Fifty Years of Malaysian Economic Development:Policies and Achievements

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Abstract: Malaysia is a small country with big achievements in economic development to its credit. In August of this year (2007) the country celebrates completion of the first 50 years of its independence. It is *fitting* that we look at its economic achievements over the past decades and the policies that shaped that success, particularly as many people regard Malaysia as a role model for developing countries, notably other OIC members. This paper attempts to highlight the major achievements and the policies that enabled them; about the long-term vision of the social order the economic effort was intended to establish; the form and speed of transformation the policies ushered in; the model of growth Malaysia chose; the measures it took to encourage equity; the way it managed crises; and the Islamic elements that it always sought to incorporate into its plans.

I. Introduction

Economic development has been one of the main *raisons d'être* of collective organization for most societies throughout history. The subject acquired particular prominence only after the Second World War when vast tracts of the globe won their freedom from colonial rule. The national leadership of the newly independent countries had a compelling duty to liberate their masses from centuries of poverty, deprivation, ignorance, and resignation, if political freedom had to have any meaning. Liberty had ignited the expectations of the people: foreigners were no longer responsible for

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their plight. Action had to be taken. The case of Malaysia, which became independent in 1957, was no different. The country had some teething problems and was hardly able to settle down for the march to economic development until 1970.[1]

Malaysia is a relatively small country with an area of 330,000 square kilometres and a population estimated in 2006 at 26.64 million. But this small country has to its credit some big achievements in the field of economic development. The country has just celebrated its fiftieth independence anniversary. It is perhaps appropriate that we look at its success story and the policies that have made it a role model for developing economies.

Starting as a low-income country in 1957, it has briskly climbed the ladder into the upper middle-income class. Its per capita income at constant prices rose from US$ 306 in 1965 through US$ 1810 in 1987 and US$ 4493 in 1996 to stand at US$ 5120 in 2004.[2] Indeed, the progress of the country has been hailed as miraculous in terms of speed and span. In 2004 the Malaysian economy occupied, in terms of size, 37th position in the world with GNP worth US$ 112.6 billion. The per capita income as noted above for the same year was ranked at 79.[3] This paper takes a brief look at the contours of its economic transformation and the major policies shaping its success story.

Instead of presenting developments in a chronological sequence, as is often done, this paper focuses on some important landmarks.[4] The next section presents the basic framework of economic thinking in the country. Section 3 then sketches the transformation process of the economy from dependence on the primary products in agriculture and mining to sprawling industries and services. In Section 4 we elaborate a little on the vision of the future taking shape in view of the confidence-building achievements over the years. Section 5 examines the use of capital controls that Malaysia resorted to as a major departure in policy from the common practice of approaching the International Monetary Fund (IMF) for financial assistance. A unique feature of economic development in Malaysia has been the liberal incorporation of Islamic norms in its programmes, especially in the area of Islamic finance. Section 6 presents the main trends and policies in this field. Finally, we wind up the discussion in section 7 with a few concluding remarks.

II. Policy Overview

Geographical location, an abundance of natural resources, a small population with low density, a work-friendly climate, and a plural social order were the initial advantages the country enjoyed. However, there was a lack of capital, and a shortage of both skilled and unskilled manpower. The size of the domestic market was too small to warrant industrialization. Expediency demanded that the country evolve a policy design that could cash in on its strengths and convert its deficiencies into advantages keeping at the same time her options flexible. The broad contours of policy that emerged over the years were as follows.

Central planning has been a major factor in shaping the economic destiny of Malaysia. Public financing was often used to stimulate the economy.[5] Planning has been instrumental in achieving social goals like the redistribution of wealth, and the provision of major public utilities. The transformation process adopted an open economy model, choosing trade as its engine of growth. The country provided infrastructural facilities, tax concessions, and remittance freedom to attract foreign capital. It rapidly expanded education and training opportunities for its citizens, at the same time bringing in a large number of foreign workers of various types to fill the gaps. It ensured an efficient coordination of sectors and kept operations almost friction-free. The hurdles and crises that came along the way were well managed. The leadership had a long-term vision for development from the very start, though it assumed explicit form and prominence much later under the name Vision 2020. We shall have a look at some aspects of Vision 2020 a little later. Presently, let us explain what policies brought about a radical transformation of the economy.

