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## **Can Vision 2020 be Far Away?**

Malaysia's Transformation Problems to High-Income Economy.

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Can Vision 2020 be far away? Malaysia's transformation problems to a high-income economy.

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## ABSTRACT

In the beginning of 1990s, the then Prime Minister Mahathir Mohamad set the goal that Malaysia in 2020 should become a high-income economy and a vigorous and economically just middle class society. We are not far away from 2020. We therefore raise the question whether Malaysia is close to or far away of becoming a high-income economy seen from an OECD country level perspective. In our examination of this question, we first discuss different strands in the debate on transformation from middle-income to high-income economies. The debate has focused on the middle-income trap issue especially from an economic perspective. It is an interesting and fruitful input to the transformation debate, particularly the question whether lack of industrial upgrading and deepening keeps middle-income economies back from becoming high-income economies. We do not deal so much with this economic trap issue in the article. Instead, we focus on income inequality as an inroad to highlight Malaysia's transformation problems. From our point of view, income inequality (high Gini-Coefficient) is an important but often neglected element in the mosaic to explain Malaysia's transformation problems both in a domestic and global policy perspective. We examine income inequality and transformation to a high-income economy from different angles. We look into the business structure; income distribution compared with high-income economies; household income distribution, consumption, lifestyle and the middle class; education and tax system as lever or barrier for reducing income inequality; old and new political coalitions as drivers for maintenance or change of income inequality. Through this analysis, we seek at the same time to highlight whether Malaysia is close to become a vigorous and economically just middle class society.

## Introduction.

Malaysia is on its way towards a high-income economy. It has been a long way. From 1950 to 2019, Malaysia has been 19 years in the low-income category and 50 years in the middle-income category. The goal is to become a high-income economy in 2020. On the way to this goal, Malaysia has had high economic growth rates, and by that standard, it has been a success story (Hill 2012; Wade 2010). When the goal 2020 (Vision 2020) was launched in the beginning of 1990s the then Prime Minister Mahathir in his strategy paper "The Way Forward", envisaged Malaysia in 2020 as a vigorous middle-class society that provides full opportunities for all, also those in the bottom third to climb out of the pit of relative poverty. He saw an economically just society that dramatically escalates its programmes of human resource development. "The ultimate objective that we should aim for is a Malaysia that is a fully developed country by the year 2020" (Mahathir Mohamad 1991 p.1). For him a fully developed country is a country that is member of OECD.

We are close to 2020 and Malaysia's economy has still fine growth rates - on average at 5.3 per cent in the period 2011-2015 (The Eleventh Malaysia Plan 2016-2020 Ch. 2 p. 3). The economic growth forecast for 2018-2020 is on the same level (The mid-term review of the Eleventh Malaysia Plan Ch. 15 p.5). However, this growth rate has not been a breeding ground for an economic just society. The Gini-coefficient tells another story of an economy with high economic inequality compared to OECD countries, and according to Khazanah

Research Institute the middle-class is relatively small, and the educational level is low (Khazanah 2014). Seen from Mahathir's "The Way Forward" the picture that he envisaged of Malaysia in 2020 is not showing up on the screen in 2019. Why has the economic transformation not gone smoothly and fulfilled Mahathir's vision of an economically just middle-class society that has a high level of human resource development? Can the new government with Mahathir back as prime minister change deep-rooted inequality policies and transform the country according to Vision 2020?

We are interested in exploring why the transformation process has led to an economy with high-income inequality and why the middle class is relatively small and far away from an OECD middle class income level. We are interested in exploring these two questions. To throw light on the economic structure in which the two questions are grounded we explore the business structure by number of companies, employment, their contribution to GDP and productivity both domestically and in an international comparative perspective. Through this analysis, we seek to outline the main economic structural problems, which we perceive as important elements in an attempt to highlight the two questions.

Our main empirical input to examine the two questions is government statistics, documents and appropriate secondary sources such as newspapers coverage, academics analyses and information from publicly available websites. We use government documents as sources to get statistical data but also as sources to outline government policy discourses on inequality among the three main income categories: Bottom 40% (B 40%), Middle 40% (M 40%) and Top 20% (T 20%). Later we will go into a definition of these three income categories. We compare the policy discourse in the Tenth and Eleventh Malaysia Plans with the Khazanah Research Institute's 2014 and 2016 reports on the State of Households in order to identify similarity and difference between a government planning agency and a private/semi-government agency in their initiatives and proposals to reduce inequality and uplifting B 40% to the middle class<sup>1</sup>.

Our analysis is organised as follows. Firstly, we give an overview of three theoretical strands that highlight transformation problems. Secondly, we outline the sources of income and profit generation in the private sector and at the same time look into the business landscape, dominated by small and medium size companies. This overview is an attempt to show connections between the business structure and problems of taking off to a high-income economy. Thirdly, we explore the income distribution by Gross National Income (GNI) compared with high-income countries in order to indicate how close or far away, Malaysia is from high-income economies. Fourthly, we examine how far away the main income categories are from the average income level of the OECD. Fifthly, we go deeper into an analysis of household income and inequality. As a part of this analysis, we explore the size of the Malaysian middle class. We discuss different authors' definitions of the middle class and in addition to that, we look at lifestyle and level of household consumption. We will examine whether the middle class and the upper end of B 40% have become consumption drivers that help to accelerate transformation towards a middle class high-income economy. Sixthly, we look into whether education and

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<sup>1</sup> Khazanah Research Institute is sponsored by Khazanah Nasional Berhad. It is a non-profit organisation. We categorise the Khazanah Research Institute as a semi-governmental agency because Khazanah Nasional Berhad is the sovereign wealth fund of the government of Malaysia and as such it a semi-governmental institution, and an agency under its umbrella is also in our view affiliated as semi-governmental.

taxation are ways forwards to reduce inequality and strengthen development of a middle class society. Seventhly, we discuss the BN coalition and maintenance of income inequality. It has not had focus on income inequality but ethnic divides. We discuss what consequences this emphasis has had on development on a middle class society. We wrap up this discussion by reflecting on whether new winds will be blowing in planning policy in terms of focusing on income inequality after the May 9 2018 general election. In conclusion, we reflect on the question whether Malaysia is on its way to become a wide and vigorous middle class society.

Theoretical strands highlighting transformation problems.

There are several ways through, which we can highlight transformation problems. Gill and Kharas have set the stage for discussing middle-income economies' transformation problems in their book 'An East Asian Renaissance: Ideas of Economic Growth' (Gill and Kharas 2007). They argue that many middle-income economies have been successful in harvesting the fruits of the transformation from low to middle-income economy, including the fruits of cheap labour, transfer of people and other resources from low-productivity agriculture to higher productivity manufacturing and services by simple imitation of technology. However, they face difficulties in pursuing an industrial policy that through investment in human resource development and innovation underpins high productivity (Gill and Kharas 2007). They are caught in a trap. Since Gill and Kharas have launched the concept of middle income trap the discussion on transformation from middle to high-income economy has concentrated on finding causes that catch these economies in a trap. We will outline two ways or strands that deal with these causes, and a third strand that focuses on income distribution and inequality under the transformation process.

One strand focuses on industrial policy. In *Tiger Economies under Threat*, Yusuf and Nabeshima, outline the South East Asia scene for industrial policy including Malaysia, Thailand, Philippines and Indonesia (Yusuf and Nabeshima 2009). In contrast to the original East Asian Tiger economies (Taiwan, South Korea and Singapore) these new tigers have according to the two authors not been able to build the indigenous capacity to design, to innovate and to diversify into new more profitable areas with good long-term prospects. Moreover, in general they have not been good to create backward links from MNCs, which have been "enclaves" and have not created forwards and backwards linkages to develop domestic higher value added production. They have neither helped to strengthen sophistication and diversification of production nor of the export structure (Yusuf and Nabishima 2009). According to the two authors, this lack of industrial upgrading and deepening has signified that Malaysia like the other new tigers appears to be sliding down the technological slop and has difficulties to get out off the trap (Yusuf and Nabeshima 2009).

