ECONOMIC BRIEF
NO. 4

ASEAN COUNTRY PROFILE
MALAYSIA: THE NEXT NIE?
The Private Investment and Trade Opportunities (PITO) project seeks to expand and enhance business ties between the U.S. and ASEAN private sectors. PITO is funded by a grant from the United States Agency for International Development (AID) with contributions from the U.S. and ASEAN public and private sectors.

The PITO Economic Brief series, which is published under this project, is designed to address and analyze timely and important policy issues in the ASEAN region that are of interest to the private sectors in the United States and ASEAN. It is also intended to familiarize the U.S. private sector with the ASEAN region, identify growth sectors, and anticipate economic trends. The PITO Economic Brief series is edited and published by the Institute for Economic Development and Policy of the East-West Center, which coordinates the Trade Policy and Problem Resolution component of PITO.

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East-West Center
Institute for Economic Development and Policy
The most striking feature of Malaysia is its relative abundance of natural resources. With a population of about 17 million, it boasts a land area of over 330,000 square kilometers (Table 1), consisting of peninsular Malaysia and Sabah and Sarawak on the large island of Borneo. Malaysia is a world class producer of natural rubber, palm oil, and tin. It has vast forest resources and exports petroleum and natural gas. For all its natural resource wealth, it is also a rapidly industrializing economy. Its relatively skilled labor force and its location along major sea routes as well as being adjacent to the dynamic free port of Singapore have made Malaysia a major participant in international trade and investment flows. Many observers already consider Malaysia to be one of the newly industrializing economies (NIEs).

Malaysia became an independent federation of states including the Peninsula, Singapore, Sabah, and Sarawak in 1963. In 1965, Singapore left the federation. The country has adopted Islam as its official religion, but Christianity, Hinduism, and Buddhism are freely practiced as well. Ethnic diversity is another major feature. Malays comprise the majority of the population with the Chinese being the second largest ethnic population that

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Contributors: William E. James and Pearl Imada, Assistant Director and Research Associate, respectively, Institute for Economic Development and Policy, East-West Center, Honolulu, Hawaii.
includes Iban, Kadazan, and other ethnic groups, including a sizable minority of Indians.

Table 1 Size of ASEAN Countries in 1989

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (millions)</th>
<th>Area (1,000 km²)</th>
<th>GDP (US$m)</th>
<th>Per capita (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>179.1</td>
<td>1,919</td>
<td>82,726</td>
<td>471</td>
</tr>
<tr>
<td>Malaysia</td>
<td>17.4</td>
<td>330</td>
<td>37,453</td>
<td>2,152</td>
</tr>
<tr>
<td>Philippines</td>
<td>60.1</td>
<td>300</td>
<td>44,349</td>
<td>738</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.7</td>
<td>1</td>
<td>28,360</td>
<td>10,582</td>
</tr>
<tr>
<td>Thailand</td>
<td>55.5</td>
<td>542</td>
<td>69,676</td>
<td>1,225</td>
</tr>
</tbody>
</table>

NOTE:

Malaysia has also made substantial progress in terms of social development (Table 2). Life expectancy rates have risen to 70 years of age, while infant mortality rates have plunged from 72 to 23 deaths per 1,000 live births from 1960 to 1988. Literacy rates have also risen.

Economic imbalances between various groups and regions in Malaysia have long been a source of concern to the government. In response to ethnic flare-ups in 1969, the government adopted a twenty-year New Economic Policy (NEP) that was intended to promote greater economic opportunities for the Malay
population. Since then, Malays have gained a larger share of economic power, though problems remain. The new policy, the National Development Plan, which was adopted in 1991, places more emphasis on overall development and growth but maintains the general goal of redressing perceived inequalities.

Table 2  Indicators of Social Development in Malaysia

<table>
<thead>
<tr>
<th></th>
<th>1960</th>
<th>1988</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life expectancy</td>
<td>53</td>
<td>70</td>
</tr>
<tr>
<td>Infant mortality rate (per 1,000 live births)</td>
<td>72</td>
<td>23</td>
</tr>
<tr>
<td>Literacy rate</td>
<td>53(^a)</td>
<td>73(^b)</td>
</tr>
</tbody>
</table>

NOTES:

a. 1962.

The government is a parliamentary democracy with a largely ceremonial monarchial system. A sultan is selected on a rotational basis from the different states. The present head of government is Prime Minister Mahathir of the United Malays National Organization (UMNO).