III. The Transformation

Malaysia started its economic journey with dependence on rubber, tin and palm oil. These three commodities along with other raw materials had already set the economic tempo prior to the country's independence. But the prices had over time become increasingly volatile, putting the economy at the mercy of fluctuations in their export value. Diversification was needed and became the national top priority. The raising of new crops for export, including pepper, cocoa and pineapple, was encouraged (Ariff, 1998). Eventually, the country decided during the seventies to shift dependence from the primary sector to manufacturing under a protection regimen. Foreign assistance from Japan and the West eased and hastened the process of transformation. Exports of manufactured goods were soon fuelling the country's growth.

Table 1 records the speed of the transformation. The GDP underwent a sea of change in its composition. The share of the primary sector declined progressively from 42.7% in 1970 to a mere 14.6% in 2006. The industrial and services sectors both expanded but the share of the services grew faster relative to that of manufacturing and construction.

Table 1: Sector contribution to GDP (%)

Sectors	1970	1980	1990	2000	2006*
Agriculture 1	29.0	22.9	18.7	8.6	8.3
Mining 2	13.7	10.1	9.7	7.5	6.5
Primary 1+2	42.7	33.0	28.4	16.1	14.6
Manufacturing 3	13.9	19.6	27.0	32.3	31.9
Construction 4	3.8	4.6	3.5	3.3	2.6
Secondary 3+4	17..7	24.2	30.5	35.6	34.5
Services: 5	36.2	40.0	42.3	53.6	58.7
Others* 6	3.4	2.8	-1.2	-5.3	-7.8
Tertiary 5+6	39.6	42.8	41.1	58.3	43.6

Source: Based on information in Bank Negara Annual Reports.
Note: '*' Denotes Provisional.

However, the declining share of agriculture in the GDP should not be understood to mean that this vital sector of the economy was being neglected. Rising food prices, dependence on imports for even chickenfeed, an increasing demand for palm oil and natural rubber abroad led to the creation of a special fund for agricultural development at the centre in 1993; all states were also directed to have agro-tourism parks (Hasan, 1993).

The country is now in the third phase of the National Agricultural Policy (NAP 3), which sets its direction to the agro-year 2010. It centres on new approaches to forge linkages between agriculture with other sectors, ventures into unexplored areas, and searches for sustainable bases for progress. It aims at enhancing food security, increasing productivity, and improving the competitiveness of the sector. It seeks to restrict the use of natural resources in order to conserve them for the long term. The contribution of the sector to Malaysian exports is on the rise. Illustrative of the policy impact is the fact that the sector grew at 2.1% in 2005 and at 6.4% in 2006. Employment in the sector went up by 11.6% during the period 2001–2006.[6]

The transition needed both capital and technology in which Malaysia was lacking. The fact that the country was not constrained by any structures already in place gave her the freedom to choose her industrialization strategy. It could and did allow foreigners to establish production units in any field and take advantage of the facilities and concessions offered, provided such production was in the national interest. The policy helped cover the twin deficiency of capital and technical know-how. Malaysia gave the incoming multinationals a competitive edge over their rivals the world over. The circumstances of the country must mitigate in a measure the criticism that the industrial structure lacked diversification, having only a few industries (electronics and electrical goods plus textiles), which moreover dependent on imports.

The government did try to create a balance in the structure. It launched a programme to establish heavy industries in the early 1980s with the incorporation of the Heavy Industries Corporation of Malaysia. The first Industrial Master Plan (1985-1995) was aimed at providing an impetus to the process. However, the programme ran into difficulty due to high costs, large debts, a market glut, and excess capacity. But the fact that the programme was in the public sector may not necessarily have been, as some have argued, the source of trouble.

It should be mentioned that heavy industries inherently have high overhead costs, longer gestation periods, need considerable domestic demand for profitability and require high levels of skills in production and management. Private investors often do not have the necessary resources for the projects or are unwilling to take the risks involved and wait until things turn around for the better. Public sector enterprises must eventually pay their way but profitability alone does not make them efficacious; their social spillages cannot be ignored. The government was quick to promote privatization of inefficient public sector enterprises and the resources thus released helped spur growth. In any case the national car project and the petroleum industry have thrived in the public sector. Pragmatism in policy-making brought about a rapid transformation of the economy.

Achievements in trade, industry and commerce that the economy has registered would not have been possible without a simultaneous expansion of the services sector. This covers a wide range of activities and touches life at many points; our very step outside the house is on the road. Assured supply of power in homes, offices and factories makes life smooth and comfortable. Services, unlike goods, are not visible or storable; yet they play a pivotal role in the smooth development of a country.[7] Malaysia spent colossal amounts on the construction and maintenance of roads, expressways, airports, railways, electricity generation, the oil and gas industry,[8] housing, education and health care. Some spectacular projects in more recent years included Kuala Lumpur International Airport (*KLIA*), Bakun Dam, the Petronas

Twin Towers, the development of a new administrative district, and the Multimedia Super Corridor. Several other projects, even more ambitious, were shelved.

