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\*In a [speech I made in January](#) this year I spoke of where we stand in our developmental path and what I felt we must do to move forward.

## **Revisiting the middle income trap**

I would like to revisit the argument of that speech to develop it further.

We are stagnating. The signs of a low growth economy are all around us. Wages are stagnant and the cost of living is rising.

We have not made much progress in becoming a knowledge and services based economy.

According to the World Bank, Malaysia's share of GDP contributed by services was 46.2% in 1987. Ten years later, that share had grown by a mere 0.2%

Between 1994 and 2007, real wages grew by 2.6% in the domestic sector and by 2.8% in the export sector, which is to say, they were flat over that thirteen year period.

Meanwhile our talent scenario is an example of perverse selection at its most ruinous. We are failing to retain our own young talent, people like yourselves, let alone attract international talent

to relocate here, while we have had a massive influx of unskilled foreign labour. They now make up 30-40% of our workforce. Meanwhile, alone in East Asia, the number of expatriate professionals here has decreased. Alone in East Asia, private sector wage increases follow government sector increases, instead of the other way around. We are losing doctors and scientists and have become Southeast Asia's haven for low cost labour.

I said that we are in a middle income trap, stuck in the pattern of easy growth from low-value-added manufacture and component assembly and unable to make the leap to a knowledge-intensive economy. Regional competitors with larger, cheaper and dare I say, hungrier labour forces have emerged. China and India have risen as both lower cost and higher technology producers, and with giant domestic markets. The manufacturing sector which propelled the growth we enjoyed in the nineties is being hollowed out. There is no going back, there is no staying where we are, and we do not have a map for the way forward.

I am glad that the characterisation of Malaysia as being in a 'middle-income-trap' has been taken up by the government, and that the need for an economic story, or strategy, for Malaysia is now recognized. We stand in particular need of such a model because we are a smallish economy. We cannot be good at everything, and we don't have to be.

We need only make some reasonable bets in identifying and developing a focussed set of growth drivers. It is not difficult to see what the elements of such a growth strategy might be. Whatever we come up with should build on our natural strengths, and our strengths include the following:

We are located at the crossroads of Asia, geographically and culturally, sitting alongside the most important oil route in the world.

a) We have large Muslim, Chinese and Indian populations that connect us to the three fastest growing places in the world today.

b) We have some of the largest and oldest rainforests in the world, a treasure house of bio-diversity when the greatest threat facing mankind as a whole now is ecological destruction and the greatest technological advances are likely to come from bioscience.

c) We have the English language, a common law system, parliamentary democracy, good schools, an independent civil service and good infrastructure.

These advantages, however, are declining ones. Our cultural diversity is in danger of coming apart in bigotry, our rainforests are being logged out and planted over, our social and political institutions are decaying.

I have spoken at length on different occasions about the causes and consequences of institutional decline. The decline in our society and indeed in our natural environment, originates in a decline in our basic institutions. The link between these is corruption. The destruction of our ecosystem for example, is made possible by corrupt officials and business-people. The uncontrolled influx of unskilled labour is a direct result of corruption.

## **Dependencies and the young**

These are problems we need to be aware of before we speak glibly about coming up with new strategies and new economic models. We need to understand where we are, and how we have gone wrong, before we can set things right.

You are young, well educated Malaysians. Many among you have left for other shores. Record numbers of Malaysians, of all races, work abroad or have migrated. Among these are some of our best people. They sense the stagnation I described. There is a certain lack of energy, ingenuity and “hunger” in the climate of this country that young people are most sensitive to. In the globalized job market, young people instinctively leave the less stimulating and creative environments for those that have a spark to them.

How did we lose our spark as a nation?

We have a political economy marked by dependence on easy options and easy wealth. Like personal dependencies, these bad habits provide temporary comfort but discourage the growth of creativity and resilience.

I mentioned our dependence on low cost foreign labour.

The other dependence is something I played a part in making possible. This is a story I want to leave you with to ponder in your deliberations today.

## **Blessing and curse**

Our nation is blessed with a modest quantity of oil reserves. As a young nation coming to terms with this natural bounty in the early 1970's, our primary thought was to conserve that oil. That is why, when Petronas was formed, we instituted the Petroleum Development Council. Its function was to advise the PM on how to conserve that oil and use it judiciously for national development. We knew our reserves would not last long.

