

## **Growth Pitfalls in China & Malaysia**

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### **Organization of Remarks**

1. Some Definitions & Facts on Growth and Convergence
2. Why is the Malaysian Economy Stuck?
3. Can China Avoid Economic Stagnation?
4. The Way Ahead for Malaysia and China

## Convergence

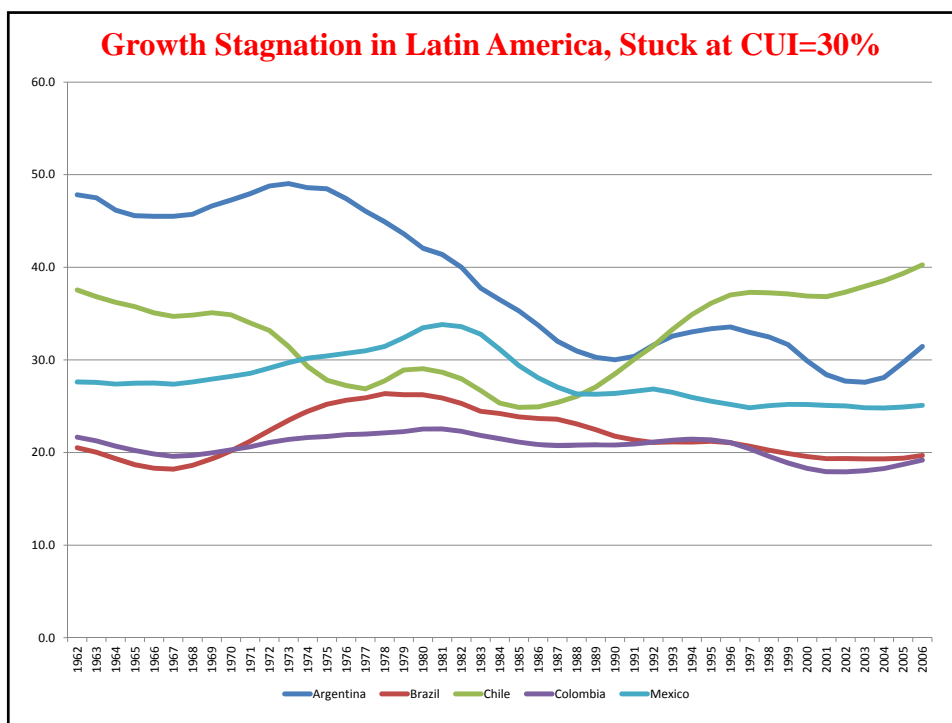
- Absolute Convergence:
  - $\text{yrate}_i = f(y_i)$  where  $f' < 0$
  - $y$  = GDP per capita
  - $\text{yrate}$  = growth rate of  $y$
- Conditional Convergence
  - $\text{yrate}_i = g(y_i, X_i)$
  - $X_i$  = specific conditions in country  $i$
- **Issue: How to switch to highest Conditional Convergence growth path?**

