Malaysia's hope to become a high-income country by 2020

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There is a lot in the pipeline for Malaysia at the moment. By 2020, its per capita income is set to rise to over 15,000 US dollars. This would classify Malaysia as a high-income country according to the World Bank. The chance of it achieving this goal is, on the whole, rather reasonable. The Malaysian economy is growing steadily and positive stimulus can be expected from various free trade agreements, in particular the ASEAN Economic Community (AEC) and the Trans-Pacific Partnership (TPP). Chinese initiatives such as the Silk Road Strategy (One Belt, One Road Initiative) also hold a lot of promise for the country. However, its goal is a long way off yet. In particular, reforms must be put in place that seek to diversify economic structures and increase productivity, as well as fulfil other objectives.

To what extent the strong economic headwinds that Malaysia is currently exposed to might delay reforms remains to be seen. The weak global economy and very uncertain recovery are particular causes for concern, as Malaysia relies heavily on exports. Low prices for oil and other raw materials, which still constitute a significant proportion of exports and government revenues, are having a negative effect on the country. The government must also find answers to questions regarding the effect that China's economic downturn will have on Malaysia, as well as China's decision to change its development model in a shift away from labour-intensive manufacturing and investment towards industrial innovation, consumerism and services.

The country has more than just changes in the external environment to worry about, however, as there are also numerous problems coming from within the country. For example, the measures devised to improve public finances have not been without controversy. Furthermore, certain things are not adding up in the political sphere, notably the finance scandal involving the state-owned investment fund 1MDB and the uncertainty regarding Prime Minister Najib's role in the scandal, which is causing a lack of public confidence (P. Boyce, "Malaysian Parliamentary Democracy in Crisis", Australian Institute of International Affairs, 15 April 2016, www.international affairs.org.au). This is also tarnishing efforts to increase the domestic demand required to stabilise growth in the face of an uncertain global economy.

Economic development declined in 2015

2015 was not an easy year for the Malaysian economy. Despite a slump in oil prices from mid-2014 and the subsequent widespread negative effects on the economies of many countries, Malaysia still managed to increase its economic output by 5.0 per cent in real terms, compared with 6.0 per cent the previous year (Department of Statistics Malaysia, "Gross Domestic Product Fourth Quarter 2015", 18 February 2016, www.statistics.gov.my).

As a result of close international integration – the export rate was over 70 per cent – the global decline led to deterioration of

Malaysia's position in term of foreign trade. Net exports fell by 3.7 per cent, after having grown by 12.8 per cent in 2014 (Bank Negara Malaysia, "Economic and Financial Developments in Malaysia in the Fourth Quarter of 2015", 18 February 2016, www.bnm.gov.my). The trade balance simultaneously dropped 1.4 per cent to 2.9 per cent of gross domestic product (GDP) (World Bank, "East Asia Pacific Economic Update, April 2016: Growing Challenges", www.worldbank.org). Furthermore, as a result of high outflows of capital, the ringgit dropped 23 per cent against the US dollar, despite capital inflow in the fourth quarter of 2015 following an increase in interest rates in the USA, which stabilised the Malaysian currency (ibid; Economic Planning Unit, Prime Minister's Department Malaysia, National Accounts and Trade Balance Statistics 2010 to 2015, www.epu.gov.my).

Exchange of goods rose by 1.2 per cent to 1.47 billion ringgit (334.3 billion euros), which led to an increase in exports of 1.9 per cent worth almost 780 billion ringgit. Malaysia was one of the few countries in Asia able to increase its exports despite the weakness of the global economy. The main reason for this was that exports of industrial finished products from the electrical and electronics industries balanced out the drastic slump in raw materials such as liquid petroleum gas, palm oil, crude oil and natural rubber (Malaysia External Trade Development Organisation, "Trade Performance for the year 2015 and the month of December 2015", 5 February 2016, www.matrade.gov.my).

Given the very modest development of external economies, the main growth came almost exclusively from domestic demand. But even this declined, increasing by only +5.1 per cent in comparison to +6.0 per cent in 2014. With this came gains in private capital investments of 6.4 per cent, although many domestic and foreign companies held off on new projects due to very uncertain economic prospects (Malaysia Investment Development Authority, "Facts and Figures: Approved investments for manufacturing, services and primary sectors, 2015 and 2014", www.mida.gov.my).

Private consumption did increase by 6.0 per cent, taking into account the overall annual figure in comparison to 2014, but this levelled out significantly from the summer onwards, as a consequence of a new goods and services tax (GST) of 6 per cent that was introduced on 1 April 2015. This replaced the former sales tax and service tax (SST) and was hailed by the government as simpler, more efficient and more transparent (details in Ministry of Finance, "Economic Report 2015/2016, Section 4: Public Sector Finance", www.treasury.gov.my). GST was met mainly with criticism from the general population, but a great deal also came from small and medium-sized businesses, who protested that they were not given sufficient time to prepare ("Can Malaysia revive its economy in 2016?", East Asia Forum, 9 January 2016). In the last few months of 2015, however, a slight surge in consumption clearly indicated that more people had come to terms with the new GST.