Second strand focuses on institutional capacity. It underlines that the way off the trap requires upgrading of productivity through both investment in human resource development and innovation, but this upgrading policy needs enormous investment in institutional capacity. Often, the problem is to build political coalition that can underpin and secure such institutional capacity. Doner and Schneider agree that in many middle-income countries the fragmentation of social groups is deep and makes it difficult to establish long-term coalitions that would buttress institution building (Doner and Schnieder 2016). Malaysia's political development does not underpin the social fragmentation argument. The political landscape in Malaysia differs from many other middle-income countries. Until the general election of May 9 2018 where a new coalition, *Parakan Harapan* (the Pact of Hope) won, a long-term political coalition has been in power. Since the Independence in 1957, the

Barisan Nasional (BN) with United Malays National Organisation (UMNO) as the leading party has formed this long-term political coalition. The BN coalition created a platform for cooperation among the three main ethnic groups Malays, Chinese and Indians. The coalition secured political stability, which has been an important foundation for attracting especially foreign investment and maintaining the long sustained economic growth.

Although the BN coalition has been successful in securing political stability and economic growth, it did not pave the way for a coalition between business and labour. From this perspective, Malaysia's political development underpins the second strand's argument that lack of long-term coalition building is an important element in explaining why middle-income countries are caught in a trap. High-income economies like the Nordic countries and Germany illustrate the explanatory argument in the second strand. They have shown that institutional capacity building in human resource development and innovation is not only an outcome of high investment but also of a long-term agreement between business and labour on connecting productivity increase and wage development (Katzenstein 1985). The authors within this strand have not found such long-term coalitions in middle-income economies (Doner and Schneider 2016). They emphasise that in general large and small domestic firms apart from pockets of domestic and foreign high tech firms have little interest in upgrading and forming partnership with labour on education and skill upgrading. These firms are reluctant to support a business-led upgrading coalition because it does not reflect their skill needs. They very well know their needs, which usually are low and resolved internally. Often, this reluctance to skill upgrading is in contrast to their business associations, which regularly list education and upgrading as one of their policy priorities ([www.fmm.org/about](http://www.fmm.org/about))

The observations of the two strands are useful to encircle causes to the slow speed towards high-income status in Malaysia. The lack of industrial deepening through widespread investment in technological innovation as Yusuf and Nabeshima point out is an important finding to explain why the Malaysian economy is not coming out of the middle-income trap. A recent World Bank analysis on productivity development argues in the same line (Malaysia Economic Monitor 2016). It emphasises that many domestic firms have low productivity compared with domestic high tech firms and multinational companies. They are barriers for skill upgrading and spread of technological innovation that would help to speed up to high-income status. Their prevalent business interests are tematised by the observation in the second strand. They have little interest in skill upgrading and they are not working for building up a long-term partnership between business and labour in order to promote skill upgrading. Their chief interest is to support a low wage policy because their competitiveness is determined by wage levels and not by technical innovation and productivity. This interest becomes a break for the transformation speed to a high-income economy.

The two strands help us on way to examine why the economic transformation has not gone smoothly and fulfilled Mahathir's vision of an economically just middle class society. They give input to explain why Malaysia has been a middle-income country in many years. They do not give much input to explain why Malaysia has not become a broad-based more equal and vigorous middle-class society although it has had high economic growth rates in many years. The third strand helps us on way to explore this question.

One approach in this third strand argues that the high economic inequality is an outcome of adopting a horizontal perspective on inequality – that is, by targeting ethnic groups that are in most need for help (Jayaraj

and Subramanin 2006). In his studies of inequality and entrepreneurship in Malaysia Gomez gives insight into how horizontal inequality policies have helped the best-connected Bumiputeras (Malays) to become wealthier and leaving behind the less resource endowed Malays (Gomez 2009 and 2012b). These horizontal inequality policies like the New Economic Policy (NEP) and the Vendor Development Programs in 2000s were successful according to Gomez in the sense that they partly have reduced inter-ethnic inequality and poverty and partly have created Bumiputera equity ownership and a Bumiputera entrepreneurial class. However, they have not led to less economic inequality seen from a vertical inequality perspective.

Theoretically, these policies are in line with classical economic development thinking of saving and capital accumulation by the rich classes as a prerequisite for economic development of modern manufacturing and services in developing countries. Lewis (1954) and Kuznets (1955), two prominent contributors to the classic economic development thinking, found that industrialization and urbanization initially would lead to increase income inequality because of scarcity of saving and capital and abundance of cheap labour especially from the rural areas. But they assumed that income inequality would be reduced in a later stage of the economic development because of demographic factors, increasing scarcity of labour, democratisation and rise of trade unions. This development trajectory has Kuznet formulated in his inverted u-curved hypothesis (Kuznet 1955). As the below mention literature on vertical inequality shows the later stage of the Kuznet inverted u-curve hypothesis has not been empirically corroborated in Malaysia in contrast to the Nordic countries (Katzenstein 1985). We are aware that the income inequality (measured by Gini coefficient and the shares of T 20%, M 40% and B 40% of total income) has since mid-1970s shown a little downward trend but not significant. We will show that many factors have contra acted the later stage of Kuznet's hypothesis in Malaysia and preserved a high vertical inequality.

This vertical inequality perspective addresses socio-economic position of individuals in need, regardless of their ethnic background (Jayaraj and Subramanin 2006). Hwok-Aun Lee and Muhammad Abdul Khalid have investigated economic inequality in Malaysia from a vertical perspective (Lee and Khalid 2014). They have found evidence in the Household Income Survey and other databases of steadily rising earnings inequality in both the private and public sector in 2000s. Like Gomez, they found that concentration of earnings and wealth is in the upper classes of the economy. In our investigation, we follow the same path as Hwok-Aun Lee and Muhammad Abdul Khalid with focus on vertical inequality. We are aware that this emphasis on vertical inequality may underexpose the effect that the horizontal inequality policy has had on eliminating poverty and reducing income inequality. As above, we will argue that this effect has not been significant in reducing the income inequality. We therefore follow the vertical inequality perspective because it helps us to put focus on the problems that income inequality causes for the transformation to a high-income economy.

The private sector in the economy. Is it on the way towards a high-income economy?

Before examining income distribution, we will analyse sources of income generation. In this analysis, our focus is on the private sector because it is the backbone of the economy and employs the majority of the workforce. Like in many other advanced and emerging economies, small and medium size enterprises (SMEs) dominate the business landscape in Malaysia in terms of number and employment (OECD 2017). The Small and Medium Enterprise Corporation Malaysia, which was formed in 1996 under the Ministry of International Trade and Industry is a central reference point for statistics on SMEs in terms of number, turnover and employment, and its

annual reports inform on current development and formulate overall policies and strategies for SMEs. As in 1996, the overall aim of the policies and strategies today is to help SMEs to become more efficient and productive. They are the Achilles heel in the transformation process towards a high-income economy because they are so many and have low productivity (Malaysia Economic Monitor 2016).