All this led to the rising capital-output ratios in the economy. The phenomenon was seized upon by critics as evidence of growing inefficiency in public enterprises. The charge was unproven. Such projects involve heavy investment in overheads and have long gestation periods of five to seven years to break even. The rising capital-output ratios must be taken with a grain of salt: mega projects are futuristic. The increasing traffic now tends to make, for instance, both *KLIA* and *LRT* look crowded at peak hours.

IV. Vision 2020

Even though developing countries have had diverse approaches to development, they invariably had a desire lurking in their heart to *catch up* with the West in terms of living standards and life-styles. May be, Vision 2020 ushered in during 1990 took its inspiration, content and direction from that desire: it has since inspired the course of developmental efforts in the country.

Table 2: Some Key Indicators of Malaysian economy

Years	Real GDP Growth Rate %	Rate of Inflation %	(Export + Import) / GDP	Export -Import Ratio
1	2	3	4	5
1990	9.8	2.9	1.25	1.10
1991	8.7	4.1	1.34	1.14
1992	7.8	4.4	1.28	1.10
1993	8.1	3.9	1.33	1.07
1994	9.2	3.7	1.85	0.98
1995	9.5	3.4	1.95	0.96
1996	8.6	3.5	1.83	1.01
1997	7.8	2.7	1.86	1.12
1998	-7.5	5.3	2.09	1.23
1999	5.8	2.8	2.18	1.26
2000	8.3	1.6	2.35	1.12
2001	7.0	1.4	2.14	1.19
2002	0.4	1.8	2.11	1.19
2003	5.4	1.2	2.10	1.23
2004	7.1	1.4	2.21	1.21
2005	5.2	3.5	2.23	1.24
2006	5.9	3.6	2.28	1.24
Mean 1990-97	8.7	3.6	1.58	1.06
Mean 1999-06	5.6	2.2	1.93	1.21

Source: Construction based on data available in Bank Negara publications.

The Malaysian planning process has met with great success over the decades. The economy registered GDP growth rates of around 9.5% per annum in the mid-nineties. Inflation was kept low, saving and investment rates ran high (Table 3) and exports were buoyant. The trade-to-GDP ratio climbed up continually, being 2.28 in 2006. The export-to-import ratio too mostly remained at more than 1 (Table 2). This is both the effect and the evidence of Malaysia's open-door economic policy and trade-led development. The approach brought in handsome dividends. The country had become among the top sixteen trading nations of the world by 1992 with foreign currency reserves sitting pretty at US$20 billion. The economy had shown remarkable capacity to absorb the increasing inflows of foreign capital closing up the financial resource gap, while the debt-servicing ratios had been falling. The success prompted a bolder socio-economic vision to direct the future course of development. This found a precise shape in 1990 in the publication of the Vision 2020 document. In broad terms, the Vision is aimed at raising the status of the country to that of a developed nation by that year. The objective has since often been reiterated to keep it in the forefront of national aspirations.[9]

Table 1 presents some of the key variables over the 1990-2005 span indicating the rapid strides the country has made on various fronts on the development road. The Table, in fact, records the culmination of a multidimensional effort to develop over the decades, focusing mainly on infrastructural and human resource expansion.[10] It shows how rapid and sustained the achievements of the country have been. It is significant that the crisis year 1998 marks the performance watershed, which the last two rows at the bottom of the Table palpably show. It may be mentioned that the country had faced an economic crisis in 1985 as well in her long development journey, but the 1998 turmoil was very different in terms of intensity, causes, repercussions and remedial measures used. We shall turn to this policy issue later.

The urge and anxiety for economic well-being in the emerging countries mentioned earlier could not rely on market forces to speed up development.[11] Various degrees and shades of central state planning authorities became the order of the day, bifurcating economies into private and public sectors with distinct and specified spheres of action and responsibility. The nature of ideological perspectives, rigidity of controls imposed, chaotic foreign relations, lack of infrastructural facilities, and rising corruption led *inter alia* to the poor performance of planning in many countries – big and small – with some exceptions, including Malaysia. The broad objective of planning effort in the 1950s and 1960s was to focus essentially on growth.[12] Up to the mid-seventies, developing countries, as a group, averaged in their GNP growth at 5.5% per annum compared to 4.9% in the developed world.[13] In contrast, Malaysia registered an average growth rate of about 8% a year over the period 1970–1975.

