The Role of Government and Governance in Economic Development: The Malaysian Experience

Prof. Mohd. Yusof Kasim
Dr. Kasim Hj. Md. Mansur
Dullah Hj. Mulok
Universiti Malaysia Sabah

Abstract

This paper examines the role of government and governance in economic development in Malaysia. Malaysia represents a developing country that has successfully achieves an impressive and sustained rate of economic growth in the last thirty years. The study focuses on the impact of government and governance economic programs and policies on various sectors over time. Specifically, it examines the relationship between government policies and economic performance in Malaysia since independence in 1957. It seeks to answer and analyze to what extend, and how the Malaysian economy has successfully met the challenges of the economic scenarios, including more recently, the Asian crises and the most widely spoken of globalization. The contributions of this study, which consists of a comprehensive analysis of the role of government and governance in promoting economic development, are multifaceted. They include how government and good governance affected the economy through its fiscal and monetary policies. It also contains review of the many developmental lessons derived from the Malaysian experience.

Introduction.

This paper deals with the role of government and governance in economic development of Malaysia, during the period of 1957 to 2000. Specifically, it will be demonstrated that in the past decades, Malaysia has had very strong and rapid economic development. Three decades ago this country was a resource-based economy, exporting tin, palm oil, and rubber among other commodities. Her per capita income was about the same as Guatemala's. By the mid- 1990's Malaysia had become an economic "powerhouse". The country has developed major export industries in electronics, textiles, shoe manufacturing. These industries have helped generate very rapid rates of growth.

Objective of this paper

The main objective of this paper is to examine the role of government and governance in economic development in Malaysia. The primary focus will be on the government's economic policies and programs in various sectors, and its impact on the national development of Malaysia. This paper will scrutinize the effectiveness of achieving the main government objective that was designed to promote economic growth, eradicate poverty and redirect economic imbalances from primarily foreign hands into *Bumiputera* (son of the soil) hands. As one of the main economic development agencies of the

Malaysian government, the National Development Policy (NDP) plays a major role in government budgeting, as well as in devising national economic development plans, stabilizing consumer prices, etc. Thus the NDP's role is very important to the Malaysian government in restructuring the economic development of the country. A single theory or economic perspective cannot explain the performance of Malaysian economy. There for it is necessary to emphasize the role of the government and governance in understanding Malaysian economic Development.

Economic Development – Definition

The word "development" means using the productive resources of society to improve the living conditions of the poorest people. In a broader term, "development" means improvement in a complex of linked natural, economic, social, cultural, and political conditions (see Peet, Richard 1999). The term "Economic Development" is used to describe the concepts that include economic growth. It also refers to the on-going process of creating wealth, in which producers deploy scarce human, financial, capital, physical and natural resources to produce goods and services that consumers want and are willing to pay for. The economic developer's role is to participate in the process of national wealth creation for the benefit of local consumers and producers by facilitating either the expansion of job opportunities and tax base or by the efficient redeployment of local resources (Malizia, 1994).

Meier, defined economic development as a process where:

> "... ... the real per capita income of a country increases over a long period of time – subject to the stipulations that the number of people below an 'absolute poverty line' does not increase, and that the distribution of income does not become more unequal." (Meier 1989).

Robbin, (1968) defined economic development as an increasing real income per head or increasing potential to produce such income. Galbraith, (1964)defined economic development as the increase in total and per capita income and products along with social improvement. Both Robbins and Galbraith agree that economic development is not confined to mere growth of production but encompasses every kind of social improvement. The development process would occur only if there were a better distribution of income and of property, which would permit a more complete development of mankind (Cardoso, F. H., 1979).

Most of these definitions of economic development are correctly considered a process, however the definition itself is static. Malizia elaborates further that economic development is a long-term on-going enterprise. Over time, new development problems continue to emerge, as existing problems are resolved (Malizia, 1994).

The real objective of economic development is not just growth in GNP, income, wealth, productivity, capital accumulation but increase people's development choices. As John Maynard Keynes, the father of neo-classical economics and the chief architect of the post World War two (WWII) financial institutions created at Bretton Words, once proposed a toast, "To economics and to economists, who are not the trustees of civilization, but of the possibility of civilization." (Cited in Higgins 1968). If we translate his statements, economic development is valuable only to the degree that it creates possibilities for human development.

William Draper, the administrator of the UNDP writes;

> "The purpose of development is to offer people more options. One of their options is access to income, not as an end in itself, but as a means to acquiring human well being...people cannot be reduced to a single dimension as economic creatures." (Draper 1990).

Economic Growth – Definition

Economic growth on the other hand is conventionally measured in term of increase of the real Gross National product (GNP) or as the increase of per capita income. The higher the annual growth of GNP per capita, the more rapidly a country is said to be "developed". Economic structural changes refer to the increasing relative importance of the Second Industries, such as manufacturing industries, within the industrial structures, or the increasing ratio of production of capital goods rather than consumer goods. From the above definitions we can conclude that 'economic growth' refers to a rise in national or per capita income and product. 'Development' is a much more broader concept of human welfare, with important social, political, and cultural implications. Today, economic development is accepted as desirable to both developed and less developed countries. That is the general tendency of thought regarding economic development.

Measuring Economic Development and Economic Growth

In capitalist societies, development is conventionally measured in terms purely of the size of the economy, as the GNP, that is, the value of the total final output of goods and services produced by an economy (World Bank, 1989). Generally the higher the GNP per capita, the more "developed" a country or region is said to be. United Nations Development Program (UNDP) measures economic development in a much broader perspective. They take into account social and cultural variables such as access to knowledge, nutrition and health services, security, leisure, political and cultural freedoms, life expectancy at birth, adult literacy and income sufficiency (UNDP, 1991).

In 1997, report from World Bank[1], out of 133 countries, there were 49 countries categorized as "low income" because their GNP per capita averaged less than $730 a year. 58 countries were called "middle income" because their GNP per capita falls between $770 - $8,210. While 25 countries were label as "high income" with GNP per capita in the range of $9,700 - $40,630 (World Bank, 1997).