At the same time, the new tax is an important source of "stable" income for the Malaysian government, given that public finances came under heavy strain as a result of the decline in international commodity prices. In 2014, oil and other raw materials contributed 30 per cent of total state revenues. This proportion fell to under 20 per cent in 2015 as a result of the GST and subsidy cuts, among other factors. At the same time, this has helped to reduce the budget deficit by 0.2 points to 3.2 per cent of GDP (Ministry of Finance, "Economic Report", loc. cit.).

Even though Malaysia's economy was able to remain relatively stable throughout 2015, the drastic drop in consumer confidence and the reasons the government has stated for this decline are both a real cause for concern. The market research institute, Nielsen, provides a corresponding index to reflect these statistics. In the third quarter of 2015, consumer confidence fell to 78 points, reaching the lowest levels in ten years. Malaysian consumers stated concerns regarding further economic development, political stability and job security as reasons for this pessimism ("Consumer confidence at 10-year low in Malaysia"; The Star Online, 4 November 2015, www.thestar.com). In the fourth quarter of 2015, a slight increase by two points was registered.

The stable position of the labour market is quoted by the Malaysian government and other international organisations as evidence for the resilience of the Malaysian economy. Indeed, the most recent figures from February 2016 indicate that unemployment rates are as low as 3.4 per cent (Department of Statistics Malaysia, www.statistics.gov.my). Although this indicates full employment, the labour market overall still has its problems. For example, the unemployment rate has risen by 2.9 per cent since December 2014, which is a source of worry for many citizens. Furthermore, the employment rate of 67.6 per cent (February 2016) is low in comparison to other regional and/or developed economies and not enough women are employed in the country.

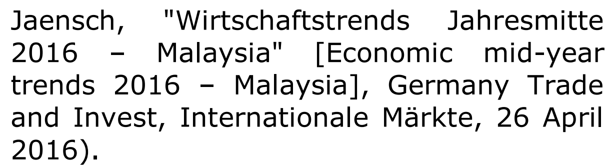
Outlook for 2016 unclear

Many of these problems will continue to affect Malaysia into 2016/2017. The greatest risk factor is the ever-weakening global economy. The development of commodity prices is also uncertain, even if oil prices have increased slightly recently. Moreover, there is always the possibility of significant financial turbulence, particularly given the uncertainty regarding processes in China.

Against this backdrop, the government has revised its forecasts for economic growth in 2016 as follows: New figures of between 4 and 4.5 per cent have been predicted, in contrast to the original forecast of up to 5 per cent ("Malaysia Trims 2016 Growth Forecast to 4–4.5%", Bloomberg, 28 January 2016, www.bloomberg.com).

International organisations also share this view. The World Bank, for example, predicts an increase of GDP in real terms of 4.4 per cent (World Bank, "East Asia Pacific Economic Update", loc. cit.). Others, however, are more sceptical. The Hong Kong and Shanghai Banking Corporation (HSBC) have projected an increase of just 3.6 per cent ("Malaysia to Miss 2016 GDP and Deficit Targets, Says HSBC", The Malaysian Reserve, 20 January 2016, http://themalaysiareserve.com).

Since the risks threatening economic development are coming primarily from outside of the country, domestic demand is the key to growth. Hope lies above all with the private sector. Whether or not it will ultimately prevail remains to be seen. In any case, consumption is expected to go into further decline. The reasons for this include the rising costs of living and the high levels of household debt. Reduced growth is also expected for private capital investments compared with the previous year due to general economic weakness. Although the investment promotion agency MIDA has announced optimism on the surface ("Mida sees brighter investment climate", New Straits Times Online, 19 March 2016), officials have reduced their targets for new investment approvals by 35 per cent (R.



Jaensch, "Wirtschaftstrends Jahresmitte 2016 – Malaysia" [Economic mid-year trends 2016 – Malaysia], Germany Trade and Invest, Internationale Märkte, 26 April 2016).

The state only has limited financial flexibility due to falling oil prices and will therefore only be able to provide limited stimulus for the economy. In January 2016, the budget for the fiscal year beginning 1 April 2016 was revised. It now takes an oil price of 30 to 35 dollars as a basis for calculations; the original base price was 48 dollars. Projects with a total value of approximately 5 billion ringgit will now be axed to compensate. At the same time, the government is looking to stimulate consumption, for example by lowering social security contributions for workers. The government is holding fast to its aim of further reducing public deficit to 3.1 per cent of GDP despite the budget revision ("Malaysia justiert seinen Haushalt nach" [Malaysia readjusts its budget], Germany Trade and Invest, Internationale Märkte, 4 February 2016, www.gtai.de).

Malaysia's greatest goal: Becoming a high-income country

Malaysia has achieved a great deal over the last ten years: The economy has been growing at an average rate of 6.2 per cent a year since 1970 (Economic Planning Unit, Prime Minister's Department, "Eleventh Malaysia Plan 2016–2020", http://rmk11.epu.gov.my). After Singapore and Brunei, Malaysia has become the third richest nation of the ASEAN group and is classed as an "upper middle-income country" by the World Bank. GDP per capita in 2014 amounted to more than 11,300 US dollars (World Bank, "World Development Indicators: GDP per capita (current US$), www.worldbank.org).