The UMNO-led National Front Government was victoriously returned to power in the October 20–21, 1990 national polls. However, in two states, Kelantan and Sabah, opposition parties captured control of state administrations. Subsequently, chief ministers of the two opposition-led states have been excluded from meetings with the federal cabinet. It appears that the opposition-
headed states will thus be given less say at the national level. Interestingly both Kelantan (which is 95 percent Malay) and Sabah are remote from the country’s capital, Kuala Lumpur, and have already felt somewhat neglected by the center.

PRESENT ECONOMIC TRENDS

Economic growth between 1965 and 1980 averaged 7.6 percent in real terms. However, in the 1980s economic growth slowed (Table 3). There was a shift in emphasis towards heavy industry following the second oil shock period. In addition after 1981, export commodity prices became depressed leading to slower export growth through the mid-1980s. Heavy foreign borrowing to finance the drive to heavy industrialization led to mounting debt service payments at the same time that exports were slowing. This contributed to a painful period of adjustment and restructuring. By 1987, the economy began to recover from the severe downturn in 1985 and 1986. Growth was restored to 9 percent in 1988 through 1990.

Manufacturing is the leading sector in Malaysia’s rapid economic growth. Growth in this sector was stimulated by greater emphasis on light and export-oriented industries and a growing influx of direct foreign investment (DFI) from Japan, East Asia, Europe, and North America. By the latter half of the 1980s, the manufacturing sector accounted for a larger share of gross domestic product (GDP) than agriculture (Figure 1). Services also showed strong growth in the recent recovery. The sharp rise in DFI and the restoration of growth has led to the expectation that
Malaysia will soon join the ranks of the newly industrialized economies (NIEs). However, much depends on the maintenance of political and social stability.

Table 3 Basic Economic Data for Malaysia

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth of real GDP</td>
<td>6.5b</td>
<td>8.1c</td>
<td>5.7</td>
<td>8.9</td>
<td>8.8</td>
<td>9.4</td>
<td>8.5</td>
<td>8.5</td>
</tr>
<tr>
<td>Export growth</td>
<td>5.1</td>
<td>23.5</td>
<td>9.4</td>
<td>17.4</td>
<td>13.1</td>
<td>15.6</td>
<td>14.0</td>
<td>15.0</td>
</tr>
<tr>
<td>Import growth</td>
<td>4.5</td>
<td>23.0</td>
<td>12.4</td>
<td>28.4</td>
<td>36.7</td>
<td>25.0</td>
<td>20.0</td>
<td>24.0</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>0.8</td>
<td>5.5</td>
<td>3.6</td>
<td>2.5</td>
<td>2.8</td>
<td>3.1</td>
<td>4.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Debt service ratio</td>
<td>na</td>
<td>7.2</td>
<td>16.3</td>
<td>22.2</td>
<td>14.6</td>
<td>11.4</td>
<td>10.0</td>
<td>8.5</td>
</tr>
<tr>
<td>FDI inflow (US$ m)</td>
<td>153</td>
<td>3,261</td>
<td>7,911</td>
<td>966</td>
<td>2,366</td>
<td>na</td>
<td>na</td>
<td>na</td>
</tr>
</tbody>
</table>

NOTES:
a. Not available.

The Malaysian economy in 1990 recorded among the highest growth rates in the entire region and, indeed, the world at over 9 percent. This strong recent growth performance came about despite weaker commodity prices throughout most of the year, indicating that Malaysia has achieved some diversification of its traditional exports. However, the recent growth has essentially been propelled by strong domestic demand growth, especially in the area of investment. Investment growth in real terms reached 15 percent in 1988 and 32 percent in 1989, and is expected to reach 21 percent in 1990. Private investment has been the leading factor in this growth. Policy changes including reorienting public
Figure 1  Major Sectors of Malaysia's GDP

Sources: Asian Development Bank, Key Indicators of Developing Member Countries of ADB, various issues.

Expenditures to infrastructure and basic social services, liberalizing regulations for foreign equity participation, and reducing corporate tax rates, have helped boost investment demand. Reflecting the investment boom, imports are growing by nearly 20 percent in 1990 (compared to 14 percent export growth) as capital goods and other industrial inputs are imported.

Sectoral output growth is being led by the manufacturing and construction sectors (both at 14 percent in real terms). The services sector also continued to grow at a rapid pace of almost 10 percent while the agricultural and mining sectors (including petroleum) grew more slowly at 3.7 percent and 5.3 percent, respectively, in 1990.
The strong growth performance has been achieved without much inflation; in fact the rate of consumer price inflation increased only slightly in 1990 to 3.5 percent. The unemployment rate has also shrunk from over 8 percent in 1988 to only about 6.3 percent in 1990. The economy has moved to a more employment-oriented growth path as private enterprise and light industry and services have been emphasized instead of heavy industry and public enterprises.