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[1] The World Bank was set up in 1944, its full name is the International Bank for Reconstruction and Development. Its aim is to borrow on world markets and lend to needy contries for development purposes. Because the World Bank is highly creditworthy, it can borrow at relatively low rates of interest. Countries with a per capita GNP greater than US$850 borrow at a rate of interest marginally above the World bank's own borrowing costs. Countries with per capita GNP less than US$850 borrow at concessionary rates via the IDA (Ingham, Barbara 1995).

Government, Governance and Institutions -Definition

In order to understand the role of government in economic development, we must first of all know what government is. Conceptualization comes first before quantification. Therefore it is useful to begin this topic by revisiting some of the definition of the government and reviewing the role governments can play in the process of economic development.

"Government is first of all a set of formal organizations. Organizations give structure and continuity to the activities of government. The distinction between government as persisting organizations and government as elected politicians is the difference between the ephemeral and the durable. Elected officeholders come and go, whereas the organizations of government are meant to last as long as a constitution endures." (Rose 1984).

Government according to the International Monetary Fund[2] (IMF) consists of the public authorities and their instrumentalities, established through political processes, exercising a monopoly of compulsory powers within a territorial area or its parts, motivated by considerations of public purposes in the economic, social, and political spheres and engaged primarily in the provision of public services differing in character, cost elements, and source of finance from the activities of other sectors (IMF 1986). 'Government' may pertain to, a body of governing actors that regulates and leads the affairs of an institution upon delegated authority; the process (a sequence- with a certain logic – of activities) of governing; or group of persons, institutions, organizations, activities and procedures of governing (Bemelmans et al., 1999).

According to Rhodes, governance refers to processes of regulation, coordination, and control (Rhodes 1997). David Osborne and Ted Gaebler define government as, "the process by which we collectively solve our problems and meet our society's needs", further they argue that "government is the instrument we use. The instrument is outdated, and the process of reinvention has begun" (Osborne, D and Gaebler, T 1992).

Thus, IMF defines government as embracing:

1). The primarily noncommercial function of its various parts, agencies, and instrumentalities

2) Social security arrangement for large sections of the community imposed, controlled, or financed by the government

2 The IMF was set up in 1944, its aims is to maintain order in the world system of payments. The IMF was to oversee orderly adjustment of exchange rates and balance of payments. The Funds offers temporary assistance to countries with balance of payments problem, to discourage them from protective trade measures. To this end, the Fund issues Special Drawing Rights (SDRs) worth about US$1.33b. Members are allocated SDRs and may draw on them in case of balance of payments difficulties. Countries in difficulty may also withdraw up to 25 per cent of their subscription (some in gold and foreign currency). Above 25 per cent, the Fund will impose certain conditions on the borrowing country, e.g. reduced public spending, higher interest rates, cuts in the money supply, devaluation. This is known as 'conditionality' (Inghim, Barbara 1995 p.381).

3) Pension funds of government employees whose reserves are invested entirely with the employing government
4). A limited range of industrial or commercial activities carried out by non-corporate units and encompassing ancillary functions, that is, meeting internal government needs, or selling to the public only on a small scale
5). A limited range of financial bodies comprising lending bodies deriving all their funds from government-and savings bodies automatically channeling to government the proceeds of liabilities to the public in forms other than time or savings deposits
6) Other nonprofit institutions serving households or business enterprises which are wholly, or mainly, finance and controlled by the public authorities or which primarily serve government bodies and,
7) The domestic operations of any supranational authorities empowered to levy taxes in the territory of more than one country.

The bottom line of the definition of government as indicated above, is to carry out public policy through the production of non-market services primarily for collective consumption and the transfer of income, financed mainly by compulsory levies on units in other sectors. Thus government performs primarily the functions of supplying certain public goods and services and fulfilling certain public purposes not for commercial or financial reasons, or, if of a commercial or financial nature, not on a major basis or not primarily for a profit (IMF 1986). Mamalakis (1989) refers to producers of government services such as all departments, establishment and other bodies of central, state and local governments, which engage in such activities as administration, defense, health, educational and social services, and promotion of economic growth whether accounted for, or financed in, ordinary or extra-ordinary budget or extra-budgetary funds.

Similarly, governance is a new term, which has a broader meaning, was invented whose meaning in relation to a more old-fashioned "government" is not clear. The American Heritage Dictionary defines governance as "the act, process or power of governing; government," the Oxford Dictionary as "the act or manner of governing, of exercising control or authority over the actions of subjects; a system of regulations". The International Encyclopedia of the Social Sciences has no entry for "governance", nor does "the manner in which power is exercised in the management of country's economic and social resources for development", while Boeninger defines governance as "the good government of society" (Cited in Lateef, 1992). Landell-Mills and Serageldin define governance as "denoting how people are ruled, and how the affairs of a state are administered and regulated. It refers to a nation's system of politics and how this functions in relation to public administration and law. Thus the concept of governance includes a political dimension" (Landell-Mills and Serageldin, 1992).

A World Bank report on Africa defined governance as the "exercise of political power to manage a nation's affairs" (World Bank 1989). Michel Camdessus, addressing a joint meeting of bankers and business association in Manila on October 18, 1994, defined governance in one of the conditions "for achieving high quality growth", as something "that serves the whole of society rather than sectional interest" (IMF, 1994). Nelson in his writing distinguishes between three elements of governance: democracy, good government, and development (Nelson J., 1992). Perhaps the Commission on global governance, our Global Neighborhood, gives the widest definition of governance in the Report: "Governance is the sum of the many ways individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interest may be accommodated and co-operative action may be taken. It includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest (Commission on Global Governance, 1995).

Government and Development

What role should the government play toward development? What should government do? What goods and services will be produced? How? And for whom? Has the government formulated the right economic policies and programs? Is the government intervention desirable? What should be the proportion of public spending in the national economy? Should government engage in direct production activities? What are the outcomes of the government's role in term of economic growth and development? (i.e., GDP, per capita income, human welfare, social, political and cultural implications). These are fundamental questions frequently debated in both developed and less developed countries. This topic is chosen because of its crucial implications to Malaysia as a developing country. This paper focuses on Malaysia, to explore issues revolving around the growth of government public spending for all thirteen states from a period starting 1957 to the present decade, and its impact on the overall economic growth, and economic outlook for Malaysia's future.