In 2016, 98.5% of all businesses were SMEs (SME Annual Report 2016/17)<sup>2</sup> According to the SME Corporation Malaysia these 98.5% SMEs were in 2016 distributed in the Malaysian business landscape with 2.3% medium size, 21.2% small and 76.5% micro companies. By sectors, the distribution was services 89.2%, manufacturing 5.3%, construction 4.3%, agriculture 1.1%, and mining and quarrying with 0.3% (SME Annual Report 2016/17). In 2016, SMEs contributed 36.6% to GDP at constant 2010 prices. They employed 6.7 million workers, which was 65.3% of total employment. The highest contribution of these 6.7 million SME workers was in services sector with 63% followed by manufacturing with 16.5%, construction with 10.4%, agriculture with 9.8%, mining and quarrying 0.3% (SME Annual Report 2016/17). Among Non-SMEs, large government-linked companies and multinational companies are important contributors to GDP (Gomez et al 2018).

This account of the SMEs in term of number and employment is an attempt to outline what the majority of companies in the Malaysian business landscape contribute to the whole economy. Their share of GDP reflects according to the SME Corporation Malaysia a relatively low labour productivity compared to large companies, which are three times more productive than SMEs (SME Annual Report 2016/17). This low productivity in micro and small companies has great impact on Malaysia's labour productivity. In its December 2016 report, Malaysia Economic Monitor has examined Malaysia's labour productivity over the past 25 years as value-added growth rate per employed person. This productivity at an average annual rate (2.65%) has been below regional countries such as Singapore (3.95%) and South Korea (3.39%) (Malaysia Economic Monitor December 2016 p. 43).

The December 2016 report found that after the Asian Financial Crisis 1997/98 an employment creation was followed by a growth in labour productivity in Malaysia. While after the 2008 financial crisis, the employment creation was not accompanied by a growth in labour productivity in manufacturing and services. The report cannot find one reference point for Malaysia's slow labour productivity. But it points at the ability of companies to acquire and adapt advanced technology to their local context as a source to explain the slow growth of labour productivity (Malaysia Economic Monitor 2016).

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<sup>2</sup> The SME Corporation has divided small companies in micro and small companies. Micro companies in manufacturing are from 1-5 employees with sales turnover up to RM 300.000 while small companies in manufacturing are from 5-75 employees with sales turnover from RM 300.000 to RM 15 million. In services and other sectors micro companies are up to five employees with turnover up to RM 300.000 while small companies are from 5-30 employees with sales turnover from RM 300.000 to RM 3 million. Medium size companies in manufacturing are from 75 to 200 employees with sales turnover from RM 15 to 50 million. In services and other sectors medium size companies are from 30 to 75 employees with sales turnover from RM 3 to 20 million. (SME Corporation Malaysia 2015).

The Eleventh Malaysia Plan walks at the same path as the Malaysia Economic Monitor in its search for explaining the transformation problems to a high-income economy. It has also an increase of labour productivity as one of its main targets for the plan period 2016-2020. Like the Malaysia Economic Monitor it cannot point at one reason for the slow productivity. Therefore, it turns its focus to the business culture. It recognises that it is difficult to foster a productivity-based culture in a business environment, in which productivity oriented thinking is not very developed. However, the Plan believes in stimulating effects of good examples. It appoints productivity champions that can act as drivers in improving labour productivity (Eleventh Malaysia Plan 2015 p 2-15).

We draw attention to this planning discourse on labour productivity because it throws light on the broad implications that the planning analysis and discussion has on the transformation problems that there are in many parts of the Malaysian business landscape. In order to bring these problems into relief we will show how far or close Malaysia is from developed countries in terms of labour productivity on country level. The Malaysia Productivity Corporation provides in its 2016/17 Annual Productivity Report data on labour productivity in a comparative country level perspective. Table 1 shows that Malaysia is not on level with developed countries but it scores better than China, Indonesia and Thailand in the Productivity Report 2016/2017 calculation of output per person employed 2015 by GDP.

Table 1

Labour productivity level of selected developed and emerging economies in US dollars, per person employed measured by GDP, 2015.

US	Australia	Japan	Singapore	South Korea	Malaysia	China	Thailand	Indonesia
120.584	102.740	64.644	80.065	53.126	21.564	14.396	10.396	7.507

Source: Productivity Report 2016/2017 p 7

The comparative country level perspective helps us to encircle how close or far away, Malaysia is from advanced economies in term of production output per person employed. It is not a fine granulated measurement of labour productivity but the Productivity Report 2016/ 2017 argues that this measurement of production output per person employed is a useful statistics tool to illustrate Malaysia's competitive position in the global economy. At the same time, it is according to the report an indication of a traditional utilisation of capital and labour with limited diffusion of innovation compared to advanced countries (Productivity Report 2016/2017 p. 138). This argumentation is similar to the argumentation of Yusuf and Nabeshima that we mentioned in the beginning. The lack of technical upgrading and industrial deepening does not only mean that many companies in Malaysia and other newly industrialising countries have difficulties to catch up to the technological level of more advanced economies but it does also mean that the contribution of per person employed to GDP is lower in these countries than in advanced economies.



This comparative perspective with focus on productivity and contribution per person employed to GDP is an entry to deal with household income and the question of transformation to high-income economy status. We will explore two tracks. By the first track, we will look at income development from a comparative per capita income perspective. We are interested in examining how far or close Malaysia is from a high-income economy status. As measure standard for high-income economies, we use the United States and OECD. By the other track, we will look at income distribution among social classes in Malaysia. We examine this distribution in a comparative perspective in order to see how far or close the income distribution is from the United States and OECD countries. Our focus is on the middle class because the transformation process should as mentioned in Vision 2020 lead to a wide and vigorous middle class society.

Income distribution by GNI compared with high income economies.

The World Bank provides data on per capita income by Gross National Income (GNI). By this measurement, the World Bank divides the World's economies in four income groups, low, lower middle, upper-middle and high. In 2017, the World Bank threshold to high-income status was US\$ 12,056 (World Bank 2018). Malaysia is close by this threshold measure to become a World Bank high-income economy. In 2017, Malaysia's per capita by GNI was US\$ 9,650. In recent years, Malaysia's curve of per capita by GNI has been up and down. In 2015, it was up to US\$ 10,570 per capita by GNI. In a 20 years perspective, there is a steady upward curve (Department of Statistics Malaysia 2018).

In his the Way Forward (Vision 2020) Mahathir emphasised as mentioned in the Introduction that the ultimate objective is that Malaysia is a fully developed country by the year 2020. For him a fully developed country is a country that is member of OECD. He did not mention the World Bank high-income economy status as an ultimate objective. Seen in the light of how close or far away Malaysia is from fulfilling the Vision 2020 this statement is interesting.

We will examine how close or far away Malaysia is from OECD countries. We will measure the distance by using the average GDP (PPP) per capita in current international dollar of OECD countries in 2017 as measurement<sup>3</sup>. It was Int\$ 43,357 (OECD 2019). Countries like South Korea and Japan are in the range of this average measure. In 2017, they had respectively Int\$ 38,357 and US\$ 43,357. The lowest GDP (PPP) per capita in 2017 among OECD member countries was Mexico with GDP(PPP) at current Int\$ 18,655 (OECD 2019).

According to the World Bank indicator of GDP per capita at current international dollar PPP 2017, Malaysia had in 2017 per capita at current Int\$ 29,511. By this measure, Malaysia is far away from the average GDP (PPP) per capita at current Int\$ of OECD but it has overtaken Mexico. If we instead of using GDP (PPP) per capita at current Int\$ as measure use household income (1.8 person has in average an income in a household in 2018) as measure another picture of the distance between Malaysia and OECD comes up on the screen. According to the

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<sup>3</sup> PPP is measured by finding the value (in USD) of a basket of consumer goods that are present in each country in the World Bank list of countries in the world. International dollar, which is a hypothetical unit of currency that has the same purchasing power that US dollar had in the United States at a given point of time.