Given its broad objective, the Vision gave to planning in Malaysia a different orientation for growth. The dominant elements it incorporated into the development plans referred to earlier include the spread of modern knowledge, improved institutions and attitudes, rational policy formulation, environmental care, and preservation of the socio-cultural heritage. It is the incorporation of these elements that made Malaysian achievements distinct even astonishing.[14] Table 1 carries in some measure the imprints of the visionary approach.

However, the notion of a fully developed nation in the Vision need not be overdone. It sees that status as having been achieved in concrete terms provided the per capita income target of US$ 10,000 for the country is realized. I had in 1998 demonstrated using a simple geometric growth model incorporating the relevant variables that the target was realistic and could be easily realized provided the underlying assumptions of the Vision were not much disturbed (Hasan, 1998). Even after the 1997–1998 financial crisis the incorporation of the changed values of variables in the model reveals that the earlier conclusions remained valid and the current trend of *Ringgit* appreciating against the US dollar gives credence to it.[15]

But here a note of realism is needed. Even as Malaysia is most likely to have a per capita income of US$ 10,000 by 2020 – it has already covered more than half the distance[16] – the country will not enter the World Bank category of *High income or developed countries* in the near future as the World Bank on average raises the income limit for being in the group by 4.3% each year (Hasan, 1998). This limit has already crossed the US$ 25,000 mark.

V. Capital Controls

The course of business, like the weather, seldom runs smooth. Financial crises, big or small, have always been a characteristic feature of free enterprise economies as business expectations are essentially unpredictable. The 1997–1998 crises the South East Asian countries experienced probably had an overdose of fear factor. For it was essentially the result of massive flights of short-term portfolio investment from the region. Originating in

Thailand, the crisis struck one country after another in rapid succession. Malaysia was among its later victims. The turmoil could hardly have been foreseen, still less pre-empted (see: Hasan, 2001-2002; 2002 and 2003).

Table 3: Saving and Investment Ratios

Years	Domestic Investment % of GNP	Domestic Savings % of GNP	Balance on current a/c % of GNP	Ratio of private to Public Investment	Private Savings-Investment Ratio:
1	2	3	4	5	6
1990	33.8	31.6	-2.2	1.96	NA
1991	39.8	30.7	-9.1	1.95	NA
1992	37.4	33.4	-4.0	1.56	NA
1993	41.2	36.3	-4.9	1.78	NA
1994	42.5	34.4	-8.1	2.10	0.55
1995	45.7	35.3	-10.4	2.42	0.66
1996	43.3	38.9	-4.6	2.79	0.68
1997	45.5	39.1	-6.3	2.82	0.61
1999	23.9	41.2	17.1	0.93	1.96
2000	29.4	39.9	10.3	1.00	1.42
2001	25.9	34.9	9.0	0.71	1.74
2002	25.8	34.8	9.0	0.54	2.12
2003	22.9	36.5	13.6	0.52	2.69
2004	24.1	37.3	13.3	0.72	1.71
2005	20.9	37.0	16.1	0.79	2.36
2006	21.0	38.1	17.3	0.84	1.40
Mean 1990-97	41.2	35..0	-6.2	2.17	0.63*
Mean 1999-06	24.0	37.5	13.2	0.76	1.93

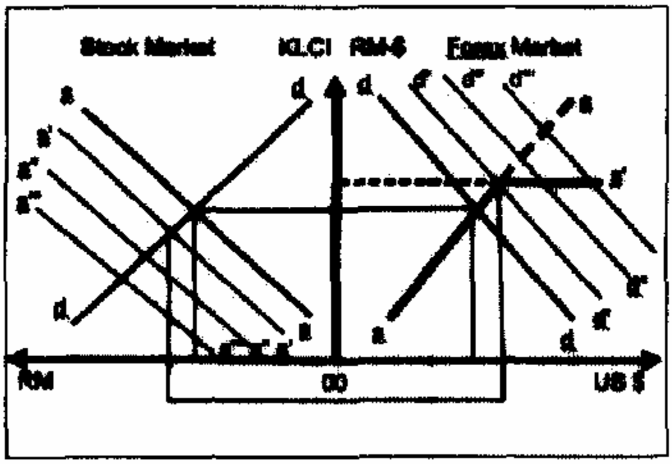
Source: Construction based on data available in Bank Negara publications.
Note: '*': *Average for four years 1994-1997*

