigenous Peoples 2007 (UNDRIP) is not given the weight of law either legislatively or judicially, especially in the area of native land rights. This needs particular attention in Sabah and Sarawak, along with Malay reserve land issues in the Peninsular.

34. On workers' rights, this study emphasises that the power of workers to defend their rights and to improve their lot is curtailed to the point of uselessness. On

the rights of the disabled, where Malaysia is party to Convention on the Rights of Persons with Disabilities 2007 (CRPD) and via the Persons with Disabilities Act 2008 (PWDA), there are a number of issues that need to be carefully assessed. Specific provisions for affirmative action such as quotas should be weighed as options in areas such as education and employment as to ensure equitable access for this particular group of society.

35. As to the rights of children, the *Report* recommends that a National Plan Against Child Poverty should be prepared, coordinating efforts and initiatives between government and non-government bodies under a common set of targets; a multi-sectoral approach, consistent with the multidimensional character of child poverty and deprivation, should be promoted, addressing not only household income but child wellbeing.

36. This study emphasises that the concept of equality has moved beyond mere "formal equality" into "substantive equality" where equality has to be contextualised, drawing upon values such as human dignity, distributive justice and equal participation.

Institutional and policy reforms

37. There are several policy reforms recommended in this *Report* to address and strengthen the strategy of inclusive growth and promote inclusive development in Malaysia. The statistical findings and arguments raised in the various chapters in this *Report* point to the urgent need to strengthen as well as introduce new concepts of growth and development, and to place multidimensional perspectives





and objectives at the forefront of policy, in order to achieve the goals of inclusive growth and thus attain better quality of life for all Malaysians. Malaysia is a complex country to govern and manage politically, economically and socially, but with balanced development and pragmatic policies it has been able to make considerable advances towards inclusive development in terms of a fairer share in the benefits of economic performance.

38. The first focus of policy towards achieving the goals of inclusive growth is economic growth itself. Malaysia needs to recover its potential GDP growth rate which was achieved during the era of high-speed growth in the late and early 1990s in order to strengthen the basis for the redistributive policies it has adopted since implementation of the NEP. Two classes of crucial reforms for inclusive growth are required in the area of fiscal and tax policy. First is the needed adjustments to the tax revenue base and a fairer sharing of the tax burden, and second is the rationalisation of tax expenditures including government transfers and the subsidy structure.

39. Several areas in labour market reforms are called into question, arising from the data and arguments presented in this *Report*. One important issue is equality of opportunity and fairness of employment practices in the labour market. In view of proven discriminations and, as asserted by the World Bank, rigidities in the structure of the labour market, it is time to introduce legislation that promotes equal opportunity and fair employment practices. Likewise, it is appropriate that the country adopt a reasonable minimum wage policy to ensure fair compensation relative to

living costs, even if it is not automatically indexed to the inflation rate but instead adjusted periodically over time; this should be implemented if the goal of inclusive growth is to be achieved.

40. There is an urgent need for social policy reform: social safety net provisions should be broadened and strengthened to ensure the economic security of vulnerable groups at the margins of society, including unemployment insurance. The creation of a Social Inclusion Commission to facilitate the conducting of research and the drafting of policies to reduce marginalisation and encourage inclusivity may be an idea worth exploring.

41. Educational provisions to improve access to quality education, qualifications of teachers and extended school facilities in rural areas as well as for the urban poor in low-cost housing estates, and in Sabah and Sarawak, should be the focus of educational policy reform to achieve inclusive growth that will have far-reaching consequences for the welfare of the poor and their improved life chances.

42. Another important dimension of social policy is access to affordable housing, not just for the poor who are provided for through public and low-cost housing programmes, but even more so for the middle class who have to go through the housing market.

43. Finally, in order to achieve the goals of inclusive growth and development in Malaysia, courageous leadership and strong political will are important prerequisites to undertaking institutional reforms relating to the media, freedom of information, the judicial system and the institutions of integrity.