Khazanah Household Report 2018, the mean annual household income was in 2016 RM 83,496 (Khazanah 2018). It is about US\$ 23,856 at an exchange rate between US\$ and Malaysian Ringgit on 1 to 3.5.

Although the mean annual household income has increased neatly in Malaysia in recent years, there is still a way up to the average annual OECD income level but it overtakes Mexico. Table 2 shows that the mean monthly salaries and wages in Malaysian household are not close to the average level of OECD. It is noticeable that the annual management household income, which in 2012 was US\$ 41,211, almost reached the average OECD income of US\$ 43,351 in 2017. The other occupation categories are long way from the average OECD income.

The low wage policy, which has been the main driver of Malaysia's growth policy, has influenced the income level of the occupation categories under the top income level. Like other middle and low-income countries, the Malaysian government has pursued a low wage policy in order to support small and medium size industries, attract MNCs and foreign direct investments and to make export-oriented industries competitive on the global market especially in the North. These considerations were since the export-oriented industrialisation strategy began in late 1960s and in the beginning of 1970s the main foundation for the BN coalition government's wage policy. In recent years, with contracting markets in the North in the wake of the 2008 financial crisis the government supplemented its export-oriented strategy with an increased focus on stimulating domestic market and demand and productivity especially in small and medium size companies (Malaysia Economic Monitor 2016; the Eleventh Malaysia Plan 2015). This increased emphasis on domestic market and demand made the government more inclined to consider minimum wage legislation.

The Malaysian trade unions have in many years sought to gain political support for a minimum wage law. The government and business associations would not support the trade unions. As noticed, the business associations had not interest in establishing a long-term political coalition with unions to support a minimum wage policy. They put more emphasis on supporting small and medium size companies' low wage interests than supporting technological innovation and productivity improvement (Malaysia Economic Monitor, 2016). Although technological innovation and productivity improvement was in line with the government's long-term policy (Productivity Report 2015/2016, 2016; the Eleventh Malaysia Plan 2015), it was not the argument that the government made when it in 2013 began to change policy towards legislation on minimum wage. It argued that it was an attempt to reduce dependence on foreign workers and encourage local workers to take low paid jobs (October 25, 2015 English [astroawani.com/my](http://astroawani.com/my)).

Until January 1st, 2019 the minimum wage was RM 1000 a month ([www.wageindicator.org](http://www.wageindicator.org)) but after January 1, 2019 the minimum will be RM 1050 a month ([www.thestar.com](http://www.thestar.com) my Sept 5, 2018). This wage is almost 12 times lower than the average OECD income level. Although the occupation categories in table 2 are not under the minimum wage level, they are not many times above this minimum level. It signals that many Malaysian households are at the bottom or middle on the income ladder. We will look closer to how the Malaysian households are placed on this ladder and what implication this income distribution has for Malaysia to become a wide and vigorous middle class economy gauged by high-income economy standard.

Table 2

Mean monthly salaries and wages by occupation of head of household, Malaysia, 2012.

Occupation	Number ('000)	Per cent	Mean income (RM/Month)
Managers and administrative	302.0	3.3 %	12,020
Professionals	1134.7	12.5 %	9,606
Technicians and associate professionals	1,188.6	13.1 %	6,098
Clerical support workers	1,136.5	12.5 %	4,896
Service and sales workers	1,685.3	18.5 %	4,215
Craft and related trades workers	133.6	1.5 %	3,872
Plant and machine operators, and assemblers	950.0	10.4 %	3,691
Skilled agricultural, forestry, and fishery workers	1,389.9	15.3 %	2,823
Elementary Occupations	1,167.9	12.8 %	2,892
Total	9,088.6	100 %	5,000

Source: Household income and basic amenities survey report 2012, Department of Statistics, Malaysia June 2013.

### Household income and inequality.

The household income and basic amenities survey report provides data on income distribution in Malaysia among three main income groups: the top 20%, the middle 40% and the bottom 40%. The income difference among these three groups has narrowed a little since 1970 but the gap is still great and reveals a big difference between top and bottom in the Malaysian society. In 1970, the difference between the top 20% and the bottom 40% was 5 times. It has narrowed to 3 times in 2014 (Household income and basic amenities 2014). The report also provides data on how much the top 20%, middle 40% and bottom 40% share of the total income. The table 3 gives an overview of this distribution.

Table 3

The top 20%, middle 40% and bottom 40% share of the total income in different years.

Years	Top 20%	Middle 40%	Bottom 40%
1979	55.7%	32.8%	11.5%
1984	53.5%	33.8%	12.7%
2012	48.6%	36.6%	14.8%
2014	46.6%	36.9%	16.8%

Source: State of Household I (2014) and II (2016), Khazanah Research Institute, Kuala Lumpur, Malaysia.

According to table 3, there has been a re-distribution of income from the top 20% to middle 40% and bottom 40% from 1979 to 2014. The top 20% has lost 9.1%, the middle has gained 4.1% and the bottom has gained 5%. This re-distribution reflects the fallen Gini-coefficient in the same period from 0.52 to 0.42 cf. table 4 below. The decrease of the top 20% share of total income is a recent development and is a positive development for more equal income distribution. From 1979 to 2009 the top 20% had 50% and above. The table 4 also reflects the stable Gini-coefficient development from 1989 to 2007.

Table 4

Gini-coefficient 1970-2014.

1970	1979	1989	1999	2007	2014
0.52	0.50	0.44	0.45	0.44	0.42

Source: State of Households. Khazanah Research Institute 2016.

What is the monthly income of a B 40%, M 40% and T 20% household? According to the Khazanah State of Household 2018 B 40% is below RM 4,360, M 40% ranged between RM 4,360 and RM 9,619 and T 20% is above RM 9,620 per month in 2016 (Khazanah 2018). To this account of the monthly income of three income categories, we would add data from the Khazanah State of Household 2016, which brings into relief the income inequality among the three income groups. According to this report, B 40% and M 40% have been better off since 2012 but their income level has not rocketed. The majority of households (65%) had in 2014 a monthly income below RM 6000. 21% of households had an income from RM 6000 to RM 10,000 per month and 13.7% earned more than RM 10,000 per month (Khazanah 2016). According to table 2, only managers and administrative in top positions earned a monthly income that reached the average annual OECD level.

In the large 65% household group, 55% has an income below RM 5000 per month. To this distribution of household income, we will add data on income distribution of active Employees Provident Fund members. As at December 2015:

- 91% of active members earned less than RM 6000 a month;
- 83% earned less than RM 4000 a month;
- 58% earned less than RM 2000 a month

Source: Department of Statistics 2016.

That 58% earned less than RM 2000 per month underscores the low wage policy's prevalence on the Malaysian labour market. The new PH coalition, although it has increased the minimum wage a little bit from January 1, 2019, seems not to have intentions to change the low wage policy in the near future. In a statement after the decision on increasing the minimum wage the government said: "The minimum wage should be increased gradually so that businesses, especially small business, are not forced to shut down due to increase in operating costs ([www.thestar.com.my](http://www.thestar.com.my) Sept. 5, 2018). With this statement, the new government seems to signal that it will not use a tough productivity increase policy like Singapore in 1980s to clean up in the number of small low productive companies. In addition, we have not seen statements from the new government that air a new policy concerning reduction in the great number of immigrant labour, which helps to keep the low wage policy and maintain a precariat in B 40%. This wage policy brings into relief the strong interests that still makes it difficult to reduce the high Gini coefficient and inequality.