This is intended to rise to more than 15,000 dollars by 2020 according to the 11th development plan, which would make Malaysia a "high income country". However, attaining this goal will not be easy. Foreign observers have pointed in particular to the risk of falling into a "middle income trap", a theory which describes how countries can get stuck on a certain level of income. On the one hand, they cannot keep up with the technological advances of other countries (yet); but on the other, their income levels are too high to remain competitive against low-wage countries.

In order to get out of this trap, Malaysia will need to do more for productivity and innovation, according to a working paper by the International Monetary Fund (R. Cherif, F. Hasanov, "The Leap of the Tiger: How Malaysia Can Escape the Middle-Income Trap", IMF Working Paper 15/131, June 2015, www.imf.org). The paper adds that Malaysia should follow the example of South Korea and Taiwan which, unlike most others, have been able to become high income countries through primarily domestic companies developing and distributing new technologies. This contributed significantly to productivity levels. Malaysia, by contrast, is heavily reliant on multinationals and direct investment from abroad, and although the country has often tried to create added value and raise the technological content of exports, these efforts have had limited success.

The Malaysian government seems to be aware of this problem. In the 11th plan, numerous measures are outlined for promoting productivity, innovation and education. The change will not be an easy one to make, however. For example, many highly educated Malaysians are starting to leave the country. If this trend cannot be halted, the country will lose a lot of its current appeal to foreign investors ("Malaysia's brain

drain reaching critical stage", ASEAN Today, 18 March 2016, www.aseantoday.com).

With this in mind, higher GDP growth rates and further reform of the economic structure are important factors. Malaysia has been prepared to promote new industry sectors with the help of the "Economic Transformation Programme" since 2010. There is a lot of movement both within the tourism sector and the Islamic financial system (M. Hussain, "Malaysia's 2020 vision", Hong Kong and Shanghai Bank, 18 November 2015, www.hsbc.com). But in the face of increasingly strong competition, it is likely that Malaysia will have to do a great deal more.

China: A competitor and business partner

Above all, China is making advances. The Middle Kingdom is shifting the focus of its development plan from labour-intensive manufacturing and investment to industrial innovation, consumerism and services, and over the coming years is set to become a competitor for Malaysia in a number of fields, such as the electronics industry. Malaysia also stands to benefit from this restructuring, however, since it predominantly exports finished goods to China (UNESCAP, "Asia-Pacific Trade and Investment Report 2015", www.unescap.org). Nevertheless, the country will need to raise the quality of its own technologies in order to compete with the increasingly sophisticated products that are "Made in China". This will not be easy. Multinational corporations, on which Malaysia is highly dependent, are generally not keen on transferring technology to other countries (R. Cherif, F. Hasanov, "The Leap of the Tiger, loc. cit.).

The Middle Kingdom has been Malaysia's biggest trading partner since 2009 and is now also an important investor. In December 2015, a Chinese-Malaysian consortium acquired a 60 per cent shareholding of a Bandar Malaysia project for 7.4 billion ringgit. The project is for a large commercial and residential complex in Kuala Lumpur, which will incorporate a train station for the planned high-speed railway line from Kuala Lumpur to Singapore ("China's 'One Belt, One Road' initiatives in Malaysia", The Edge Property Singapore, 16 February 2016, www.theedgeproperty.com).

China is also getting involved in other ways. For example, Malaysia became the second clearing centre after Singapore for trade in the renminbi yuan in the ASEAN area in April 2015 ("Malaysia poised to become major renminbi clearing centre", The Star Online, 15 April 2015, www.thestar.com). In addition, the Chinese Prime Minister, Li Keqiang, announced during a visit to Kuala Lumpur in November 2015 that China was keen to buy more Malaysian government bonds, allocating Malaysia 50 billion renminbi yuan in Chinese securities.

The reason for this heightened interest is that China considers good relations with Malaysia to be an important prerequisite for the success of its Silk Road Strategy (One Belt, One Road Initiative) and the new Asian Infrastructure Investment Bank (AIIB). Both initiatives are also supported by Kuala Lumpur.

Malaysia is also placing a great deal of faith in the ASEAN Economic Community (AEC) and the Trans-Pacific Partnership. However, the advantages of these will go hand in hand with a number of disadvantages. It is likely that, as part of the general opening up of the market, production will be moved from Malaysia to neighbouring countries where costs are lower. Conversely, Malaysia could take on production from Singapore in the electronics industry, for example (D. Rehn, "Singapur fürchtet China-

Abschwung [Singapore fears slowdown in China], Konrad-Adenauer-Stiftung, Regionalprogramm Soziale Ordnungspolitik in Asien/Auslandsbüro Japan, 12 April 2016, www.kas.de/japan). Furthermore, thanks to the TPP, Malaysian companies are gaining access to new markets, most notably to the USA market. According to observers, connections with another major market could help Malaysia to strengthen its improved relations with China (M. Hussain, "Malaysia's 2020 vision", loc. cit.).

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