Economic Management during Political Transition: Five Management Principles for Malaysia

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Getting the Analogy Right: A Patient Complains of General Fatigue (1/2)

- **Outcome 1**: Patient leaves clinic, laughing, clapping and dancing. He came in slightly depressed but left in high spirits.
- **Outcome 2**: Patient is put under heavy sedation, put on a stretcher, rushed to the operating room of the General Hospital, and confined to intensive-care unit (ICU) for a week before being discharged in wheel chair. He had walked into the clinic but was carried out.
- **Question**: Is the clinic's doctor competent if it is Outcome 1 but incompetent if it is Outcome 2?

Getting the Analogy Right: A Patient Complains of General Fatigue (2/2)

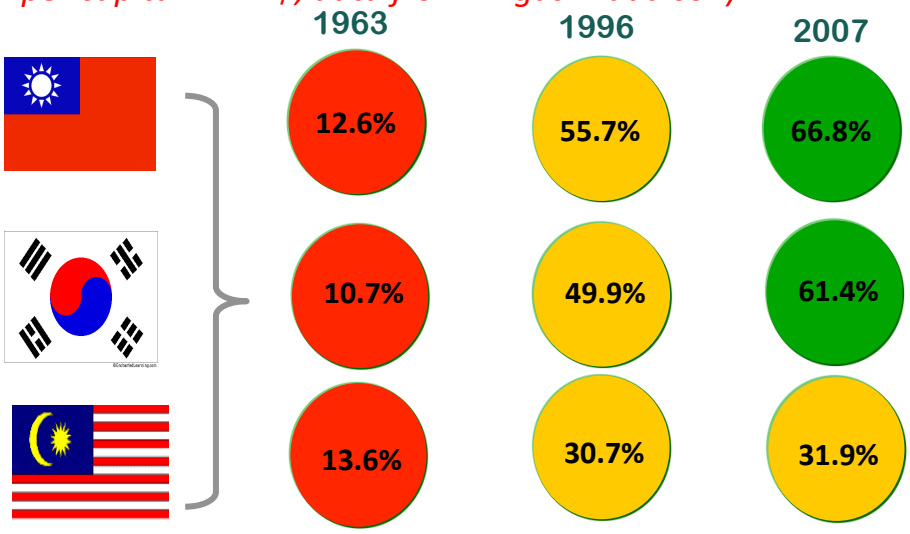
- Question was stupid question. Not enough information to decide competence, we need to know:
  - What's long-run consequence in each Outcome?
  - What's the ailment of the patient?
- Long-run consequence for
  - Outcome 1, patient died after 2 hours. Doctor treated symptoms (and not root cause) by giving large dosage of adrenaline-LSD mixture, which exacerbated heart condition and caused death
  - Outcome 2, patient lived to see college graduation of grand-daughter because doctor had recognised a blocked artery
- ***My message: Higher growth of GDP in 2012:4Q is Outcome 1 because it is not sustainable.***

3 Questions I Want to Discuss Today …

1. Is the Malaysian Economy Sick?
2. What is Making the Malaysian Economy Sick?
3. What is the international experience in curing the type of economic sickness that Malaysia is suffering from? What general principles to guide the reform?

We Cannot Blame the Global Financial Crisis for Present Economic Stagnation

COUNTRY'S INCOME AS % OF US INCOME *(Income in GDP per capita in PPP$, data from Angus Maddison)*



What do the Federal programs reveal?

TalentCorp MALAYSIA — **Great shortage of human talent**

KORIDOR UTARA — **Highly unequal geographical distribution of development**

ECONOMIC TRANSFORMATION PROGRAMME — **Severe shortfall in domestic investment**

GTP GOVERNMENT TRANSFORMATION PROGRAMME — **Drastic deterioration in performance of governance institutions.** ***PEMANDU & KPIs to the rescue!***

Most of the post-Mahathir "reforms" are in essence scaling up of existing initiatives (*palliatives*)

Principle #1: Treat the Root Causes of the Disease not Its Symptoms. Diagnosis determines the Direction of Reform

Malaysia's Fork in the Road

Reform the policies that are making the Malaysian economy sick

OR

Continue scaling up existing programs to try to offset the ill-effects caused by existing policies