#### Household income, consumption and middle class.

The above account of household income distribution and inequality had touched upon M 40% as an income category in relation to B 40% and T 20%. But M 40% as an income category does not reveal the size of the middle as a social class. It is difficult to set the limit for this class. The Asian Development Bank identified in its study of "The Rise of Asia's Middle Class" (Asian Development Bank 2010) those who are living between 2 and 10 dollar a day as belonging to the developing world's middle class. This range between 2 and 10 dollar a day is a wide entry door to the middle. In an upper middle-income economy such as Malaysia, this entry threshold opens the door for most of the Malaysian households to a middle class position. Instead of the Asian Development Bank's broad definition of thresholds for entering the middle class, we find Banerjee and Duflo's definition more useful in our examination of Malaysia's way to 2020. They emphasise two factors that drive the creation and sustenance of a middle class (i) stable, secure, well-paid jobs with good benefits, and (ii) higher education (2008). This definition is in line with sociological tradition that defines middle class from its employment relations and education arguing that educational or technical qualifications (credentials) are the most important determinant for the middle class' market power and self-identity (Dahrendorf 1959; Giddens 1973; Goldthorpe 1987). This definition is not without problems. It is unclear whether member of the middle class should have higher education credentials to be included in the middle class or whether members of the middle class give high priority to higher education. We interpret the definition in a narrow and wider sense. In the narrow sense, the middle class primarily consists of salary and wage earners that bolster their social position with higher education credentials. It means that many owners of small companies are excluded from being members of the middle because they normally do not have higher education (Mann 1993). From a household income perspective they are however qualified to a membership of the middle class because they have a

household income that is in the range of or above a well-paid job<sup>4</sup>. In a wider interpretation of the above-mentioned definition of the middle class, we would include well-paid clerical workers in the middle class because they are according to the calculation below within the range of a well-paid job.

As well as it is difficult to define the limits of the middle class, it is difficult to set the amount of a well-paid middle class job. We will use information in the Khazanah State of Household 2018 report on the income range of M 40% household to determine a well-paid middle class job. According to the report, households that in 2016 earned between RM 4,360 and RM 9,619 per month were in the M 40% (Khazanah 2018 p. 18). If we look at table 2 the mean income of head of household in 2012 for clerical workers was about the threshold line to B 40%. As mentioned earlier household incomes have increased since 2012, so we assume that well-paid clerical workers are within the income category M 40%. However, many of these workers are not well paid and are under the threshold line to B 40%. The above-mentioned income statistics of the Employees Provident Fund shows that many are under this line.

If we sticks to the narrow definition of the middle class as a class of income earners with higher education credentials the statistics shows that the number of tertiary education graduates has increased in recent years. Since 1980s, more and more people have graduated from higher education and got the entry ticket to a middle class position according to the narrow definition. In 1982, one of 16 employees in the workforce had tertiary education. The number has increased markedly in the last three decades. In 2015, the share of employed persons that had a tertiary education was 27.4 per cent (Malaysia Monitor 2014). Although it approximately covers the percentage of managers and administrative, professionals, technicians and associate professionals in table 2. We cannot equalize these employment categories with the middle class in narrow sense. Many managers and persons in administrative positions belong rather to the upper class or the Rich. If we consequently deduct the 27.4 per cent with around 3 per cent, we have 24.4 per cent as an approximate measure of the educated middle class.

In our definition of the middle class, we distinguish between middle class in narrow and wider sense. The educated middle class is accordingly to this definition middle class in narrow sense. To determine the middle

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<sup>4</sup> According to John Goldthorpe's class scheme, small company owners with employees are the main constituents of the petite bourgeoisie, which is the old middle between the bourgeoisie and the working class. Goldthorpe emphasised in his analysis that the new middle of well-educated wage earners (the salariat) has grown bigger in modern societies than the old middle, so Banerjee and Duflo's definition of the middle as primarily consisting of a well-educated salariat is in line with Goldthorpe (Goldthorpe 1987). In order to illustrate that small company owners with employees are not economically bad off we will refer to SME Corporation Malaysia's definition of SME. In this definition, small company owners have a sales turnover between RM 300.000 to RM 15 million and employees from 5 to 75 in manufacturing (total number of companies in 2013: 13.934) and in services a sales turnover from RM 300.000 to RM 3 million and employees from 5 to 30 (total number of companies in 2013: 106.061). If we include the total number of small company owners in M 40%, it would be a little share of this category. According to the Eleventh Malaysia Plan the total number of M 40% households was in 2016 2.67 million.

class in wider sense we use a well-paid job as determinant. Above we said that clerical workers were within this category. In 2012, according to table 2, 12.5 per cent of the total number of head of households were within this occupation category. If we add 24.4 per cent to 12.5 per cent, we have approximately a percentage (36.9%) for the wider middle class. This percentage for the middle class in wider sense is a little more than the size that the Malaysia Economic Monitor set for the middle class (Malaysia Economic Monitor, December 2014). In this report, it set the middle in 2014 to approximately 35%. Both Malaysia Economic Monitor and our estimate of the size of the middle class is lower than the estimate that Abdul Rahman Embrong sets in his analyse of the middle class in Malaysia (Embrong 2014). He does not operate with the category middle class household but with middle class employed workers. He argues that 50.6% of the employed workforce belongs to the middle class. He reaches this percentage because he includes all clerical support workers and services and sales workers (cf. table 2). Many of these workers have a monthly mean income below RM 4,360 and therefore below our entry threshold to a middle class position.

This discussion on threshold to the middle class illustrates that there is little consensus on entry criteria to the middle class. Although the concept is not clear and consistent, we have seen in recent years an increased interest in studying middle class development especially in emerging Asian economies. These studies focus on middle class as an inroad to throw light on the drivers and obstacles towards a high-income status (Kharas 2010; Asian Development Bank 2010). The roots of these studies are OECD' economic history, which shows that a large middle class is an important indicator of a high-income economy (Kharas 2010).

In our attempt to examine whether Malaysia is on its way to become a high-income economy we will not only refer to the size of the middle class as an indicator but also to its role as a consumer class that enjoys a lifestyle with durable goods like cars, televisions, mobile phones etc. This focus on consumption and lifestyle is in line with the classical studies of Max Weber and C. Wright Mills. (Weber 1978; Wright Mills (1951/2002). Both emphasised the interrelation of consumption and lifestyle in their multifaceted approach to defining the middle class. The critical question is therefore whether the middle class and the upper end of B 40% are such consumption drivers that help to accelerate the transformation process to a high-income economy. We will examine this question by discussing whether these two classes - middle and working classes - have become a stable consumer group.

Our data to examine this question is the Household Income and Basic Amenities Survey Report, which provides data on percentage distribution on households' purchase of durable goods like cars, motorbikes, mobile phones etc. Table 4 below shows that the distribution of cars in urban areas is almost at the level of mobile phones and washing machines. In urban areas, 83.6 per cent of the households have one or more cars while in rural areas it is 62.7 per cent. This distribution of durables like cars indicates that not only the top 20% can afford to buy durables. The M 40% and the upper end of B 40% are also taking part in this consumption of durables.

Table 5

Percentage distribution of households by items used urban/rural, Malaysia, 2012.

Car	Urban	Rural	Motorcycle/ Scooter	Urban	Rural	Mobile phone	Urban	Rural	Washing machine	Urban	Rural
	83.6%	62.7%		61.5%	77.6%		96.4%	91.6%		93.5%	82.9%

Source: Household income and basic amenities survey report 2012, Department of Statistics, Malaysia June 2013.