The Malaysian economy has attracted a huge volume of direct foreign investment in recent years, reaching over US$7 billion in 1990. The government has used its strong position to reduce foreign debt while maintaining more than adequate international reserves. The Malaysian economy has been assisted by a number of international economic trends. The industrial restructuring in Japan and East Asia has led to accelerated inflows of DFI into Malaysian industries. Globalization of production, liberalization of financial markets, and strong growth in world trade have also contributed to Malaysia's growth. The ongoing changes in Europe and the recent oil price rise have also affected Malaysia's performance of late. The future economic outlook of Malaysia will be strongly influenced by the global economic trends.

Before commenting on the outlook, however, some economic policy changes are considered.

RECENT CHANGES IN MALAYSIA'S ECONOMIC POLICIES

The Malaysian government has been steadily pursuing a macroeconomic stance of fiscal prudence and accommodative
monetary policy. The public sector deficit has fallen from 19 percent of gross domestic product in 1982 to only 3.2 percent in 1990. External debt has been reduced through refinancing, prepayments, and careful debt management. The emphasis in policy has shifted from promotion of public enterprise to an emphasis on private sector development. By late 1990, over 30 government enterprises had been privatized, with another 68 firms being either approved or under consideration for privatization. There is now in place a Privatization Master Plan (PMP) to oversee the program. In tandem with the privatization program, a series of measures to support private investment have been implemented. These include allowing up to 100-percent foreign equity in export-oriented sectors; reduced taxes (the corporate income tax rate was cut from 40 to 35 percent); introduction of a credit guarantee system for loans to small and medium-size enterprises; more favorable investment regulations; and other institutional changes. Capital market liberalization and measures to facilitate the development of the stock exchange for private bond trading have been introduced.

The National Development Policy and the Sixth Five Year Plan, which will run through the year 2000, represent a stronger move to promote economic growth and private sector activities. It includes the more flexible investment policies adopted in the 1980s and accelerates the pace of privatization of state enterprises, reduces subsidies, loosens wage and price regulations, and pledges prudent monetary and fiscal policies. At the same time, hefty outlays are planned to improve infrastructure and to boost
worker productivity through new training and education programs. Skilled foreign managers and professionals will be allowed to enter in sectors where they are needed.

THE MALAYSIAN ECONOMY: THE ROAD AHEAD

The uncertain fate of the GATT (General Agreement on Tariffs and Trade) negotiations, recession in some developed countries and economic slowdown in others, macroeconomic imbalances, and the problems of economic restructuring and reform in Eastern Europe and other countries under central planning are all likely to impinge on the economic situation in Malaysia.

For these reasons, it is expected that growth of the Malaysian economy will decelerate, though only slightly over the next two years. In 1991 and 1992, real growth is expected to be 8.5 percent. Inflation is expected to increase to 4.5 percent over the next two years. The current account balance is expected to show a small deficit (less than 2.0 percent of GDP), as the merchandise trade balance improves with less import growth. It is expected that the services trade deficit will rise somewhat.

On the policy front, few surprises are likely. Malaysia has made a strong shift towards emphasis on industries in which it has the comparative advantage, including processing of its natural resources and a number of light industries such as food processing, wood-based industries, electronics, machinery, and rubber products. This represents a reorientation of industrial policy away
from the heavy-industry push that was attempted with little success in the early 1980s.

The emphasis on light, consumer, and export-oriented industries combined with the strong resource-based industries should allow Malaysia to perform better than most other economies even with a slowdown or recession in some industrial nations. The changes made in the 1980s have assured its place as the newest NIE.

Electrical and electronic equipment

Malaysia is presently one of the world’s top exporters of semiconductors and other electrical and electronic equipment. Despite the slowdown in 1990 due to slower world trade growth, the sector continued to grow in 1990 and investment by foreign firms in this industry has boomed. Companies engaged in the manufacture of consumer and industrial electronics for the export market, designated to be a priority sector by the Malaysian government, may be eligible for attractive tax incentives.

Natural resource-intensive industries

Malaysia is the world’s largest producer of natural rubber (nearly 40 percent of world output), palm oil (60 percent of world output) and tin (30 percent). Using its large natural resource base, it has begun to emphasize exports of goods utilizing these commodities. For example, rubber products including automobile tires and latex products for medical, fashion, and other uses have become important export items as has pewter-ware and tin
products. Opportunities are also available in processed palm oil, wood-based industries, and cocoa-related products.
TABLE SOURCES


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