Economic development has been a central goal for all governments, the number of specific economic programs has proliferated. "Sustainable development' is an emerging approach to development, combining traditional economic development with elements of equity and social policy.

Styles of Good Government and Governance

Government must be democratic by definition. In fact, whether we should be governed by public or by private monopolies is not a very stimulating question. The United Nation (UNDP, 1994:4) suggests "a more pragmatic third option":

> *"People should guide both the state and the market, which need to work in tandem, with people sufficiently empowered to exert a more effective influence over both.... Market need to be reformed to offer everyone access to the benefits they can bring. Governance needs to be decentralized to allow greater access to decision making. And the community organization need to be allowed to exert growing influence on national and international issues"*

Good government is also seen as an essential condition toward the wider goal of good governance. Described as the "use of political authority and the exercise of control over society and the management of its resources for social and economic development", good governance encompasses the "nature of functioning of a state's institutional and structural arrangements, decision-making processes, policy formulation, implementation capacity, information flows, effectiveness of leadership, and the nature of the relationship between rulers and the ruled" (Serageldin and Landell-Mills, 1991). Good governance, therefore, concerns not just the organization and activities of the government but, also the ends to which they are put in terms of achieving levels of economic, human and institutional development which "benefit the population as a whole" and promote the "literary, education and employment opportunities" which in turn enhance the ability of the population to demand, and participate effectively in, good government (World bank, 1991).

In general terms, good government is an essential precondition for good governance. Good government is intended to lead toward a governmental framework accepted by a participatory public as legitimate, responsive to the needs of the population and committed to improving its welfare, competent in providing law and order and delivering public services, and providing an effective policy environment and open-handed in its conduct. Such a system of government would also want to disengage itself from direct involvement in other areas, particularly economic production, to concentrate its efforts and abilities on societal priorities. Once political reform is under way and centrally controlled economies dismantled, this argument suggests, liberal market principles can begin to promote economic development, which in turn should promote participation in the political processes. The long- term economic and political objectives would thus complement each other while working toward "an educated population, which both political knowledge and the will to act, coupled with a modern industrial economy, a homogenous society, and a long established set of democratic political values along with justice and accountability" (Riley, 1992; Kasim, M. Y. et. al., 2000).

What are these principles of good governance? According to Islam, there is a broad consensus that the adherence to the following principles is central to the evolution of internationally competitive economies (Islam, I. et al. 1997):

i) The state should primarily allow market-based, private sector-driven, initiatives in the mobilization and allocation of resources to growth-promoting activities.
ii) Government should intervene only in cases of clearly established market failure (i.e., in cases where private-sector operations do not correspond to societal interests).
iii) In cases of proven market failure, attempts should be made to implement workable and incentive-compatible policies.
iv) The state should provide 'pure public goods' (law and order, national defense, public infrastructure) including the proper assignment and enforcement of property rights.
v) The state should provide a stable and predictable macroeconomic environment through appropriate coordination of fiscal, monetary and exchange rate policies, a principle that is increasingly being referred to as 'time-consistent' policies (ADB, 1994).

vi) The state should enforce a free-trade (or almost free-trade) regime on the ground that such a 'neutral' policy regime restrains the government from making sector-specific interventions (Krugman, 1987; Lal and Rajapatirana, 1987)

What is the role of government?

What role does government play in the achievement of the end of nature?[3] (Smith 1976a). Adam Smith in his book *'the wealth of nations',* (1976) argued for a limited role of government. He contended that "according to the system of natural liberty, the sovereign has only three duties to attend to, which is, external security, internal security (law and law enforcement), and certain public works and certain public institutions" (Smith 1976a). Besides these three duties, there is also a little-noticed fourth duty:

> *"The law of all civilized nations....impose upon men and many....duties of beneficence. The civil magistrate is entrusted with the power..., of promoting the prosperity of the commonwealth, by establishing good discipline, and by discouraging every sort of vice and impropriety; he may prescribe rules, therefore, which not only prohibit mutual injuries among fellow-citizen, but command mutual good offices to a certain degree (Smith 1976a)".*

Most important of all according to Smith, is the duty of the government to safeguard external security (Smith 1976b). Smith attempted to show how competition and the profit motive lead individual, in pursuing their own interest, to serve the public interest.

Mamalakis in supporting his argument that general governments did generally produce services satisfying the collective needs of household and all producers,(i.e., financial and non-financial corporations), NPISHs, defense, foreign affairs, and public order and safety and general government itself as well as households in their function as unincorporated enterprises. Collective services guaranteeing basic human, political and economic freedoms and right for all citizens, on an equal, sustainable basis (Mamalakis. 1999).

The ultimate objective of the government is to strive in promoting 'the prosperity of the commonwealth" (Smith 1976a). Government is a non-market organization, and it generally must do things on a large scale. It has the duty of maintaining internal security (including enforcement of contract), the provision of a system of "administration of justice", the provision of information (such as agricultural research and extension), provision of basic public services which are inherently large-scale in scope (such as roads and communications and those things in which the government is at no disadvantage in providing on a large scale, and where private agents may face a disadvantage in attempting to do so) and to protect every member of the society from the injustice or oppression of every other member of it (Smith 1976a; Mamalakis, 19 ; Krueger, 1990;

[3] Smith's five ends of nature (self-preservation, procreation of the species, order, happiness, and perfection of the species)

Brunner, 1985). Further, Adam Smith, even though he was a strong advocates of laissez faire, he recognized the usefulness of government's role in protecting rights (Smith A. 1776). The importance in the protection of property rights has also been emphasized in North (1991).