The distribution of cars in Malaysia is not only illustrating penetration of consumption lifestyle but also of government-supported consumption to promote industrialisation of Malaysia (Fleming and Søborg 2017). The national car project Proton Saga, which the then Prime Minister Mahathir launched in the beginning of 1980s was thought as a lever to make Malaysia a middle class consumer society. Mahathir attempted to create a kind of Malaysian “Fordism” that coupled industrialisation and consumerism. But the low wage policy did not promote such “Fordism”. The Proton Saga became not a low price car that every household could afford to buy. In order to help to spread the national car the government made it easy to get loan to buy durable goods like cars (Bank Negara Malaysia 2014).

The ease access to loan and consumer credit helps to explain why many households in spite of the low wage policy have financial opportunity to buy durable goods. This ease access to loan and consumer credit is a break with the widespread Asian saving culture that instigates people not to purchase goods before having earned the money. Many people in Malaysia have broken with that culture and the country has become a consumer society built on easy access to borrowing and, as a consequence, a growing household financial vulnerability (Embrong 2014). Especially for low income, household repayment of loans has been a heavy burden. Many of these households repay more than 60% of their total monthly salary (Y. Ramlan 2017). Compared to other Asian countries Malaysia is in forefront in terms of household debt to GDP. In 2013, Malaysia’s household debt to GDP was 86% while the percentage in Singapore was 60%, China 35% and Indonesia 10% (Malaysia Rating Corporation 2014).<sup>5</sup>

This account of household income, consumption and middle class indicates that the middle class and the upper end of B 40% are on way to a consumption level similar to many high-income countries. For instance, the spread of cars, which is the highest in South East Asia, illustrates this consumption level. From 1997 to 2012, registered private cars had an average growth rate of 6.7%. This number is well over three times the rate of population growth (2.0%) and approximately 1.6 times the rate of growth of the economy as a whole (4.2%). This expansion of cars gives Malaysia a person-to-car ratio of one to three. That is a high ratio, close to high income countries such as Denmark, which has a person-to-car ratio of one to 2.5 in 2015 (Fleming and Søborg 2017).

Education and access to the middle class.

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<sup>5</sup> In the first quarter of 2017, the household debt to GDP was 86.9%. New Straits Times November 3, 2017.



As noticed above penetration of consumption lifestyle is a prominent part of a middle class society. Another part is education as lever to status and income. Table 5 below indicates that higher education is not only a way to get an entry ticket to the middle class but also to get more financial room of manoeuvre in the new consumer culture.

Table 6  
Education attainment and monthly average wage income<sup>6</sup>.

Tertiary	Secondary	Primary	No Formal
RM 6473	RM 3074	RM 2071	RM 1607

Source: Malaysia Economic Monitor, Towards a Middle Class Society, December 2014.

The Eleventh Malaysia Plan draws attention to the same connection between higher education and income. It emphasises that enhance access to higher education would be a vehicle for B 40% to increase its income. But according to the Plan, it is not easy for the B 40% to get the entry ticket to the middle class. The number of school dropouts is high in B 40% although students have favourable opportunities to financial aids and stipends. Other more fundamental barriers are at works (Eleventh Malaysia Plan 2015, p 3-18). Like in many other countries, mainly middle and upper middle class families give high priority to education and particularly tertiary education. They have a social and education background that makes it easier for their children to navigate in higher education than young people from B 40% (Malaysia Monitor 2014).

It is not only social and education background that makes it difficult for B 40% to get access to higher education. It is also fee and tuition payment that makes it difficult for individuals from not financial well-off families to get an entry ticket to the middle class via higher education although there are a great number of scholarships available (Fleming and Søborg 2014). The amount of fee and tuition payment is depending on whether the student is enrolled at public or private universities. As a general rule of thumb, it costs respectively RM 3.500 and RM 25.000 to study at a public versus a private university a year. In addition to fee and tuition expenditure is cost of living that students and their families must take into consideration. Although many students do not have high cost of living a survey conducted by HSBC bank found that parents on average spend RM 38.000 a year on their child's university education (Z. Mustafa 2017). These numbers illustrate that securing a middle or upper middle class position for a child makes up a great part of a household's budget. Many middle

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<sup>6</sup> Tertiary education refers to any type of education pursued beyond the high school. This includes diplomas, undergraduates and graduates certificates, and associate's, bachelor's, master's and doctoral degrees. Secondary or high school in the United States. High school starts at age 14-15 and finishes at age 18-19. Generally, a student goes to high school for four years. Source: [http://learn.org/articles/what\\_is\\_tertiary\\_education](http://learn.org/articles/what_is_tertiary_education),

class families start saving for their child's education when it is born (Z. Mustafa 2017). They do this because an attractive tertiary education has become expensive especially if it is a twinning program with half of the curriculum at an overseas university.

The wide spread of private colleges and universities illustrates the demand for education especially in middle and upper middle class<sup>7</sup>. In 2015, there were 56 private colleges and universities with 580,929 students. The number of public universities was 20 in 2015 with 540,638 students (Social Statistics Bulletin 2016). As we noticed earlier, this number of students at higher education has increased every year since 1980s. When they graduate, they have an opportunity to get an income that opens doors for middle or upper middle class positions. But the middle and upper middle class do not increase in line with the number of graduates. More and more students experience a mismatch between their higher education qualifications and labour market demand (Fleming and Søborg 2014). They need to go through a re-qualification process to get a job, which not always is a well-paid job that opens for a middle class position. Moreover, the number of potential middle and upper middle class members in Malaysia are reduced by more than a million well-educated Malaysian citizens who are working abroad particularly in Singapore (Malaysia Monitor 2011). In addition, many female graduates who leave the labour market once they start to have children are also reducing the number of individuals who potentially could have jobs that would open for middle and upper middle class positions.

The B 40% and access to the middle class.

We have seen above that the middle class has grown especially since 1980s due to the increased number of graduates. Yet, the economic transformation has not accelerated social mobility and created a wide spread middle class society. According to the Eleventh Plan, the social mobility of B 40% through education attainment has been limited. In 2014, only 9% of B 40% has a family-member with tertiary education (Eleventh Malaysia Plan 2015, p 3-18). The Plan does not inform about alternative ways to a middle class position than the education way, for instance by business and entrepreneurship.

The Eleventh Malaysia Plan is concerned about the extent of B 40% and suggests several measures to help uplifting this class to a middle class position. These measures include reducing school dropouts, enhancing accessibility to higher education and skills training, increasing productivity through adoption of modern technology, enhancing adoption of information and communications technology and enhancing integrated

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<sup>7</sup> The expansion of private universities and colleges began after the private higher educational institutions act 555 in 1996, which allowed for establishment of private universities and colleges ([www.agc.gov.my/act](http://www.agc.gov.my/act) 555 private educational institutions). After the financial crisis 1997/98, many families could not any longer afford to send their children to overseas universities and colleges and therefore they chose local private universities and colleges as the second best. This choice was also an outcome of a government decision after the crisis on putting a cap on the amount of money that private households were allowed to send abroad. Moreover, many foreign students especially from Muslim countries went to Malaysia for studying. After the crisis, the enrolment to private universities and colleges has expanded both with local and foreign students.

entrepreneurship support. The Plan does not reflect upon what the different measures to support entrepreneurship have meant for lifting B 40% to the middle class. It is not the first plan period that has focus on these kinds of measures to support entrepreneurship, so it is noticeable that the Plan does not refer to assessments of effects of support to entrepreneurship (Eleventh Malaysia Plan 2015, p 3-18/19).

