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Building a More Resilient and Balanced Economy: Challenges and Lessons for Malaysia

VGR Chandran[a], Evelyn S. Devadason[b], Lim Hock Eam[c]

1. Guest Editors' Forward

This special issue is devoted to building a more resilient and balanced economy by understanding developmental factors and challenges, and deriving policy lessons for Malaysia. Though the country has advanced economically over the years, its risks to outlook remain, originating from domestic and external sources. To increase its resilience and unlock further growth potentials, institutional quality, human capital and technological endeavours are vital. The slowdown of the manufacturing sector with the reduction in its net export surplus, is an indication of the stalling of industrial expansion in the country. Additionally, Malaysia is running the risk of balancing growth. The 2017 World Happiness Report showed that Malaysia's average happiness score for 2014-2016 had declined compared with 2005-2007. Further, being a small and open economy that is well integrated into the world economy, Malaysia is also vulnerable to external economic shocks, the sword of protectionism hanging over global trade, and disruptive capital outflows. Specifically, the low commodity prices, weakening ringgit and rising non-tariff measures (NTMs) are some of the challenges that could eventually moderate growth.

This special volume reflects the breadth of topics that economic scholars may consider when debating on issues related to resilience of, and equitable growth for, the Malaysian economy. These include growth-enabling factors (institutions, human capital, and research and development or R&D), growth balancing factors (happiness and other well-being non-monetary factors such as health and family values) and resilience to external shocks (commodity price shocks, exchange rate volatility, capital outflows and rising trade protectionism). Some of the papers take on a comparative approach in

[a] Department of Development Studies, Faculty of Economics and Administration, University of Malaya. *Email: vgrchan@gmail.com*
[b] Department of Economics, Faculty of Economics and Administration, University of Malaya. *Email: evelyns@um.edu.my*
[c] School of Economics, Finance and Banking, Universiti Utara Malaysia. *Email: lheam@uum.edu.my*

analysing the above related issues relative to other Asian economies, while the rest are Malaysia-centric. The papers bring together new insights from empirical work based on macro and micro (firm/survey level) data. Evidences drawn from all five papers conclude that specific policy changes are required to further strengthen the Malaysian economy.

The first two papers emphasise the importance of domestic factors such as the quality of institutions, human capital, and R&D for growth and development. As development economists argue, part of the problem for economic progress lies in differences in institutional arrangements. While the developmental path of Malaysia in the early years focused on economic liberalisation, the current debate highlights the greater demand for institutional reforms given that competitiveness is affected by the quality of public institutions' delivery and their effectiveness. Tajul and Naseem focus on the links between institutional quality and foreign direct investment (FDI) in the Association of Southeast Asian Nations (ASEAN). They use different measures of institutional quality to show that greater institutional quality relative to competing countries is needed to attract FDI. They also contend that political stability and rule of law, specifically intellectual property, and curbing corruption are indispensable in attracting capital inflows. Chandran, Gopi and Devadason use sectorial information to investigate the link between human capital and R&D for industrial performance in Malaysian manufacturing. There is mounting concern among scholars and policy makers on the slowdown in the manufacturing sector. Some argue that Malaysia is experiencing premature deindustrialisation, while others opine that the sector is trapped in low value-added activities and is therefore unable to upgrade itself. An important finding of the paper is that the impact of R&D on industry performance is much smaller than that of human capital. The authors stress that policymakers should therefore, go beyond the focus on the quantum of R&D and address the types of R&D needed for improving industry performance.

Lim, Shaw and Liao move the discussion away from growth-enabling factors to balancing growth by examining the income-happiness nexus in a comparative perspective of Malaysia and Taiwan. Economic growth has been the focus of Malaysia and other Asian countries. Unfortunately, it came at the expense of environmental destruction, income inequality, and other social problems, such as crime and an eventual deterioration of the quality of life. In the context of the East Asian countries, a "happiness gap" has been observed; countries with high economic growth seem to have lower level of happiness suggesting that economic growth or income could have diminishing returns on happiness. The paper provides answers to two interesting questions: Is the focus on the economic growth excessive? Can the focus on economic growth be justified in terms of achieving happiness?

The evidence indicates that income growth does matter for happiness for Malaysia and Taiwan, contrary to predictions of recent empirical studies.

The last two papers in this special issue address the challenges facing the Malaysian economy, namely the weakening exchange rate and the rise of NTMs. The fourth paper by Mukhriz and Shri Dewi focuses on the link between commodity prices and the exchange rate. The depreciation of the Malaysian ringgit and the decline in exports pose considerable pressure on economic development. The authors examine the link between palm oil price and exchange rate, an important commodity for both Malaysia and Indonesia. They posit that fluctuations in palm oil prices have had a persistent negative impact on the real exchange rate. In other words, changes in palm oil prices have resulted in exchange rate appreciations. The fifth paper by Sithamparam, Devadason and Chenayah examines the strategic responses of Malaysian exporters towards NTMs using firm-level data. The findings reveal that a majority of firms choose to comply with NTMs, and they are largely reactive in their approach. In this aspect, capacity building would enable firms to maximise their strategic options through a proactive approach.