

Ng Chien Xen, 14/7/2014

**Question:** Malaysia has experienced strong economic growth over the past decades, but income inequality has not significantly lowered and many people are still left behind. What economic policies can Malaysia implement to reduce income inequality without sacrificing its rapid growth?

The proverbial wave of economic growth as described by John F. Kennedy has, more often than not, run boats aground instead of lift them. The laissez-faire style of growth that preceded the May 13<sup>th</sup> 1969 racial riots amplified institutionalised colonial inequalities. Clearly, such a style of growth is incompatible with Malaysia.

What then can we do to prevent inequality from rearing its often violent and pernicious head? I have chosen to centre my discussion around a few factors only because I believe it is better to analyse a few issues in depth and formulate an accurate policy response, rather than to attempt to analyse many factors and obtain only superficial conclusions.

### Examining history: The Golden Ages of Income Convergence (1976- 1989)<sup>[1]</sup>

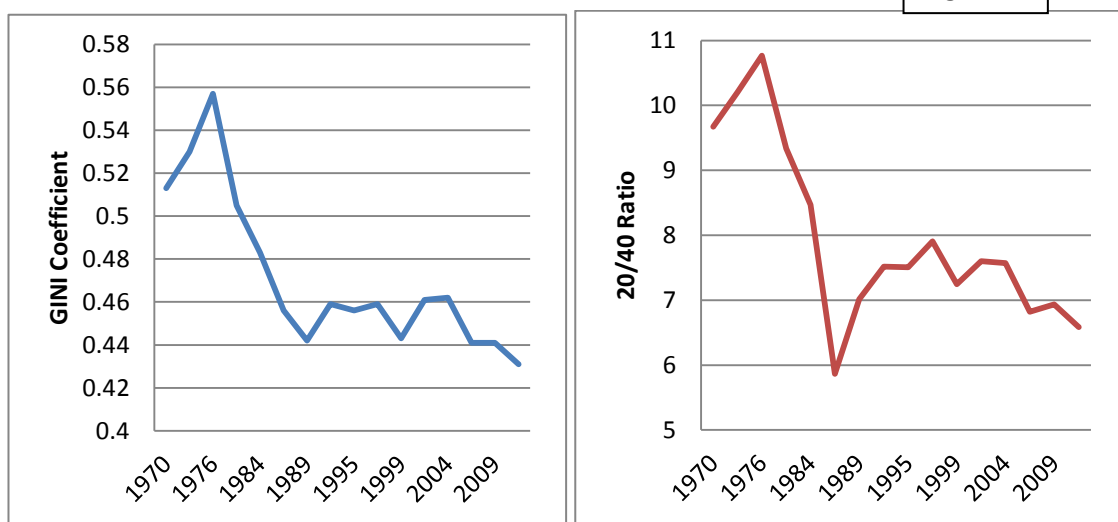


Figure 1 shows a popular measure of income distribution: the GINI coefficient. Inequality peaked in 1976 at a GINI coefficient of 0.557 before falling to 0.442. Since then, inequality has remained steady. A similar trend can also be observed with the ratio of income of top 20% wealthiest households to bottom 40% poorest households (20/40). This means that most of the fall in income inequality has occurred between 1976 and 1989. We have not made any progress at all in the last 25 years in establishing a greater degree of equality in society!

With such a clear change in trend, we clearly have much to learn from the lessons of history. What policies did Malaysia adopt in the 1970s that allowed such a remarkable convergence and what went wrong in the 1980s?

### Education and Training

#### *1) Background and discussion about education in Malaysia*

Education is different because it kills two birds with one stone. While other equity-promoting policies may slow down economic growth, education promotes both simultaneously. A large body of economic literature<sup>[2][3][4]</sup> supports the theory that education plays an important role in reducing income inequality. It is clear that education must be a key part of any effort to reduce income inequality.