The crisis began unfolding with an abrupt fall in the Kuala Lumpur Composite Index (*KLCI*) on July 29, 1997 while the *Ringgit* recorded depreciation on the exchange market, both trends gaining pace by the following week. One could see the economy rolling down the hill unstoppably. During the 63 weeks – July 1997 to September 8, 1998 – the stock market fell by 68.65% and the domestic currency lost no less than 37% of its value in dollar terms. The nexus between the two markets was: sell the stocks at the

KLSE and with the money so released buy in the foreign exchange market the dollars to be taken out. The increased supply of shares relative to demand in the stock market brought the KLCI down, while the rising demand for the dollar in the exchange market sent its price up in local currency, resulting in depreciation of the *Ringgit*. Figure 1 explains the nexus between the two markets. During the two years, 1997 and 1998, short-term capital worth US$ 33 billion left the country. The economy registered a negative rate of growth of -7.5% in 1998.

The literature on the subject – and it is quite voluminous – mostly does not deny this market interaction but is divided on two vital issues: First, what was essentially responsible for the crisis: internal weaknesses of the economy or foreign speculators? Second, was the remedy of controls that the country employed to get out of the crisis appropriate and did it serve the long term national interest?

Figure 1: Stock – Foreign Exchange Market Interaction



On these issues the economists on the national circuit mostly adopted a very critical stance. They argued that the crisis was basically home grown, a culmination of what the government policies pursued over the years had continually been ignoring: the large-scale and persistent financing of long-term projects with short-term external borrowings. The overheating of the economy created a bubble, especially in the property sector, that was bound to burst sooner than later. This being the source of trouble, it was naïve, in their opinion, to blame external forces for the trouble. At most these forces may have *triggered* the fire, the straw being already there (Ariff, 2002). Capital controls and the pegging of the currency to the US dollar the central bank resorted to as remedial measures were not advisable. Malaysia was sending the wrong signal to foreign investors. They would shy away from the country and her long-term economic development would suffer (Mohammad, 2002). This part of their argument did not offer an alternative solution. But by implication they seemed inclined to seek IMF help as the cure.

It was difficult to go with this thesis. Put briefly, the argument is as follows. The crisis – like all crises – was inherently a *short-term* event. It could not be determined by distant happenings. The past is water over the dam. Around the crisis, Malaysian economic fundamentals were by no means fragile. Even in the year 1997 the economy grew at 7.8%, inflation stayed low at 2.7%, trade-GDP ratio was 1.86 and exports exceeded imports by 12%. External debt never exceeded 64% of the GNP in the years preceding the crisis. It was for most of the time well-covered by foreign reserves. The debt-service ratio to export earnings too did not cross 6.7% during the period (see: *Bank Negara Annual Report*, 2000: 5, Table A. 21). Also, note that it was high domestic savings that have of late been the *main* source of financing development in Malaysia. The investment–savings gap was of course negative and rising before the crisis year but it was not alarming. It was just – 6.3% of GNP even in 1997 on the eve of the turmoil (See Table 4).

Table 4: Savings and Investment as % of GNP in Malaysia

	1996	*1997*	*1998*	*1999*	*2000*
Gross Domestic Capital Formation	43.5	45.5	28.1	23.9	29.4
Gross National Savings	38.9	39.1	42.0	41.1	39.5
Balance on Current Account	-4.6	-6.3	12.9	17.1	10.0

Source: Bank Negara Malaysia Annual Report 2000.

Again, prior to the crisis, the economy was being run increasingly by private enterprise. The private to public investment ratio rose from 1.96 in 1990 to 2.52 in 1997 (Table 3). If and to the extent the internal forces were responsible for the trouble, as the critics put it, who must one blame – the private sector or the public authorities? Is it not bizarre that when a developing economy is flourishing the economists sing praises for private enterprise but should there be an adversity they pick up the stick to beat the public authorities? Responsible behaviour is surely equally important for both.

If it was not the internal weaknesses of the economy, what else then brought about the turmoil? Public authorities believed that the currency was attacked by foreign fund managers. This sounds like a sensible view, and many argued it. There is a well researched contention in the literature that currency speculators played a leading role in the 1997–1998 financial crises. Unbridled speculation was fuelled by panic among the traders; contagion was the transmission line linking nations. Malaysia was essentially the victim of *contagion* (IMF, 2001).