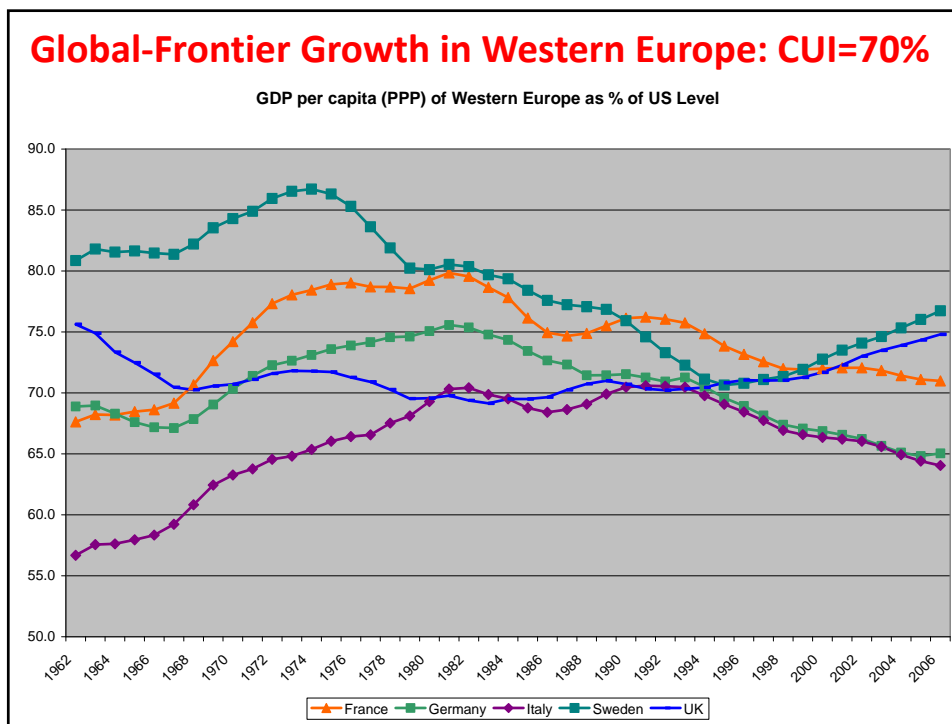
## Characterising Economic Growth

- **Type 1: Global-Frontier Growth**
  - Growth of the countries with the highest standards of living, e.g. USA, Japan
- **Type 2: Catch-Up Growth**
  - Growth that closes the gap in standard of living with USA-Japan
- **Type 3: Growth Stagnation**
  - Growth that does not close the gap in standard of living with USA-Japan
- **Issue: How to accelerate Catch-Up Growth?**
- ***The Catch-Up Index (CUI) to indicate progress***
  - ***CUI = country's income level / US income level***

## Illustrating the Growth Types with the Largest Economies in Each Region

- 5 largest in Europe: Germany, UK, France, Italy, Sweden
- 5 largest in Latin America: Brazil, Mexico, Argentina, Colombia, Chile
- 10 largest in East & South Asia: China, India, Japan, Indonesia, S-Korea, Thailand, Taiwan, Pakistan, Philippines, Malaysia