Increasing the stock of human capital in Malaysia through education provides more equal opportunities for all Malaysian citizens, thereby reducing income inequality. Investments in human capital also have the added benefit that human capital cannot be owned by others. This means that investments in human capital will directly benefit the target group, unlike investments aimed at increasing the productivity of land<sup>[5]</sup>. Human capital investments,

such as education and training, can therefore be very cost effective at reducing income inequality. At the same time, human capital promotes economic growth in the following ways:-

- a) Development of a knowledge-based (k-economy) economy. Malaysia has depended on a capital investment and export-led strategy for economic growth. This leaves us more vulnerable to structural changes in world demand. For example, a decrease in world demand for palm oil would severely affect the Malaysian economy. Comparatively, a k-economy depends on innovation to drive growth. Its dependence on human rather than physical capital means that growth is more sustainable and that its benefits will be more spread out, instead of only accruing to existing owners of physical capital and land.
- b) Attracts foreign direct investment. Large companies look for a diverse set of skills that can only be gained via an effective and up-to-date education system. Sought after skills include, but are not limited to, computer proficiency, interpersonal skills and critical thinking<sup>[6]</sup>.

	Increase in Enrolment (%)			
	1971-1975	1976-1980	1981-1985	1986-1990
Primary	12.8	16.4	9.1	11.7
Lower Secondary	54.5	25.0	13.1	2.4
Upper Secondary	85.4	67.4	34.4	10.6
Degree Level	76.5	65.0	72.4	58.6

It is likely that a large part of the decrease in income inequality from 1976 to 1989 is strongly tied to increases in access to education. However, once the scope for educational catch-up had passed, progress on income inequality could no longer continue by simply building more schools. Table 1 shows that although efforts in the 1970s to increase access to education were largely successful, it inevitably decreases to a point where the income convergent forces of education are small relative to other divergent forces. As the 'quantity' of education is approaching its cap, its quality becomes ever more critical.

Unfortunately, the quality of education in Malaysia has never been a top priority. Examination of any 5-year Malaysian plan will reveal that the 'overall objective of education is to promote national unity'<sup>[8]</sup>. Although social cohesion is important in providing a stable environment for business, it should not come at the expense of the quality of education. For instance, the government has chosen Bahasa Malaysia as the medium of instruction even though, by their own admission<sup>[9]</sup>, English proficiency is essential for Malaysian to be internationally competitive. Clearly, if we are to rely on education as a driving force for income convergence, educational attainment has to rise at a rate comparable to that of the 1980s.

There are three large obstacles faced when attempting to achieve equity through education.

**Problem 1: Private tutoring**

Imagining a parallel, unregulated education system running alongside the existing mainstream one would horrify most lawmakers. Malaysian students are among the most dependent on tutoring in Asia. By the time a Malaysian reaches upper secondary school, there is an 83%<sup>[10]</sup> chance that s/he would have received tutoring. The best case scenario is that those who can afford tutoring are more likely to receive higher wages in the future as wages correlate with educational attainment. While education in Malaysia is universal, a good education is not. Education as a force for equity is diminished as only those who are already wealthy enough to afford private tutoring will reap the benefits of even higher income in the future.

However, a pessimistic outlook is that widespread tutoring exacerbates the flaws of the existing education system. Tuition centres often revolve around achieving strong results in national examinations. This promotes a culture of rote learning,<sup>[11]</sup> which will be discussed in Problem 3.

### Problem 2: Brain Drain

Students pursuing a higher quality overseas education are unlikely to return to Malaysia. The two most commonly cited reasons for this are large salary differentials and perceptions of social injustice. As highly skilled students emigrate, Malaysia loses its capacity to innovate, decreasing its attractiveness as a FDI destination for multinational companies<sup>[12]</sup>, perpetuating the vicious cycle. This not only hurts growth opportunities but it also means that some portion of taxpayer funded education investments will leak overseas.