Osborne and Plastrik argue that governments do have several important roles to play in the governance process. First, governments must actively participate in the planning, financing, delivery, and evaluation of public services. Second, they must creatively and innovatively deal with changes and initiate public choices, programs, and projects, which contribute to solving emerging problems, meeting society's changing needs, and achieving a sustainable future. Third, they must do this efficiently, effectively, equitably, and also humanely. Fourth, governments must act transparently so that citizens have the necessary information, access, and involvement to hold them accountable for the outcomes they produce. Fifth, and perhaps most importantly, governments must actively participate in the process of creating the conditions under which governance take place. They must assure that civil order prevails, democracy thrives, so that collectively we are able to undertake actions designed to solve problems, meet society's needs, and achieve a sustainable future (Osborne, and Plastrik 1997).

Moe argues that government can best be understood as a two-tier system in which politicians and interest groups interact on one tire deciding the manner in which political authority will be exercised. Governmental managers (i.e. civil servants) operate on a different tire caring out the everyday activities of the bureaucracy. In this two-tier model, understanding the role of the state political executives in the governance process is essential to understanding political struggles (Moe, T, 1990). Thus, for governance theorists, analyzing the process of coordination as such is the main concern: The role of government in the process of government is perceived as an empirical question (Campbell, Hollingsworth, and Lindberg 1991; Hollingsworth, Schmitter, and Streek 1994; Hyden 1992; Koolman 1993; Rhodes 1996, 1997).

In most of the developing countries the main objective of the government has been to give a larger role to market forces, especially by taking the government out of production activities through privatization of public enterprises (World Bank, 1995). The notion of wealth distribution by the government is well known in both eastern and western economies. Government wealth redistribution by way of explicit and implicit taxation necessarily lowers the incentive to create and accumulate wealth, thereby lowering the potential productive power of the economic system. But government also promotes production and trade, because they are assignors and protectors of property rights, and provide for the enforcement of private contracts. These are wealth-enhancing activities that help the productive coexisting modes: "the productive model" and "the redistributive model" (Jordan, 1996).

John Maynard Keynes "the economic role of the government in the 18^{th} century had been highly distorting" As a reaction to that distorting role, during the 19^{th} century many classical economist and political; philosophers, who were discovering the virtues of the market, advocated a minimal role for the state. For them, the state should limit its role to the essential or core functions, which were mostly of an allocative character. These are defense, law and order, basic public goods, externalities, income maintenance, and redistribution could play in promoting public spending was not yet perceived. As a consequence of these attitudes, in the period between 1870 and 1913 the level of public spending in national income remained, on average, around 11-12 percent. There was almost no growth in that level over the period even though this was a very dynamic and modernizing period for the economies of the non-industrial countries. Much of the expenditure in this period was of an allocative kind. The next part of this paper focuses on the Malaysian economic performance and analyzes the Malaysian government and governance's contribution to economic development.

Malaysian Economic Performance

Between 1993-1997, Malaysia's real gross domestic product (GDP) growth averaging 9 percent per year was one of the most rapid growth rates among ASEAN countries and among the highest in the world. Only right after the Asian crisis in 1997 Malaysia experienced economic slow down. However inflation has been kept below 4 percent, unemployment has been reduced to 2.5 percent and poverty has been reduced to less than 10 percent. Literacy rate is currently at 93 percent, income inequality has been reduced, and per capita income has increased to US$4,650. By September 1993, when the World Bank published 'The East Asian Miracle: Economic Growth and Public policy,' Malaysia had become one of the eight "high performing" Asian economies which were characterized by the highest growth rates in the world between 1965 and 1990.

Malaysia's "miracle", has largely been attributed to sound economic policies vis a vis good governance, accompanied by liberalization, reformation, and Malaysia's economic transformation from a producer of primary commodities to a manufacturer of sophisticated industrial goods. It is the world's third largest exporter of semiconductors, after Japan and the United States.

Through out the 1990s, the international community came to expect the continuation of sustained, rapid growth in the developing economies of East Asia including Malaysia. However, these expectations were shattered by a sudden emergence of financial, economic and even political disruption throughout the region in July 1997. Nevertheless, by early 2000, the Malaysian economy has shown a significant 'come back'. By first quarter of the year, the GDP has been recorded at 11.7 percent, as announced by the governor of central bank of Malaysia.

Thus, the growth process of Malaysia after independence in 1957 seems to contain special policy implications and is an interesting case study and model. Since independence, Malaysia has undergone three distinct strategies at different time, namely a market-led approach (1957-1970); a mixed market /regulatory policy (1970-1980); and a state-centered strategy (1980 to present). It is often pointed out that the government has played a vital role in promoting rapid growth by intervening in the market-based activities after independence from British rule.

Table 1 presents the basic macroeconomic indicators of the Malaysian economy.

TABLE 1.1
Basic macroeconomic indicators of Malaysia, 1971-2002

Indicators	1971 -80	1981 -90	1992	1994	1996	1998	1999	2000	2001	2002
Real GDP growth rate (%)	7.8	5.2	7.8	9.2	8.6	-6.7	-0.6	8.3	2.0	5.0
Inflation rate (%)	6.0	3.2	4.7	3.7	3.5	5.3	5.9	1.6	1.3	<2.0
Gross domestic investment	24.9	30.7	33.8	34.5	41.6	25.8	n.a	n.a	n.a	n.a
Gross national savings	29.1	33.0	35.5	33.0	36.7	38.8	n.a	39.5	36.6	n.a
Current account	-1.2[a]	-1.9[b]	-3.7	-6.2	-4.8	13.0	15.0	10.2	7.9	n.a
Debt service ratio	4.6[a]	29.0[b]	6.3	5.0	8.5	6.6	6.2	5.1	5.8	n.a

Source: Asian Development Outlook (various Issues) and IMF Staff Country Report No. 99/85.
Notes: a 1980; b 1985

Malaysian development program and planning

Development program and planning has been describe as "a deliberate governmental attempt to co-ordinate economic decision-making over the long-run and to influence, direct and, in some cases, even control the level and growth of a nation's principle economic variables (i.e., income, consumption, government spending, employment, investment, saving, exports, imports, etc). in order to achieve a pre determined set of development objectives." (Todaro, M. 1977).