However, the emphasis in the Eleventh Malaysia Plan on measures to lift B 40% into the middle class illustrates that the period with high economic growth rates has left many households behind in the transformation process. The government has been successful in implementing hard infrastructure (roads, ports, internet etc.) that underpinned investment and growth (R. Wade 2016). It has also ploughed enormous amount of money into education, skill training and technology development. When the Eleventh Malaysia Plan retrospectively looks at these investments, it admits that it has been limited how much they have benefitted B 40% (Eleventh Malaysia Plan 2015, p 3-18/19). It does not draw the same conclusion as E.T. Gomez that the rich and the upper middle class have harvested the fruits of these measures (Gomez 2009), but it recognizes that the inequality is high. The same recognition is in the mid-term review of the Eleventh Malaysia Plan (The mid-term review of The Eleventh Malaysia Plan Ch. 2 p 5-7). According to Hwok-Aun Lee and Muhammed Addul Khalid focus on inequality and measures to reduce the overall income inequality is a new policy discourse in Malaysia. The Tenth and Eleventh Malaysia Plans were the first economic policy planning reports, which did not give top priority to measures to reduce inter-ethnic divides among the three main ethnic groups (Lee, H-A. and M. A. Khalid 2014). Vertical inequality has come in focus.

#### New policy planning discourse and inequality.

Before the dawn of this new policy discourse, subsidies and affirmative measures have flourished to level out inter-ethnic different among the three main ethnic groups. The New Economic Policy, which was launched in the beginning of 1970s, has been pivotal in leveling out such ethnic economic and social differences. It built up a system of affirmative policies, which aim to help Bumiputeras to come up at the same economic and social level as particularly ethnic Chinese (Gomez 2012). In many respect this policy has been a success story. It has helped to lift Malaysia up to a middle-income economy that is on its way to become a high-income economy. More Bumiputeras have become richer. Government policies have been lever for creating such rich segment of Bumiputeras. Particularly two policies areas have been breeding places for Bumiputeras to become members of the rich segment. Government supported infrastructure projects have been such breeding place for Bumiputera developers. Another area is the industrial policy. Through this policy, the government has emphasised to build up government owned and semi-government owned companies. It has been a vehicle to groom an entrepreneurial class among Bumiputeras (Gomez 2012). This policy has been so successful that government-linked companies have become important players and drivers in the domestic economy (Gomez et al 2018).

These government policies favouritising Bumiputeras are still operating although they officially were phased out in the beginning of 1990s (E.T. Gomez 2012 b). They are maintained because influential Bumiputera groups have had strong interests in keeping subsidies and special privileges and because they have been vehicle to secure political backing (J.M Nelson 2012). Before resigning as prime minister in 2003, Mahathir Mohamad strongly criticized Malays for clinging to subsidies and special privileges. In his view, merits not special privileges should matter in the future (Mahathir Mohamad 2002). Although he was a very powerful prime minister in his first long period as prime minister, he was not able to scrap subsidies and special privileges that

some people have grown accustomed to get and enjoy. The consequence of this favouritising of special Bumiputera groups has until now been that not much has been done to reduce the overall income inequality. The large number of B 40% is an illustration of that.

New winds are however blowing. Not only because of a new government coalition has come into office. But also because a changing focus of the Tenth and Eleventh Plans on income inequality and policies to uplifting B 40% to middle class status signal a new policy discourse in economic policy planning institutions in Malaysia. Their policies for alleviating the overall income distribution problem are in line with the supportive policy tradition, which as noticed includes measures to avoid school drops out and enhance entrepreneurship support. It is noticeable that the two Plans do not mention redistribution through the tax system as a measure to limit the high-income inequality.

In the two Plans' policy considerations, redistribution issue through the tax system was likely left out because such redistribution has not had high priority on the political agenda. We have not noticed that the BN coalition government has taken initiative for using the tax system as a vehicle to push forward redistribution in favour of the low wage earners. It did not levy taxes like estate duties, annual wealth taxes, accumulated earnings tax or federal taxes. Income taxes, which are levied after several deductions have recently been at its highest at 28% but are now cut down to 26% for residents and 27% for non-residents (Malaysia Economic Monitor 2014).

The World Bank report Malaysia Economic Monitor has compared Malaysia with OECD and non-OECD countries in order to show the effect of re-distribution through the tax system. Malaysia and Sweden have nearly the same Gini- coefficient before taxes and transfers on 0.43. But after taxes and transfers, Malaysia is on 0.41 while Sweden is on 0.26. It illustrates the effects of two different tax systems in terms of re-distribution. It also puts spotlight on power to prevent re-distribution and protect wealth.

The BN political coalition, inequality and middle class society.

In the 61 years long government period, the BN coalition has protected the rich from income re-distribution measures through the tax system. The long growth period has not as we have shown made significant changes in the income relations among the main three income groups. The rich has harvested most of the fruits in this period. The B 40% is still a large group. Due to the easy access to loan, it has opportunity to touch the consumer life of the middle class. But it has not walked into the middle income class.

The skewed distribution of income and wealth has not until recently eroded the political power of the ruling government coalition BN. It anchored its power in an authoritarian political regime with a close connection between the party and state (Rodan and Jayasuriya 2009). The authoritarian orientation of this regime has its historical origin in the days before and after the independent in 1957. It was in days of cold war, communist resurgent groups had been active and they continued to hold arms in several parts of Malaysia in 1960s. The government excluded them from participating in the political system by an internal security act. It did not trust their political loyalty to the system's Western capitalist orientation. Political stability and security reasons were

in these days the economic and political elite's legitimization of the system's authoritarian orientation (R. S. Milne 1967).

With the 13 May 1969 up rise, the ethnic divide tension became the chief orientation for social and economic policies. Especially the poor Malays' strong protest against the economic and social inequality among the three main ethnic groups shocked the BN power elite. The BN coalition had to handle this ethnic tension to maintain its legitimization. The NEP policy from the beginning of 1970s was this elite's attempt to maintain political legitimization and avoid unrest (E.Gomez 2012 b). In this respect, it has in several decades succeeded to navigate between ethnic grievances between Malays and Chinese and between moderate and revitalize Muslims. However, in the course of 2010s social and economic inequality problems pile up in the horizon (Rodan 2018).

Seen from the 2018 general election, the ruling BN coalition did not take seriously enough the alarm signal from the general election 2013. Until the 2008 general election, the BN coalition had 2/3 majority in the Parliament and needed not to pay attention to the opposition. The 2013 general election became a turning point in Malaysia's political history. The Pakatan Rakyat opposition coalition got the majority of the votes but because Malaysia has the British parliamentary election system where the party, which first pasts the post gets all the votes in an election district the BN Coalition won. The Pakatan Rakyat opposition coalition succeeded to gain support behind policies targeting the lower strata and emphasizing need based programmes instead of ethnic redistribution programmes, which have been dominant issues in Malaysian politics since NEP in the beginning of 1970s. Since the general election, the parties in the Pakatan Rakyat opposition coalition split. But focus on inequality and need based programmes did not evaporate from the political agenda.

In particular, the Parti Keadilan Rakyat (People Justice Party) the biggest party in the new government sticks to this agenda. It is a reform-party, which according to its founder Anwar Ibrahim, former finans minister and vice-prime minister in the BN government in the 1990s, aims to change the existent ethnic based distribution policy. Anwar Ibrahim sees this policy as the main source to the high inequality in Malaysia (Anwar Ibrahim ,[www.jahilgoblok.net/image/mea.pdf](http://www.jahilgoblok.net/image/mea.pdf)). Instead of the ethnic based distribution policy, the Parti Keadilan Rakyat (PKR) aims to pursue an individual based distribution policy inspired by the European Social Liberal and Democracy Parties' distribution policy. It would be a great reform in a Malaysian context because as noticed many Malaysian especially Bumiputeras have no interest in scrapping this ethnic based distribution policy.