It was a bit surprising when the critics dubbed the use of controls to meet the upheaval as unorthodox and innovative,[17] when the monetary history of the world is full of examples of all sorts of countries using this measure, the developed and the developing.[18] In any case, the measure worked. Malaysia recovered faster and unscathed compared with countries like Indonesia and Thailand who relied on IMF assistance. The statement of the former Thai Prime Minister on the point is worth quoting. On the day (July 31, 2003) that his country fully cleared the IMF loan of US$ 14.5 billion as part of a reform package, he vowed in a television broadcast to the nation that the country would never enter into the bail-out-support of the US-based financial institution again (see: *New Straits Times*, August 2, 2003 page B1). Malaysia was able to hold her self-esteem and eventually won praise, even from the IMF, for its reforms including capital controls (IMF, 2001).

To be sure, saying that internal weaknesses of the Malaysian economy were not the primary cause of the 1997–1998 crisis does not mean denying their existence. The crisis put the spotlight on them. The two sections of Table 2 – the first before the 1998 divide and the second after – are indeed revealing. Until 1998 domestic investment was rising fast, domestic savings were lagging behind; the gap between the two was covered by inflows of funds from abroad, the balance on current account remaining negative throughout. The ratio of private to public investment was climbing, demonstrating fast privatization of the economy as globalization required. At the same time, private savings continually fell short of private investment: their ratio remained less than one. All this boils down to one thing: the private sector was expanding fast but living beyond its means, increasing leverage earnings through reckless borrowing abroad. Even though it did not raise the wind it could not remain standing in the storm.

The lessons of the crisis are reflected in what happened to the same variables in the Table after the crisis. The economy started cooling off, investment slowed down, public spending is making up effective demand, domestic savings are increasing, balance of payments growing favourable, and the pace of privatization is restrained. Private savings now more than cover the investment; in fact, excess savings are flowing out for investment abroad. The economy looks stable and tranquil. The last two rows of Table 2 clearly bring out the difference between the two periods.

VI. Social Equalization

The social equalization programme of Malaysia has been one of a kind in the world in the sense that the haves voluntarily agreed to grant economic concessions to the have-nots, a better share of the national cake, in order to reduce poverty and improve distribution. The general goal was promoting societal cohesion. The policy of positive discrimination, as it is sometimes referred to, has of late been hailed as sagacious on the international circuit as well. It was mooted in the wake of the infamous race riots of 1969, rather mildly called 'the May 13 incident'. Positive discrimination took concrete shape in what is now known as the New Economic Policy; (NEP).

Launched in 1971 with a time span of twenty years, the NEP was aimed at alleviating poverty and sought to end the identification of ethnicity with economic classifications: agriculturists, traders, and businessmen. It was designed in particular to improve the economic status of ethnic Malays and other indigenous people collectively designated as *bumiputeras* or '*sons of the soil*' in a local language. The concessions included things like quotas for them in low-cost housing, university placements, corporate equity ownership, and preference in public sector contracts. The time span of the NEP expired in 1991. However, as it was not able to improve the *bumiputera* share in national assets to the targeted levels, discriminatory concessions were retained under the National Development Policy (NDP) programmes.

The poverty alleviation and inequality reduction efforts of the country have met with mixed success.[19] The NEP was intended to lessen inequality with reference to the ethnic groups in the country. In that respect the result, we noted, was not elating. But if the ethnic context is ignored, the effort to reduce overall poverty has been 'steady and impressive', to quote the Asian Development Bank (Report, 2006). For instance, in Peninsular Malaysia the incidence of poverty in terms of the Gini coefficient was 49.3% in 1970 but government programmes succeeded in reducing it progressively from 0.529 in 1976, to 0.446 in 1990. The narrowing of the gap was accounted for by a fall in the share of the top 20% in the GNP combined with an improvement in the share of 40% in the middle and lower income groups.

However, after 1990 the redistribution process took a U-turn: the income gap began to widen. The Gini coefficient started climbing: it rose to 0.459 in 1993, to 0.460 in 1995, and touched 0.524 in 1997 when the financial crisis started. The deterioration was blamed on the slackening of commitment to poverty reduction and the fast pace of economic growth during the period. The argument that fast growth increases income disparities finds support in other writings as well.[20] Notice that after the financial crisis when things normalized and growth relatively slowed down, the Gini coefficient for Malaysia registered a fall to 0.492 in 1999 and to 0.480 in 2002. Renewed efforts are being made to help the weaker sections of the community. These include improving the financial facilities for food security, agriculture, and SMEs (for details, see: see Bank Negara Annual Report 2006:10-16).