Historically, the Malaysian government development policies and programs before 1969 followed the colonial guidelines (i.e., the commitment of the state to an unregulated private enterprise system) which benefited foreign and non-*Bumiputeras* local capital[4]. As a result, income inequality increased for the population as a whole, and the wealth gap among races worsened during the 1960s.

The first five-year plan was called 'A Plan of Development for Malaya, 1956-60' also known as the First Malaya Plan. The First Malaya Plan was based on the report of the World Bank, which visited the country in 1954 (IBRD, 1955). The mission arrived at the height of the Emergency when the interim pre-independence government was preoccupied with the burden of finding revenue to finance Emergency expenditure, a problem that was aggravated by the decline in the prices of rubber and tin, then the two main exports of Malaya, in the aftermath of the Korean War boom (Jomo and Wells, 1983).

The Second Malaya Plan of 1961-65 was again formulated with technical assistance from the World Bank, but before it was launched, the Emergency had officially ended in 1960. Its stated objectives were to achieve "an improvement in the standard of living of the population, the provision of greater employment opportunities and a faster rate of economic growth, the diversification of agriculture and industries, and the expansion of social overhead facilities" (Malaya, 1961:5). The planning techniques adopted, however continued to emphasize the objective of increasing the rate of growth of national output (Robertson, 1984).

The New Economic Policy

The government in 1971 established the New Economic Policy (NEP). It is a twenty-year plan designed for national unity by a "two-pronged" approach. The first prong of the NEP and now, the National Development Policy (NDP) was directed to redistribute equity from primarily foreign hands into *Bumiputera* (indigenous peoples) hands. The other aims were to accelerate the process of restructuring Malaysian society and redress the economic imbalance between the *Bumiputeras* and non-*Bumiputeras*, so as to reduce

[4] Lewis comments on colonization "colonial government were not business or development minded" (Lewis, W.A. 1984).

and ultimately eliminate the identification of race with economic function (Malaysia, 1971).

The primary objective of the NEP was mainly Malay politico-economic empowerment (Morgan, J. 1971), where numerical targets were introduced to meet the objectives of equity redistribution among *Bumiputera*, non-*Bumiputeras*, and foreigners on the basis of 30-40-30 ratio respectively, within the twenty years period from 1971 until 1990; Meaning to say that, the Malays should own and manage at least 30 per cent of total commercial and industrial activities at all the scales of operation. In 1970, the *Bumiputera* share of corporate ownership was only 1.9 percent, while 23.5 percent controlled by the non-*Bumiputera* (the Chinese 22.5 percent, and the Indian 1.0 percent), and 60.7 percent was foreign owned (Malaysia, 1978). The NEP consequently set a target equity ownership level of 30 percent for foreigners, 40 percent for other Malaysian, and 30 percent *Bumiputeras* to be reached by 1990 (Malaysia, 1971).

Aggressive programs were instituted in pursuit of the target, including the compulsory transfer of shares to the *Bumiputeras* and the creation of specialized financial institutions. By 1990, the distribution of equity ownership had improved markedly where 43 percent was by foreigners, 45 percent was by non-*Bumiputeras* and 12 percent was by *Bumiputeras* (of which 7 percent was institutional). This achievement however was still far from the NEP target. In 1985, 25 percent went to foreigners, non-*Bumiputeras* had increased to 57 percent and *Bumiputeras* increase by a relatively small percentage to 18 percent (8 percent institutions) (Jomo, K.S., 1995).

The restructuring of the economy to bring the *Bumiputeras* share to 30 percent was to be achieved by a very high rate of growth overall, so that in absolute terms there would be large increases in ownership for non-*Bumiputeras* and foreigners as well as *Bumiputeras*. Non-*Bumiputeras* were assured that there would be no deprivation of their rights or prospects ((Milne, R.S., 1976).

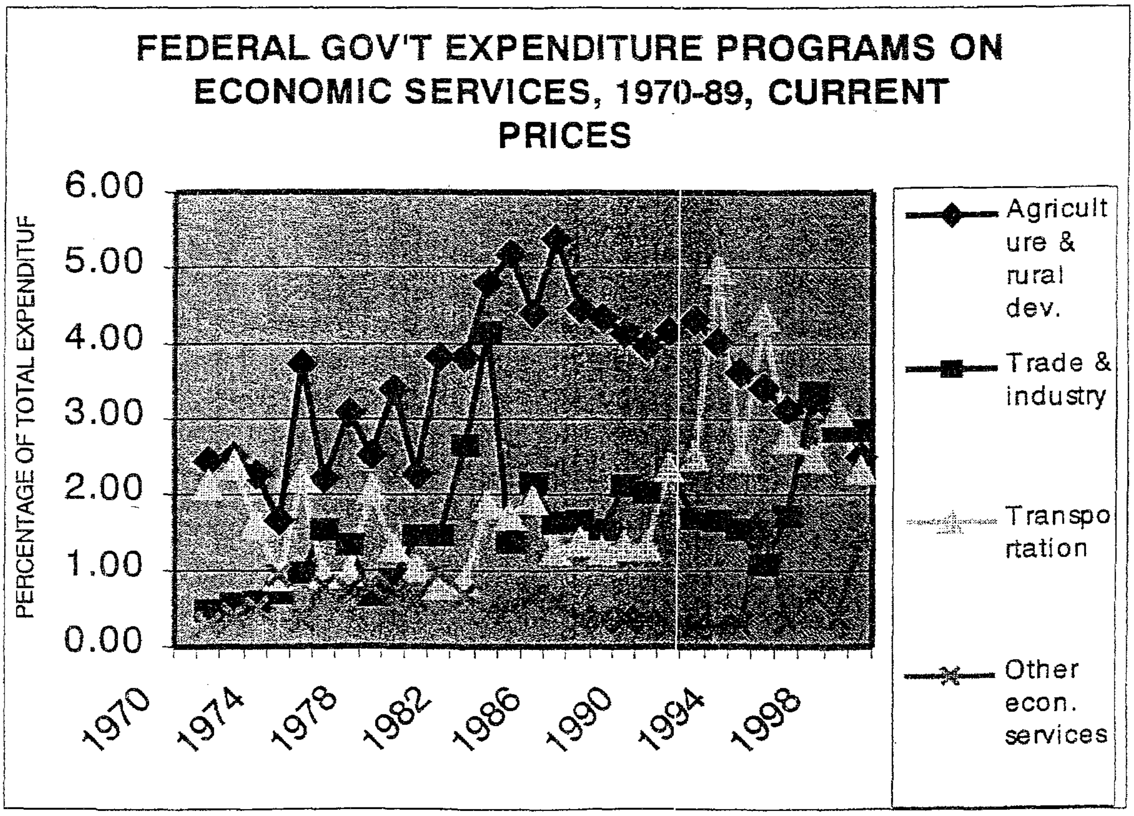
The establishment of free trade zones beginning in 1971 reflected the on set of the New Economic Policy (NEP). In addition a number of economic privileges were granted to the *bumiputera*. These included restricted ownership in a number of important economic areas; such as logging, shipping, petroleum distribution, etc.; provision of capital at better than prevailing rates of terms, ownership, management, and employment in certain industries, (especially if they were influenced by foreign interests) and much support in the education sector; including higher ratios of entrance to Malaysian Universities: They received financial support for study both at home and abroad.