The new government has not proclaimed that it will go for pursuing PKR's policy. A distribution reform was not an issue on the election campaign for the Parakan Harapan opposition coalition. Focus was on rising living costs and corruption in the BN coalition, especially former Prime Minister Najib Razak's involvement in the 1. Malaysia Development Berhad scandal. The new government needs to do something with these election issues before it turns towards greater reforms.

Mahathir Mohamad as prime minister for the new coalition government is a signal that it will not cut the roots to the long history of the BN coalition immediately. He has shown that by appointing ministers close to the BN coalition. Moreover, he has made a succession appointment with Anwar Ibrahim. In the first two years, he will remain as prime minister and then the door is open for Anwar Ibrahim to become prime minister.

Mahathir Mohamad signals with this government construction that the election victory of the Parakan Harapan opposition coalition was not a political power revolution. A change in the distribution policy is as noticed a serious attack on the existent power elite privileges. Both Mahathir Mohamad and Anwar Ibrahim are aware of the political problems to challenge the elite. In an interview with BBC Anwar Ibrahim said that a change in the power relations is a long process and it will take years to pave the way for PKR's political agenda including a new distribution policy (Anwar Ibrahim, BBC News 15 June 2018). The Eleventh Malaysia Plan's mid-term review launched in October 2018 is also cautious in its reform agenda. The Parakan Harapan government does not in this mid-term review challenge the establish distribution policy. The 19 priority areas and 66 strategies concentrate on reforming the public sector towards greater transparency and accountability. In its economic outlook, the government now anticipates that Malaysia will breach the threshold to high-income economy in 2024 (Eleventh Malaysia Plan, Mid-term review oct 18 2018)

Until the new government begins its reform work, Malaysia is still a country in waiting to become a wide and vigorous middle class society, entering the group of high-income economies. The income distribution among the three main income classes has not changed most during the NEP and the long government period of the BN coalition. As noticed, the B 40% and M 40% have become participants in a middle class consumption due to easy access to loans. But the B 40% has not been able to enter the middle class and has not been part of the education expansion. The Rich 20% has not become less rich. The Khazanah State of Household 2018 has documented that in this report. It shows in figure 1.52 that the real mean household income gap between T 20% and B 40% has grown bigger in the period 1970 to 2016 (Khazanah 2018 p 64).

#### Concluding remarks.

The analysis has shown a transformation process towards a high-income economy with a Janus Head. On one side is a steady high economic growth, which in the past four –five decades has brought Malaysia close to a World Bank high-income economy status. In this respect, the Malaysian transformation is a success story. The other side of the Head shows a transformation process that has not yet fulfilled Mahathir's Vision 2020 according to which Malaysia in 2020 should be a wide and vigorous middle class society that is economically just and that dramatically has escalated its programme of human resource development. The analysis has primarily focused on this side of the Head.

Our business structure account reveals structural problems that to some extent explain why Malaysia not yet is in the reach of fulfilling the Vision 2020. Micro and small companies dominate the business structure and compared to larger companies their productivity is low. The Eleventh Malaysia Plan emphasises this low productivity as a main problem in the transformation process. Although previous plans have launched several initiatives to foster a productivity-based culture among micro and small companies they have not taken big leaps forwards such culture. This low productivity drags down Malaysia in comparative analyses of production output per person employed with developed and emerging economies.

This dominant feature of the business structure has impact on income level in Malaysia. Although the mean annual income level has increased in recent years, the average income level is still far away from Mahathir's

ultimate objective for Malaysia in Vision 2020 to be at OECD country level by the year 2020. It is far away from the OECD annual average income level at current Int\$ PPP but has overtaken Mexico by this measurement. The income level in Malaysia is highly marked by the low wage policy that the government has pursued in order to support small and medium size industries and to make export-oriented industries competitive on the global market. The low wage policy is an important key to understand the big income difference between top and bottom in Malaysia.

In the analysis, the focus is on what this income inequality means to develop a wide and vigorous middle class society. In analysing this question, we discuss various definitions of income thresholds to enter the middle class. We found the Asian Development Bank's definition of those who are living between 2 and 10 dollar a day a too wide entry door to the middle. Instead, we find Banerjee and Duflo's definition more useful. They emphasise two factors that drive the creation and sustenance of a middle class (i) stable, secure, well-paid jobs with good benefits, and (ii) higher education. Our estimate of the size of the middle class is 36.9%. It is in line with the Malaysia Economic Monitor's estimate in 2014. But it is lower than Abdul Rahman Embong's estimate, which is about 50% and based on income level of the employed workforce. We therefore emphasise that the threshold for entering the middle class is debatable and there is no consensus on whether Malaysia is a wide and vigorous middle class society or it is on way to become such society. From our perspective, it is on its way.

In order to go deeper into the discussion of what the income inequality means to develop a middle class society we examined the spread of a middle class consumption culture, the trickle down of higher education to B 40% and redistribution through the tax system. Our findings indicate that the low wages that many Malaysian earn has not been a hinder for developing a wide spread middle class consumer society. As we pointed out the spread of cars is remarkable high. We find that the easy access to loan has alleviated the constraints that the low wages otherwise would have put on many households' financial opportunities to purchase durables like cars. While many Malaysian from B 40% have become part of the middle class consumer society, few have been uplifted through higher education to a middle class position. In this respect, Malaysia has not yet realized Mahathir's vision of a middle class society that provides full opportunities for those in the bottom third to climb out of the pit of relative poverty. The tax system has neither been a vehicle to reduce the high inequality. In contrary to a high-income economy as Sweden there is a little redistribution of income through the tax system in Malaysia.

With the economic growth rates, Malaysia had since 1970s, it is understandable that Mahathir in the beginning of 1990s envisaged Malaysia in 2020 as a wide and vigorous middle class society in the high-developed economy club. Now on the threshold to 2020 Malaysia is nearly a high-income economy by the World Bank per capita income of Gross National Income measurement standard. But it is far way from being an OECD high income economy.

It is difficult to provide a single reason why Mahathir's vision is not yet fulfilled. Our analysis points out the high income inequality as an important barrier for realising the vision. It has prevented that the potentials of the B 40% have been unfolded and consequently limited the size of the middle class. The political power structure with the Barisan Nasional Coalition as key actor in this structure has not in many years been a vehicle for reducing the income inequality. This political power structure has delivered steady economic growth, which has helped to maintain political and social stability. It has uplifted the Bumiputeras from poverty and grooming a

new entrepreneurial class among Bumiputeras by the New Economic Policy. But it has shown limited interest in making Malaysia an economic just society. We have suggested that new winds are blowing in the political power structure. The change in the Tenth and Eleventh Malaysia Plans' policy planning discourse, which did not any longer give top priority to measures to reduce inter-ethnic divides among the main three ethnic groups, indicates an awareness in the political elite about the problems of inequality and B 40% difficulty of climbing up in the middle class.

This change of winds can be stronger if the new government coalition Parakan Harapan is able to challenge the old power elite and set a new political agenda. The biggest party in the government coalition Keadilan Rakyat is a reform-oriented party and it aims to set a new political agenda including a new distribution policy. Seen from this perspective, the political landscape in Malaysia is breaking up from the old regime. The new is drawing contour of what may be coming. Malaysia is in an exciting interregnum. How long it will take is difficult to Are Emerging Southeast Asian Economics Caught in a Middle-Income Trap? Case: Malaysia. Paradoxes in Provision of Higher Skilled Labour. And Malaysia's national car project: between success and failure?foresee. A transformation of a 61-year-old regime is a long process.

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