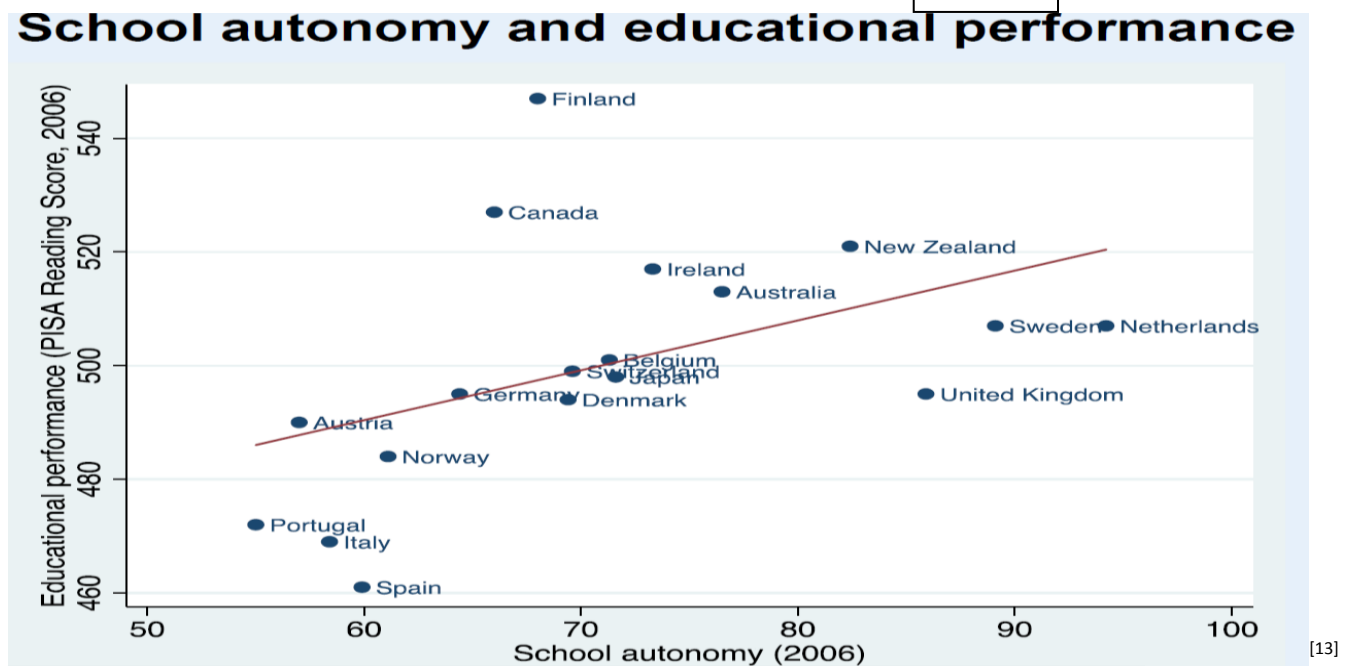
### Problem 3: Rote Learning

Rote-learning in the current education system creates the pervasive 'I-teach-you-listen' attitude amongst most education institutions in Malaysia. This attitude is corrosive to the process of creativity and critical thinking. It explicitly discourages the explorative component of learning, and teaches that mistakes should be avoided at all costs. Hence, the quality of education is likely to be stymied despite high education spending levels.

#### II) Policy Solutions

##### a) Policy 1: Decentralisation

Figure 2



[13]

Figure 2 depicts the change in educational performance vs. school performance.

The first solution is to decentralise the education system. This means that decision-making power initially held by the central government is delegated to local governments and schools. The graph above demonstrates the efficacy of such a policy with respect to educational performance.

Firstly, the government should minimize interference in the day-to-day running of schools. Instead, schools should be more accountable towards parents in each municipality. Parents will be able to apply significant pressure to schools now since the negotiating can be done locally, instead of with the higher authorities. Schools will be incentivised to utilise their endowment more efficiently. Therefore, the government delegates the job of monitoring schools towards parents, who have the on-the-ground information required to make better decisions.