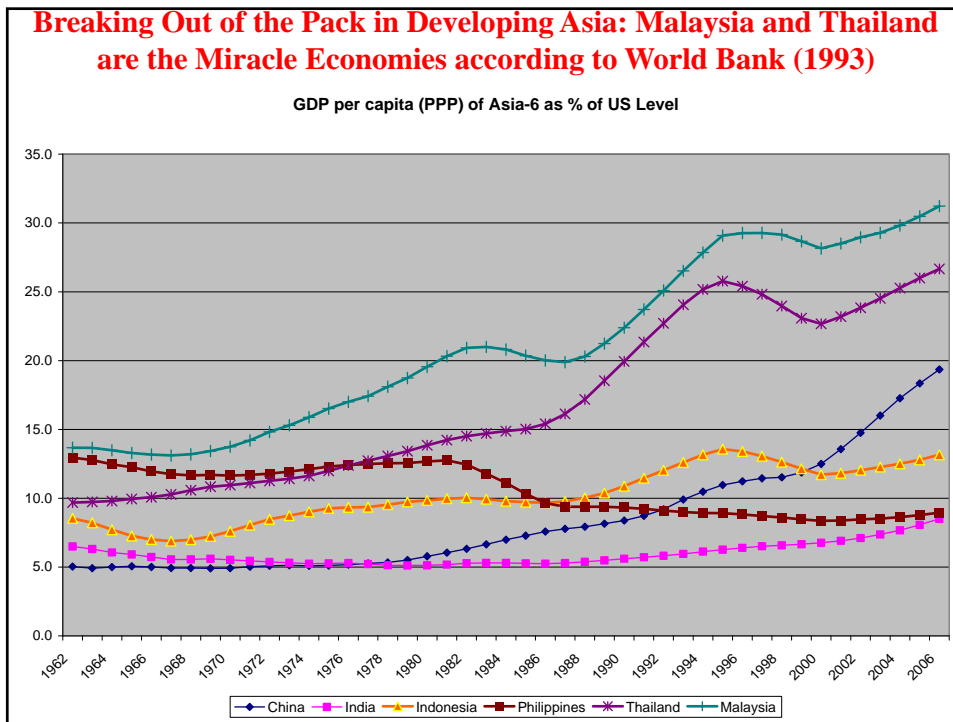


### Why is European CUI < 100% ?

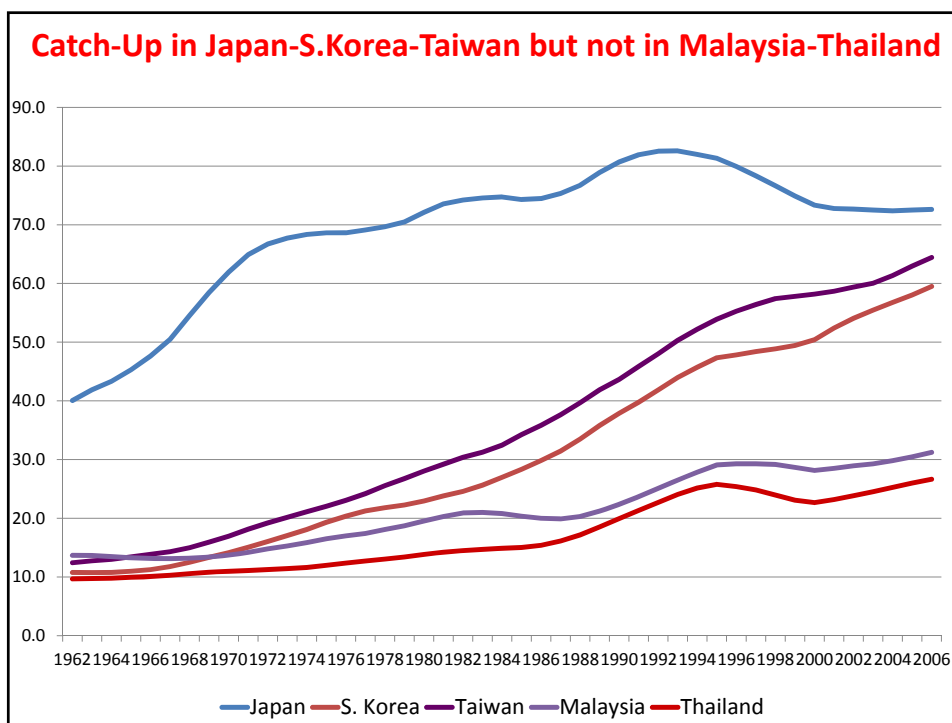
Decompose (GNP/L) into:

$$(GNP/[H*W])*(H/[365*24])*(W/L)*(365*24)$$

- GNP = total output
- L = Population Size
- H = Number of hours actually worked
- W = Number of people actually working
- $(GNP/[H*W])$  = output per person-hour worked is very similar in USA & Europe
- $(H/[365*24])*(W/L)$  in Europe is 75% of USA



**Actually, Malaysia and Thailand has been experiencing Growth Stagnation since about 1994.**



**2001: Mahathir Promised Coming of Glorious Decade, 7.5% Growth**

**Optimism in 2001 Upon Recovery from the Asian Financial Crisis**

	GDP (percent)	source of growth (in percentage points)		
		labor	capital	TFP
1971-1990	6.7	2.4	3.4	0.9
1991-2000	7.0	1.7	3.5	1.8
2001-2010	7.5	1.6	2.7	3.2

	investment as percent of GDP		
	<u>total</u>	<u>private</u>	<u>public</u>
1990	33.0	21.9	11.2
1998	25.8	14.4	11.4
2000	25.7	12.6	13.0
2010	28.7	21.4	7.3

Data are from The 3rd Outline Perspective Plan, 2001-2010 (2001) and the Midterm Review of the 7th Malaysian Plan (1999?)

**The growth slowdown in 2001-2010  
occurred *before* the 2008-2009 Global  
Financial Crisis (average GDP growth rate  
in period, %)**

	8th Malaysian Plan: actual	9th Malaysian Plan: actual
<u>1987-1997</u>	<u>2001-2005</u>	<u>2006-2010</u>
9.4	4.5	4.2

**Growth Slowdown is from Collapse in Private Investment**

**Composition of Investment by Ownership in Malaysia**

(actual value of category as % of GDP)

	<u>1990</u>	<u>1995</u>	<u>2000</u>	<u>2005</u>	<u>2010</u>
total investment	33.9	45.7	25.6	20.0	20.2
private investment	21.9	32.7	12.8	8.9	9.5
public investment	12.0	13.0	12.7	11.2	10.7