VII. Islamic Finance

Malaysia has taken a keen interest in the promotion of Islamic interest-free finance including banking, unit trusts and insurance. Bank Negara Malaysia, the central bank of the country, is committed to promoting and supporting the industry. Innovation and growth are the guiding stars of its policy. It allowed the mainstream commercial banks in 1992 to open 'Islamic windows' to increase competition. It developed assets, established a regulatory framework, accounting standards, and training facilities to provide skilled manpower for the fast expanding sector.[21] An important step has been the establishment of the Islamic Capital Market which has recorded impressive developments in terms of higher issuances of Islamic papers. These developments have enhanced the position of the country as a leading hub for Islamic finance in the world, where Islamic banks operate in 70 countries with a total asset base of over US$ 200 billion growing at an annual rate of 15%.

At the end of 2005 the Islamic financial system in Malaysia consisted of six exclusive Islamic banks, eleven commercial banks operating participatory windows, four merchant banks, seven discount houses, five development finance institutions and one finance company (Bank Negara Annual Report 2005). Deferred payment transactions and mark-ups remain the dominant modes of financing, as Table 6 demonstrates.

Bank Negara aims to raise the market share of the Islamic sector in total finance from 2005, as indicated in Table 6 below. Even as commercial banks can still operate *windows*, they are encouraged to open exclusive branches for Islamic business. Also, there has been more insistence on *Sharīʿah* compliance in transactions. The policy is having the desired impact.

Table 5: Modes of Islamic Financing in Malaysia (% Share)

S. No	Modes of Finance	Years			Mean
		2000	2003	2006	
1	al-Mushārakah	1.4	0.3	0.2	0.63
2	al-Muḍārabah	7.0	-	0.7	3.83
3	al-Istiṣnā'	0.9	0.7	3.9	1.83
4	al-Ijārah	4.3	1.4	4.5	3.40
5	al-Murābaḥah	-	6.4	25.2	15.80
6	al-Bay' Bi-thaman Ājil	48.3	47.6	55.9	50.60
7	al-Ijārah Thumma Al-bay'	22.2	27.9	--	25.05
8	Other Islamic Contracts	15.9	15.8	9.6	13.70
9	Total	100	100	100	-

Source: Bank Negara Malaysia Annual Reports

Table 6: Mixed Versus Exclusive Islamic Banking in Malaysia (% share)

Category of transactions	1999		2002		2005	
	Exclusive	Mixed	Exclusive	Mixed	Exclusive	Mixed
Total Assets	32.4	67.6	29.6	70.4	38.8	53.4
Total Deposits	39.0	61.0	30.8	69.2	42.5	51.0
Total financing	36.7	62.3	24.9	75.1	30.6	67.4

Source: The percentages are based on the data in Bank Negara Annual Reports 2000 (Table 4.14, p.153) and 2002 (Table 4.18 p.156) and 2006

VIII. Concluding Remarks

Malaysia's achievements in the field of economic development have been extraordinary. The process has been both fast and sustained for 50 years. Without appropriate policy design at various stages of the journey and, more than that, without speedy and efficient implementation of the policy, the country could not have achieved what it has in terms of growth, human resource development, infrastructure expansion, diversification, trade and crisis management. Today, Malaysia is among the brightest stars in the development firmament.

Location, richness in natural resources, cheap labour, and a work-friendly environment were Malaysia's initial advantages which she put to good use, especially during the closing decades of the last century. The realization that an open economy model led by trade harmonizes best with the country's circumstances is evidence of the farsightedness and wisdom of Malaysia's leadership. It had an appropriate vision from the very start. Present leaders have already started talking of a vision 'beyond 2020' its first exhibit being the massive Johore project on the anvil. Islamic ethical norms and injunctions have been among the basic policy ingredients of Malaysia – policies for poverty alleviation, wealth redistribution, and promotion of Islamic finance, reflect that commitment.

Today, every country – developed or developing – has to 'go with the flow' of traffic on the globalization road, no matter whether it likes the rules of the game or not; there is no *U*-turn possible. Malaysia chose that path from the very beginning. The country was among the earliest to open its gates to the world for the free flow of men, money, and materials and allowed others to make use of its endowments. This policy encouraged private enterprise not only to be entrepreneurial but to do so in partnership with the public sector in the cause and process of national advancement. In external economic relations Malaysia advocated for and adopted the '*prosper thy neighbour*' attitude. Her business-friendly stance made the country one of the largest recipient of foreign direct investment prior to the 1997–1998 crisis. It was not because of the measures the country adopted to deal with the crisis, but because of the emergence after the crisis of major competitors like India and China after the crisis that Malaysia slipped somewhat in 'the rankings'. The economy is sound and is developing at a calm, steady pace – FDI flows also tend to pick up pace.