Root Causes of the Malaysian Economic Malaise

Government Policy	Private Sector Adjustment	Outcome
Abuse of socio-economic policies and ignoring ability as criteria in order to benefit cronies e.g. selection based on relationship not performance	Brain drain occurs in every ethnic group	Shortage of human talent
Tax on growth of non-bumi firms, i.e. mandated sale of proportion of equities at discount to govt-selected individuals upon listing	Capital flight & SMEs leave Malaysia to grow elsewhere or choose NOT to grow	Large shortfall in domestic investment
Over-centralisation at Federal level, suppressive of local development initiatives	Inadequate infrastructure (production bottlenecks) outside of KL-Putrajaya	Highly unequal geographical distribution of development
No transparency in Federal operations	Public unable to monitor performance	Deterioration in governance

Negative effects from brain drain, capital flight, insufficient hard infrastructure, and sub-standard soft infrastructure were not clearly seen before 2000 because

BEFORE — YEAR 2000 — AFTER

Negative growth aspects were outweighed by:

- Massive inward FDI;
- Big investments by GLCs;
- Large infrastructure projects financed by oil and gas revenue.

Post-1990 external trends and pre-2000 extended period of mismanagement have greatly reduced the magnitudes of offsetting factors, resulting in significant slowdown in growth → Malaysia in the middle-income trap

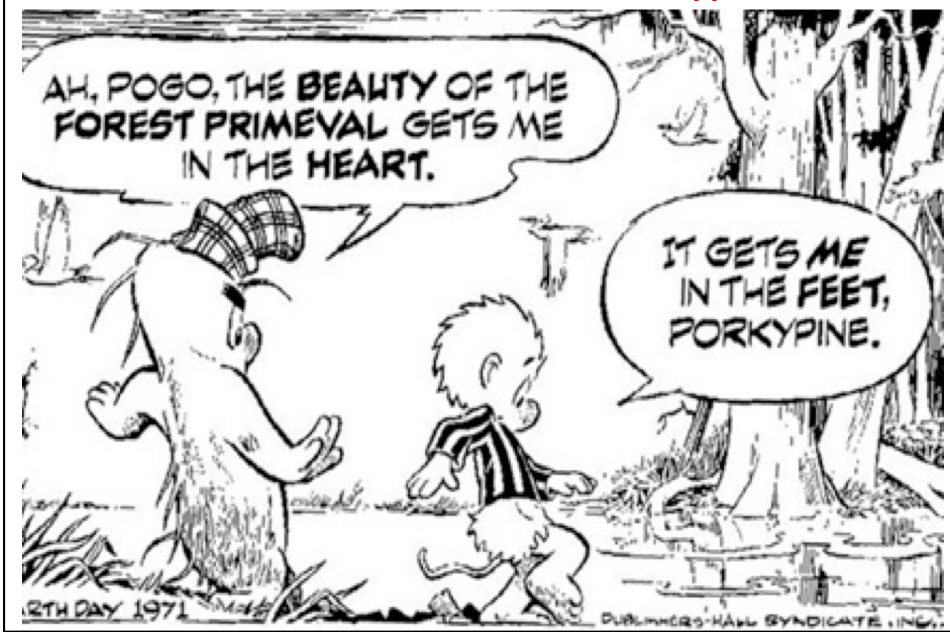
Over-Use of Emergency Room Procedures

PENANG PARADIGM

Government Policy	Circumstances at that time	Situation Today
Affirmative action policies	To quickly reduce the socio-economic gap between ethnic groups	Large, well-educated Malay middle class created; but use of relationship rather than performance in govt and economic stagnation are causing Malay brain drain.
30% of shares be sold at discount to govt-selected individuals(>IPO reqn, min 25% of share capital offered)	To quickly increase Malay ownership of capital	Required share lowered to 12.5% IN 2010, but rest of world has 0% requirement.
Over-centralisation of power at Federal level	Existential crisis in 1957 *(Emergency)* and in 1963 *(Konfrontasi)*	Chin Peng and Soekarno have long disappeared
No transparency in Federal operations	Until 1980, population inadequately educated and would not understand explanations	Incompetent, unresponsive governance that is below aspirations of educated, confident public

Summing up the Malaysian Dilemma *a la* the famous American comic character Pogo

The Malaysian Dilemma (1/2): Badawi and Najib, full of hope, went for a walk in the forest after Mahathir stepped down



The Malaysian Dilemma (2/2): Their hope and soles *(and Our Souls)* are hurt from treading on the policy path left created by Mahathir. Hence the insight: "we have met the enemy and he is us"

Background for Other 4 Management Principles: Experiences from History's Big Turn Coming into the 21st Century