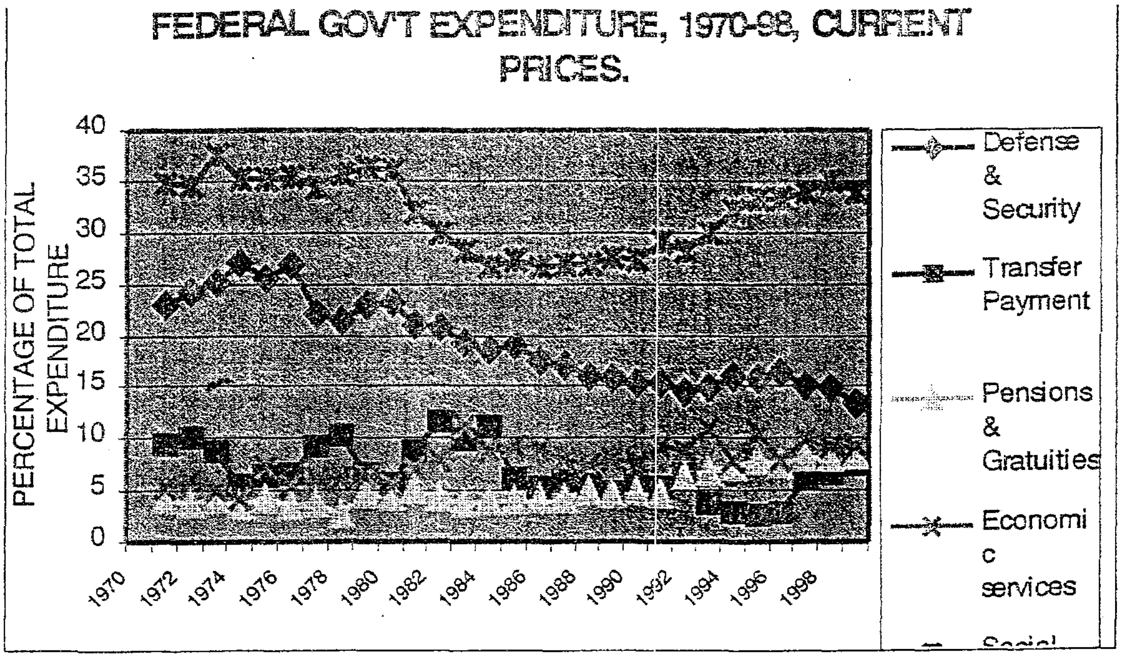
Infrastructure Development

The World Bank commission, who visited Malaya in 1954, praised Malaysian economic planning. "The country's telecommunication system was well developed, its railway system compared favorably with other systems throughout the world, its road system was one of the best in Asia, and its installed power capacity was high relative to peak loads" (Naidu and Lee 1997).

This sequence of events suggests that the political economy may offer a useful perspective on Malaysia's growth record over the last several decades. So far the government in Malaysia has managed the economy extraordinarily well relative to the rest of the developing countries. The government has been able to promote macroeconomic stability and long term development. Only in the middle of 1997 did the Malaysian economy momentarily caught up in the regional financial crisis. Several factors contributed to the success of the Malaysian economic policy. Among other factors which helped was the sustained political stability, enabling the government to be consistent in their approach and implement longer-term economic strategies (Lindauer and Roemer, 1994). Prime Minister Mahathir Mohammed led Malaysia for 23 years. Of course, stable political leadership is far from sufficient to engender sustained economic development. Countries like North Korea, Myanmar, with long-lived governments have performed poorly from an economic standpoint (see Rodelet, Sachs, and Wha Lee 1997).

FIGURE 1





Government Expenditures: An Overall View

Figure 3 depicts, the role of the government as a consumer, as a provider of social insurance, and as a redistributor of income. As in figure 5 shows, public assistance and redistribution is 19.57 percent of all expenditures. Public assistance and redistribution plus veterans pensions and benefits can be categorized as transfer payment, and together they constitute 27.77 percent of all public expenditures. Consumption expenditure for nondefense purposes (Education plus other economic services) is approximately 40.6 percent of total federal expenditures.

The size of the Public Sector in Malaysia

It is impossible to calculate accurately the size of Malaysia's public sector, however the pattern of the government's economic activities and trends in revenue and expenditures can be assessed. Infrastructure requirements during early stages of development typically generate heavy public investment, while demand for social expenditures increases government consumption at later stages. During the past thirty years, public expenditures, as a share of GNP, have grown steadily. In 1970 public expenditures were 4.51 percent of GNP, and grown rapidly between 1980 to 1986, and since then it has been between 5 to 6 percent of GNP. From Malaysian experience there has been larger and larger social service outlays established since independence in 1957. The most spectacular increase in government expenditure since 1970 until 1998 has been in the field of education and national defense and internal security. The next most important field are general administration and veteran and pension and benefits which account for 12.6 percent and 8.20 percent of total expenditure respectively.