Notes

1. In 1948 the territories of Malay Peninsula under the British rule formed the Federation of Malaya. The Federation won its independence from the British in 1957. In 1963 Singapore, Sabah and Sarawak joined the Federation under the name Malaysia. The first several years of the amalgam thus formed were quite turbulent as Indonesia tried to dominate the country. The claims of Philippines on Sabah and the cessation of Singapore from the Federation in 1965 were disquieting events aggravated by the rising mistrust among the various races that eventually culminated in the bloody riots of 1969.
2. The per capita income in 2004 is much reduced due to the depreciation of the domestic currency vis-à-vis the US dollar by about 33%.
3. World Development Indicators 2006, Table 1.1. Per capita income (est..) for 2006 is US$ 5407
4. I prefer to go with those who consider her success as the result of hard work, right policies, and their efficient implementation; not like miracles/God's gift.
5. Look at column 5 of Table 2 carefully after the 1998 financial crisis.

6. Malaysia and Indonesia contribute 89% of palm oil production and have 83% share in its exports. Palm oil exports from Malaysia grew by 25% over the yeas 2001-2006.
7. The country today has 85,000 km. of paved roads including express ways; 1900 km. of railways; 282 km. pipelines carrying oil, gas, and water; 117 airports; 11 sea ports; and the merchant marine fleet consisting of 312 vessels of different sorts. There are eight public universities supplemented by a number of private colleges, most of them having twinning programs with foreign universities. The mean development expenditure on these and other services in million *Ringgits* was as follows: 1970-1980 (2667); 1981-1990 (5,154) and 1991-2000 (14,931)
8. The country has substantial proven reserves of oil and natural gas. It is a net exporter of both and has gained from the current rise in oil prices. This enabled the government to cut subsidies to the industry.
9. Incidentally India too has of late introduced its own version of Vision 2020 to guide its future developmental efforts.,
10. In Human Development Report 2005 Malaysia occupies rank 54.
11. Currently the Ninth Malaysian Plan is in operation.
12. The issue of equitable distribution was put the back burner on the plea that in economies where per capita incomes were agonizingly low, efforts to enforce equity norms would only redistribute poverty. Distributive concerns may wait until the cake assumes some size. Others reposed confidence in the so-called *trickle down theory* that time showed never worked to their dismay.
13. But this could be little cause for elation. The gap between the rich and the poor nations of the world only widened for the simple reason that the calculation base of the former was several fold larger than the latter. For evidence see Hasan (2006: 17, Table 1.2).
14. The growth in per capita income in four decades is recorded in the following table:

Table 3: Growth in GDP per capita (%)

	1960s	1970s	1980s	1990s
Average for the decade	3.1	5.8	3.6	5.9

15. Notice that within a year since Malaysia detached the *Ringgit* from the US$ in late 2005, it has appreciated against the dollar already by around 10% (June 1, 2007) and the climb continues unabated.
16. To be specific, from US $304 in 1965 Malaysian per capita income rose through US$ 1810 in 1987 to US$ 4,465 in 1996. The financial crisis reduced the dollar value of the *Ringgit* by about 1/3. Despite that, the exchange rate per capita income of the country is estimated in the World Development Indicators is about US$ 5120 for 2006
17. The action was not so uncommon. In fact I had unfolded the basic elements of the regimen of controls scheme the government announced in September 1998 during a seminar in late June that year at the International Islamic University. To me, the commotion imposition of controls caused was ill-informed.
18. India had, for example, had put in place a Capital Controls order in 1949. I am not aware if it has been repealed.
19. For a neat and well documented analysis see Azlina bt. Haneef (2007). Azlina is presently a PhD student in Economics at the IIUM. She wrote this paper as an assignment she picked up in January for writing in my Islamic Economics class. The use of information from her work in this section is gratefully acknowledged.
20. See, for example, Hasan (1998) Supra n.11: He argues citing the case of Malaysia that in a competitive fast race the weak are bound to be left behind; income disparities increase.

21. The bank has established the International Centre for Education and Islamic Finance (INCEIF) which has become operational since March 2006 with an endowment fund of RM 500 million. This is an investment in human resource development which is vital for putting the Islamic financial services on a sound footing.

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