We saw our oil reserves as an unearned bounty that would provide the money for modernization and technology. We saw our oil within a developmental perspective. Our struggle then, was to make the leap from an economy based on commodities and low cost assembly and manufacture to a more diverse, economy based on high income jobs.

Aware that we had an insufficient tax base to make the capital investments needed to make the leap, we planned to apply oil royalties to what you would call today strategic investments in human capital. whatever money left after making cash payments, allocations for development funds, etc, was to be placed in a Heritage Fund for the future. The Heritage Fund was for education and social enrichment.

In working out the distribution of oil between the states, who had sovereign rights over it, and the Federal government, we were guided by concerns for equity between all Malaysians, a concern to develop the poorer states (who also happened to be the oil rich states) and a concern for inter-generational equity. That oil was for special development purposes and it was not just meant for our generation.

Sabah and Sarawak joined Malaya to form Malaysia because of the promise of development funds. Yet today, despite being their massive resources, they are some of our poorest states.

Instead of being our ace up the sleeve, however, our oil wealth became in effect a swag of

money used to fund the government's operational expenditure, to bail out failing companies, buy arms, build grandiose cities in the middle of nowhere. Instead of helping eradicate poverty in the poorest states, our oil wealth came to be channeled into our political and politically linked class. Instead of being the patrimony of all Malaysians, and for our children, it is used as a giant slush fund that has propped up authoritarian rule, eroded constitutional democracy and corrupted our entire political and business class.

Our oil receipts, instead of being applied in the manner we planned upon the formation of Petronas, that is, according to its original developmental purpose, became a fund for the whims and fancy of whoever ran the country, without any accountability.

The oil that was meant to spur our transition to a more humane, educated society has instead become a narcotic that provides economic quick fixes and hollow symbols such as the Petronas Towers. Our oil wealth was meant to help us foster Malaysians capable of building the Twin Towers than hire foreigners to build them, a practice in which we preceded Dubai. I would rather have good government than grand government buildings filled with a demoralized civil service.

It is no wonder that we are no longer productive, no longer using our ingenuity to devise ways to improve ourselves and leap forward.

Malaysia is now an “[oil curse](#)” country.\*\*



When I started Petronas in 1974, I did not realize I would see the day when I would wish we had not uncovered such bounty.

The story I have told is a reminder of the scale of the challenge of development. My generation of young people faced this challenge in the 1960's and 70's. You face it now. The story tells us that development is about far more than picking strategies out of a box.

You have kindly invited me to address a seminar on strategies for reinventing and liberalizing Malaysia's economy. But the story of our squandered oil wealth reminds us that it was not for want of resources or strategies that we floundered. Our failure has been political and moral. We have allowed greed and resentment to drive our politics and looked the other way or even gone along while public assets have been stolen in broad daylight.

I encourage you to take up the cause of national development with the ingenuity that earlier generations of Malaysians brought to this task, but the beginning of our journey must be a return to the basics of public life: the rule of law, honesty, truth-telling and the keeping of promises.

The Malaysia we need to recover is one that was founded on laws and led with integrity. With the hindsight of history we know such things are fragile and can be overturned in one generation, forgotten the next. Without a living foundation in the basics you might sense an air of unreality around our talk of reinventing ourselves, coming up with a new economic model, and liberalizing our economy.

So before we can reinvent ourselves we need to recover our nation. That larger community, bound by laws, democratic and constitutional, is the context of economic progress, it is the context in which young people find hope, think generous thoughts and create tomorrow.

**NOTE:**

**\*Opening speech at**

**THE 1ST YOUNG CORPORATE MALAYSIANS SUMMIT**

*“Reinventing and liberalising malaysia’s economy: strategy and directions”*

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### **\*\*The resource curse thesis**

The idea that natural resources might be more an economic curse than a blessing began to emerge in the 1980s. In this light, the term resource curse thesis was first used by Richard Auty in 1993 to describe how countries rich in natural resources were unable to use that wealth to boost their economies and how, counter-intuitively, these countries had lower economic growth than countries without an abundance of natural resources. Numerous studies, including one by Jeffrey Sachs and Andrew Warner, have shown a link between natural resource abundance and poor economic growth. This disconnect between natural resource wealth and economic growth can be seen by looking at an example from the petroleum-producing countries. From 1965-1998, in the OPEC countries, gross national product per capita growth decreased on average by 1.3%, while in the rest of the developing world, per capita growth was on average 2.2%. Some argue that financial flows from foreign aid can provoke effects that are similar to the resource curse.

(Wikipedia: “ [Resource curse](#) ”)