Sources of Growth in Expenditures

The rapid growth since 1970 in nondefense expenditure was largely accounted for by increases in transfer payments. As can be seen in table 1, transfer payments and other retirement programs have increase steadily. Percentage of transfer payment as a percentage of total government expenditure were decreased from 1970 to 1995 but bounced back from around 2 percent in 1993 to 7.48 percent in 1998. Medical service programs were kept at a steady rate at around 7 percent for the last thirty years, while pensions and gratuities increase by double the amount from 1970 to 1998.

In the United States such programs quoted by Stiglitz as middle-class entitlement programs. The main beneficiaries are the middle class, and benefits are provided not on the basis of needs but because the beneficiary satisfy certain eligibility standard (i.e., age, number of member in the family etc.). As soon as they satisfy these criteria, they become eligible and entitled to receive the benefit (Stiglitz, 1986). But in Malaysia programs like medical services applies to all citizens regardless of the economic background. Thus during the period 1970-1999 there were a marked increase in the overall size of the government (relative to GNP) and a marked change in the composition of the government expenditures, with socially oriented programs such as education, and health services increasing while defense, agricultural and rural development, and other social services such as welfare services programs declined. However, housing which is included in the social services increased and is expected to continue to increase in the near future, largely for the construction of low-cost houses for the lower income group, particularly in the major urban centers as well as for housing programs for the armed forces and police personnel (Malaysian Economic Report, 1999). Education remains an important component in the efforts towards preparing appropriate workforce for the country. Postal and broadcasting services, and other economic services such as public utilities and telecommunication increasing steadily over the years, while debt service charges increased, due both to the rising debt and to the high interest rates.

Year	Other social services % of Exp.	Defense & Security % Of Exp.	Agriculture & rural dev. % of Exp.	Trade & industry % of Exp.	Transportation % of Exp.	Other econ. services1 % of Exp.	Education % of total Exp.	Medical services % of Exp.	Postal & broad-casting services % of Exp.	Transfer Payment % of Exp.	Pensions & Gratuities % of Exp.
1970-74	1.14	24.98	2.52	0.65	1.84	0.49	23.77	7.71	2.84	8.00	3.90
1975-79	1.69	23.27	2.69	1.18	1.25	0.72	25.93	7.44	2.51	7.61	3.75
1980-84	1.57	19.75	4.41	2.34	1.43	0.64	19.32	5.85	2.06	9.43	4.15
1985	1.48	17.47	5.40	1.64	1.26	0.59	18.51	5.37	1.26	5.19	4.13
1986	1.42	17.00	4.47	1.67	1.37	0.35	18.66	5.47	1.37	5.98	4.12
1987	1.41	16.06	4.35	1.55	1.25	0.34	19.02	5.32	1.25	5.39	4.71
1988	1.50	15.75	4.13	2.12	1.32	0.37	19.40	5.37	1.32	4.71	4.60
1989	1.54	15.40	3.96	2.05	1.30	0.32	19.18	5.40	1.30	5.88	4.73
1990	3.24	15.21	4.17	2.37	2.36	0.26	19.83	5.26	0.83	5.35	4.61
1991	1.94	14.38	4.31	1.68	2.50	0.27	20.43	5.17	0.74	6.63	6.41
1992	2.20	14.95	4.02	1.67	4.97	0.24	21.37	5.65	0.74	3.61	6.81
1993	2.52	15.92	3.62	1.54	2.47	0.28	22.85	6.15	0.70	2.92	7.20
1994	2.85	15.68	3.41	1.09	4.33	1.61	23.38	6.20	0.76	2.71	7.81
1995	2.49	16.42	3.10	1.71	2.72	0.31	23.40	6.52	0.79	2.92	7.53
1996	2.47	15.10	3.27	3.35	2.48	0.67	23.70	6.87	0.75	6.03	8.00
1997	2.44	14.79	2.91	2.86	3.09	0.38	24.54	7.34	0.73	6.47	8.15
1998	2.09	13.23	2.51	2.87	2.33	1.45	23.61	7.47	0.61	7.48	8.20
1999	5.10	13.80	4.80	12.40	12.80	0.20	17.10	3.70	1.30	n.a	8.10
2000	5.40	8.30	4.20	13.10	17.40	0.60	25.40	4.60	0.80	n.a	7.40
2001	6.10	8.90	7.20	13.70	12.40	0.10	30.00	3.40	0.00	n.a	8.00
2002	7.00	10.50	10.40	8.50	12.40	1.30	20.80	4.50	0.20	n.a	7.00

Source: Government of Malaysia (Various years)

Government Revenues: Federal Taxation

The federal government relies on four major components of revenues: direct taxes, indirect taxes, non-tax revenue, and non-revenue receipts. Direct taxes consists of Corporate income tax, petroleum income tax, personal income tax, stamp duties, and other form of direct taxes such as real property gains tax and cooperative income tax. Indirect taxes consists of export duties, import duties, excise duties, sales tax, service tax and other form of indirect taxes such as betting and sweepstakes and gaming tax. While, non-tax revenue comprise of licenses and permits, petroleum royalty, interest and returns on investment (profit from PETRONAS and central bank of Malaysia) and other form of non-tax revenue namely services fees and fines and penalty. Direct taxes contribute more than half (52.93%) of the total revenue of the federal government where, the corporate income tax is the single largest source of tax revenue for the federal government, accounting for more than one third of the of total government revenue in 1998. Personal income tax on the other hand contribute about 23 percent of the total direct taxes collected in 1998, which is about 15 percent of the total federal government revenue. Indirect taxes accounted for 27 percent which include sales and excise duties accounting for approximately 48 percent of the total indirect taxes collected in 1998.