Secondly, I suggest that there should be a greater differentiation of schools by their quality. Currently, the only official distinction between schools in Malaysia is the 'high performance school' status. This concept should be

expanded to include many more tiers<sup>[14]</sup>. The best performing tiers will receive more funding and recognition. One advantage of this is that schools will feel rewarded more often as they incrementally attempt to improve performance. Another advantage is that the competition incentivises schools to be more efficient and develop innovative teaching techniques. The practices in the best schools can then be replicated throughout Malaysia.

Thirdly, there must be a much greater emphasis on the quality of teachers on Malaysia. In Finland, a country renowned for its astounding education system, all teachers have master degrees and teaching is consistently the most admired job in Finland<sup>[15]</sup>. It is admittedly an ambitious proposal to emulate an education system such as Finland's, but there is no reason not to begin now. One suggestion is to provide pay that is proportional to a teacher's qualifications. For example, highly qualified teachers should earn salaries up to that of doctors or engineers. There is therefore a large incentive for the most talented in Malaysian society to pursue teaching as a career.

**Policy 2: Coursework**

The problems described previously, especially 1 and 3, are so deeply ingrained in our system that bold solutions must be proposed to remedy them. I suggest that every student must choose a subject of their preference and undergo a coursework-based project, which will be a separate component of the final SPM grade. This system will have the following advantages.

Firstly, a coursework project will measure a student's skill that cannot simply be 'gamed' by attending private tutoring. This creates a more holistic assessment of a student. It encourages the student to apply what s/he has learned throughout their schooling life in an open-ended situation. The active participation of students in this way is also likely to motivate them, which is a major contributor to future productivity in the future.

Secondly, it promotes genuine academic passion. More often than not, the constraints of the standard syllabus is damaging to a student's budding interest in a subject. Interest in a subject is a precursor to any creative process, and helps students make decisions about what their 'true calling is'. This ensures that students will make better choices about their future occupation and therefore, be as innovative as possible.

Such a system requires very skilled teachers to fairly and accurately evaluate a student's projects. As a result, I would advise that this policy should only be implemented after the quality of teaching has risen. Pilot trials could be first run in well-established schools to ascertain the effectiveness of this policy. While it is true that such a system will likely face problems in its nascence, it is certainly possible. After all, the International Baccalaureate (IB) programme has done this successfully on an *international* level. Malaysia will have many references to ensure a smooth transition.

**b) Pro Growth, Pro Equality Taxes**

Table 2<sup>[16]</sup>

	GINI Coefficient	
	Before tax and transfers	After Tax and Transfers
Australia	0.468	0.336
South Korea	0.344	0.315
Japan	0.462	0.329
Switzerland	0.409	0.303

A discussion about policy would be incomplete if methods of raising the finance required are not discussed. The table above also illustrates the equalizing powers of taxes and transfers. We can also establish two propositions.

- a) The enactment of the Real Property Gains Tax Act 1976, which taxes a proportion of profits gained from property sales, may have a strong equalizing effect.
- b) Property gains and consumption taxes are less damaging to growth than corporate and income taxes<sup>[17]</sup>.

It therefore makes sense to raise tax revenue by increasing the Real Property Gains Tax. At the same time, Malaysia's corporate tax rate of 25% is quite high relative to our regional neighbour's, such as 20-24% in South Korea and 20% in Thailand. Lowering corporate tax rates might attract FDI and create new high-paying job prospects, alleviating **Problem 2**. In fact, if FDI increases by a greater proportion than a decrease in corporate tax rates, tax revenue may in fact increase. Meanwhile, we should restructure consumption taxes to exempt staples while heavily taxing luxury items will alleviate their regressive nature.

Therefore, a pro-growth, pro-equality tax would be a mixture of raises in property gains taxes and perhaps, consumption taxes while decreasing corporate taxes.

## Conclusion

There is much progress to be made with the Malaysian economy. The GINI index of Malaysia is 0.111 points away from the OECD average of 0.32, and while there are solutions to Malaysia's biggest problems, they have always been kept away by the shroud of partisan politics. However, the recent willingness of the government to consult international bodies on the Malaysia Education Blueprint 2013-2025 could be the start of something different. There is still reason to be hopeful.

2006 words, excluding graphs and tables

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