- 1991: implosion of the SCviet Union established in 1917 **<74 years>**; Soviet bloc 1945-92 **<47 years>**
- 1997: defeat in Korean presidential election of the Grand National Party (GNP), the successor to the military-backed regime that took power in 1961 **<36 years>**
- 1998: Soeharto resigned, he had ruled since 1965 **<33 years>**
- 2000: defeat in Taiwan's presidential election of the Nationalist Party (KMT) that had ruled since 1945 **<55 years>**
- 2000: defeat in Mexican presidential election of the Institutional Revolutionary Party (PRI) that had ruled since 1929 **<71 years>**

Political Re-Reversal in Korea, Mexico and Taiwan

- 2013: GNP (Park Geun-hye), KMT (Ma Ying Jeou) and PRI (Enrique Pena Nieto) are now back in power
- However, the *new Mode of Governance has endured*
  - GNP, KMT and PRI are NOT restoring the state-backed crony capitalism that had characterized their previous reign, e.g. chaebol groups in Korea no longer as influential in government policies
  - Instead, the KMT, GNP and PRI are now committed to the continuation and broadening of the equitable and sustainable economic growth strategies of their immediate predecessors in the same way that the successive post-1998 Indonesian ruling parties have done.
- **GDP, KMT and PRI had complete internal make-over during their periods in political wilderness.**

Principle #2: New broom sweeps clean

- **New political leaders, not encumbered by inherited vested interests, are more likely to initiate turning points in economic management.**
- Their successors (even if from competing party) will follow the new direction until external conditions and internal situation have changed substantially. Different direction when new person is less beholden to past:
  - Chernenko's heir Mikhail Gorbachev versus Boris Yeltsin (Putin is continuing Yeltsin's line)
  - Mao's heir Hua Guofeng versus Deng Xiaoping (Xi Jinping is continuing Deng's line)
- Immediate economic response to reform: Growth for Deng versus collapse for Yeltsin. *Speed was the culprit?*

Principle #3: Reform Speed depends on the task

- Debate on "fast, comprehensive (shock therapy) reform" versus "gradual, piecemeal reform" is too simple-minded. **The particular aspect of economy being reformed sets the optimum technical speed**, e.g. the optimum speed for price deregulation and enterprise privatization are different.
- No relationship between immediate economic response and reform speed. Differences in national initial conditions. **Economic Development in East Asia vs Economic Restructuring in Eastern Europe and former Soviet Union**.
- *Same reform direction in Russia and China.* ***Direction is more important than speed*** *(speed doesn't matter when the direction is wrong), but desirability of speed must be kept in mind.*
- Slow reform is susceptible to being paralysed after honeymoon period and to being captured by vested interest groups. Cannot justify slow elimination of poverty when it could be faster!
- China's slow speed due to political not economic factors.

Principle #4: Look at global experience for policy instruments

- **The adoption of best international practice sets the direction of reform, but this has to be tempered by adaptation of the international procedures to local circumstances.** ***Adopt and Adapt is the key.***
- Debate on "do not reinvent the wheel" versus "indigenous institutional innovation" is caused by confusion between "institutional innovation in the global sense" versus "institutional innovation in the local sense" e.g. replacing central planning with market mechanisms is global-type innovation while changing the sequence of of steps to deregulate the financial market market to suit local conditions is local-type innovation.
- Convergence in economic institutions to international norms is generally more efficient in accelerating the catch-up process than experimentation to discover new alternative economic institutions, e.g. the debate on the efficiency and durability of the collective form of ownership (versus private ownership) for small-medium enterprises in rural China in 1984-1995.

Principle #5: Be aware that a MESS will be inherited

- **Political transition occurs generally because of mismanagement by the incumbent; the most common feature being a large hidden budget deficit that is destabilizing the economy.**
- **The aspiring govt must hence be ready to start governing immediately upon election victory,** i.e. must have a detailed election manifesto that is operational in tackling the identified root causes of the economic crisis. The resulting economic rehabilitation program has the legitimacy to be implemented quickly because it had been scrutinized by the electorate.
- In the absence of generous foreign aid, orderly resolution of the budget deficit requires low-cost access to commercial loans, which is possible only if the new govt presents credible new mechanisms to restore control of budget, and to raise the private investment rate (hence increase GDP growth).

We have applied these 5 principles in drawing up the Penang Paradigm, a 10-year development plan for Penang (and Malaysia). We are seeking PUBLIC GUIDANCE to improve the report which is available online.

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