State and Local Government

The sources of revenue available to the state and local government are very much limited. A number of measures was taken to increase revenue. This included a review of tax rate and non-tax base in order to broaden the revenue base and computerization of tax collection. The petroleum and forestry-based revenue is the most significant resource-based revenue for the state government.

Changes in the Budget and its Components.

The federal budget situation has changed markedly over the past thirty years. The rise and fall in deficits, indicates an important transitions that have occurred on the revenue and expenditure sides of the budget (see table 3)

Deficit Financing.

Table 3 Shows the federal budget deficits as a percentage of GDP at current prices. Financing of budget deficit has caused great consternation and which has been and will continue to be a thorny issue, even for rich economy with no capital controls. For example the US economy would have encountered severe financing problems, had it not been for significant foreign capital inflows. This is not to deny that its deficits were financed largely by local capital and also by foreign capital, which have played a very important role in financing the balance of payment (BoP) deficits. From Malaysian experience, because of the federal government's ability to tax, these deficits do not cause the same kinds of problems that large debts incurred by private firms or individual would. Budget deficit has been sustainable, and high domestic savings rates and lucrative trade taxes made it possible to finance them in a non-inflationary way. These purely economic features of the

Malaysian economy, and its openness, has clearly contributed to low inflation and consistent exchange rate policies (Haggard, S. M., 1994). According to Central Bank of Malaysia there are four mitigating factors. One is that Malaysia has a fairly high savings ratio, nearly 40 percent of GNP, second it has been sufficiently financed largely from domestic non-inflationary sources, also draw down of assets. Third, the deficit was finance by the inflow of long-term foreign capital, and the other factor is that it has a BoP account surplus (Central Bank of Malaysia, 2000). The widening deficit in the current account reflects a short-term trade-off, in term of increases in the imports of capital goods needed to improve the long-term production capacity and resilience of the economy. There was a concerned, that the deficits contribute to inflation, that they could lead to higher interest rates and lower level of investment. However from Malaysian experienced, the level of inflation remains low, the government took full control of the stress signals and continues to adopt a risk averse approach in managing the economy to ensure that external equilibrium continues to be maintained and inflationary pressures contained. This call for timely adjustment measures to minimize the need for sharper tightening of policies at a later stage which could have less desirable effects on the external balance and growth (Malaysian Economic Report, 1995/96).

Table 3

Malaysia: Budgets, 1967-97, Selected years, US$ Mil.

Year Ending 31 December.

	1967	1970	1975	1980	1985	1990	1995	1997
Revenue	151.9	210.7	531.75	1805.33	1845.08	3306.5	5454	5429
Expenditure	249.25	310.99	1084.09	3418.31	3834.43	5213.18	7356.09	494.69
Deficit	103.55	100.29	552.34	1612.99	1989.34	1906.68	1901.88	1065.55
Deficit % of GDP	3.29	2.6	6.58	6.8	6.74	4.65	3.32	1.42
Expenditure % of GDP	7.92	8.07	12.92	14.42	12.99	12.72	8.96	8.66
Revenue % Of GDP	4.83	5.06	6.34	7.62	6.25	8.07	6.64	7.24

The two most important sources of revenue are export taxes, and corporation, including petroleum, taxes. In 1980, revenue from petroleum formed over 20 percent of total revenue. National budget were expansionary in 1971, and 1972, in line of the government to stimulate the economy. However, with the export boom in 1973, the government reversed the policy in the following years. The recession in most of the western countries in 1973 led the Malaysian government applied the expansionary economic policy in 1975. Expansionary budget policy were also introduced in 1980 and 1981, in view of the economic slow down in most of the western countries, and also the domestic demand of the NEP. Expenditures jumped to an estimate of 37-38 percent of GDP and the budget deficit increased between 9 to 10 percent of GDP (Wawn, Brian, 1982).

Civil service and Governance

There is strong evidence from all regions that a skilled, motivated, efficient civil service with a professional ethos is one of the key requirements for good governance (defined as efficient management of public resources, accountability, transparency and the rule of law). Experience shows that a good civil service is necessary but not sufficient for good governance; a very bad civil service is sufficient but not necessary for bad governance. We will discuss how strong the Malaysian civil service and their contribution to economic performance. In turn, there are fundamental links between governance and development (see World Bank, 1992).

According to Wagner's Law, the government tends to expend in relative size as the economy grows, both because of a consensus in favor of enlarging access to social services and because of a tendency for all large organization to expend. Also, there is a positive association of government employment with education levels, availability of financing, and of course, number of population. Population is by far the largest single influence on government employment levels. However other variables are also consistently significant such as per capita income, government wages relative to per capita income, and fiscal deficit relative to GDP (Schiavo-Campo, S, et al., 1997). The ongoing privatization has a direct effect on the number of workforce in the public sector. Between 1990 and 1995 the total numbers of public servants fell by about 6,000. In August 1995 there were more than 830,000 public servants (including teachers and approximately 90,000 police).

Conclusion

Governments and good governance are dynamic mechanisms that play a very important role in the process of economic development. A good government and governance can enforce, guide, and establish the "rules of the game" that promote the common good. Government can promote social objectives, raise revenue, spend revenues productively, enforce contracts, produce public goods, protect property, and human right.

Malaysia is among one of the country in East Asia who made impressive economic performance and had a sustained record of high economic growth for the last two decades. During 1980-1990, Malaysia recorded an average rate of growth of GDP of about 5 percent per annum and in the 1990's, the economy grew on average by 6.75 per cent per year with an annual per capita GDP growth of 8 per cent. Only during Asian financial crisis in mid-1997 the overall economic performance were deteriorated until end of 1999. However year 2000 until 2002 have shown some positive sign of economic recovery. With some exception following September 11 incident plus United States strikes on Afghanistan.

As demonstrated in this paper, the Malaysian Government succeeded in transforming the country's institutions within decades, and in having a major developmental impact. Much was done. Much remains to be done. The present paper has demonstrated a large degree of progress, but has also highlighted the areas of concern where better government policies are still needed.

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