Data are from 7th, 8th, 9th and 10th Malaysia Plan (MP),  
and 9th Midterm Review (MTR)

### **Bath Tub Analogy of Malaysian Growth Engine**

1. Level of water in tub is level of investment rate.
2. Capital flight and brain drain are the two leaks at bottom of tub created by mis-governance.
3. Water inflow from 2 faucets: FDI and Oil Revenue. Before 2001, inflow larger than leaks, so Malaysia boomed
4. FDI slowed down since 2001 → lower growth → lower state revenue → UMNO has lower amount of patronage power → unraveling of the usual politics
5. Oil revenue down → GLC investment down
6. FDI decline from (a) China's WTO membership (b) no more cheap labor (c) post 9-11 global Islam-phobia (d) deterioration in governance

**Can China Avoid a Malaysia-Type Malaise?**



### **During Administration of Hu Jintao and Wen Jiabao, 2003-2013**

- Strengthening of State Capitalism at the Expense of Private Sector (decline in economic dynamism)
- Worsening of Social Exclusion (decline in social harmony)

### **Risto Herrala & Yandong Jia, 2015, "Toward State Capitalism in China," *Asian Economic Papers***

- Analysed the "credit availability of listed firms in China between 2003 and 2011."
- Found "that favoritism of state-owned firms in access to credit grew continuously more pronounced until at least 2011, that is, even after the accommodative policies in response to the first phase of the 2008–09 global financial crisis had abated."
- **Hypothesized "that political influence on banks' credit policies contributed to an increase in economic growth in the short run above its long-run potential, ... [explaining why growth] remained resilient even during episodes of significant international economic headwinds."**

**Wang & Woo (2011) "The Size and Distribution of Hidden Household Income in China," *Asian Economic Papers***

Category	% of urban residents	Official income (RMB)	"True" income (RMB)	Distribution of hidden income (%)
Lowest income	10	4,754	5,350	0.4
Low income	10	7,363	7,430	0.0
Lower middle income	20	10,196	11,970	2.3
Middle income	20	13,984	17,900	5.1
Upper middle income	20	19,254	27,560	10.9
High income	10	26,250	54,900	18.8
Highest income	10	43,614	139,000	62.5
<i>All urban dwellers</i>	<i>100</i>	<i>16,885</i>	<i>32,154</i>	<i>100.0</i>

**Some Policy Measures for China**

### **Sustainable growth through reforms not through macro-stimulus or export**

- **Financial market reform**
  - more loans to small and medium enterprises
- **Land policy reform**
  - privatize rural land
- **Hukou reform**
  - promote urbanization process (which enhances human resource development of rural residents)
- **Strengthen the Rule of Law**
  - fight corruption & increase judiciary independence
- **Improve governance through greater accountability, transparency, and monitoring**
  - more use of elections & more media freedom

### **One Additional Policy Dimension for BIG-Country China**

- Growth management for China is more than fixing **domestic hardware problems** (“get the prices right” & “get the macro-balances right”), and fixing **domestic software problems** (“get the institutions right”)
- China also has to help fix **global infrastructure problems** because its internal developments and external actions affect global parameters
  - Need to manage economic spillovers (e.g. trade)
  - Need to consider global sustainability (e.g. US-style urbanization is globally unsustainable)
  - Need to supply global public goods (e.g. AIIB)
- **China’s perception of its problems has to go beyond Harmonious Society to Harmonious World**

## Some Policy Measures for Malaysia

### Ending Growth Stagnation in Malaysia

- **Replace race-based socio-economic policies** with need-based policies and merit-based practices in order to increase domestic private investment, to reduce brain drain, and to strengthen tertiary education
- **Free the markets** to improve national competitiveness, e.g.
  - Make domestic monopolies face import competition by joining free trade areas like TPP
  - Reduce state participation in businesses e.g. stop buying over successful Chinese-owned real estate companies
- **Decentralise administrative governance** to empower local governments to undertake local growth initiatives, and to fund local infrastructure
- **Upgrade administrative performance** by increasing accountability and monitoring of policymakers; and by improving the legal system

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