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Has Malaysia really escaped the resource curse? A closer look at the political economy of oil revenue management and expenditures☆

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ABSTRACT

Malaysia has been widely cited as belonging to a group of developing countries which has escaped the resource curse. No doubt its inclusion in this group has been based on its impressive growth record prior to the Asian financial crisis, and its achievements on poverty alleviation and economic diversification. Since the Asian financial crisis however, growth rates have slowed, the economy has experienced premature deindustrialisation and oil and gas revenues have become the major source of financing the budget, casting doubts on whether Malaysia has in fact been untouched by the resource curse. The paper concludes by examining the policy implications of the findings.

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Introduction

Prior to the Asian crisis, Malaysia was one of the fastest growing economies in the world and was on track to achieve developed country status by the year 2020. Since independence in 1957, per capita incomes have increased more than eightfold and the incidence of poverty has been reduced from 49 percent in 1970 to 3.8 percent in 2011. Over this period the Malaysian economy was transformed from an agricultural producer and exporter of primary commodities to one where manufactured exports comprise over seventy percent of exports.

This record has been matched by few developing countries, particularly resource rich ones. Indeed Malaysia has been widely lauded for being one of the few resource rich developing countries to have escaped the resource curse-the paradoxical outcome that resource rich countries have performed worse than resource poor ones. Discussions on the paradox usually focus on the poorest countries in the world where despite decades of mineral extraction entrenched poverty persists among the masses while the elite captured the lion's share of this wealth.

The resource curse literature has been widely applied to Sub-Saharan Africa where this phenomenon is widely evident in countries such as Chad, Nigeria, Angola and the Democratic Republic of the Congo (see Sala-i-Martin and Subramaniam, 2003). Conversely a group of mainly middle, upper middle and advanced economies such as Botswana, Chile, Australia, Norway and Canada appear to have escaped the curse and Malaysia has been widely cited as belonging to this group (see Abidin, 2001; Rosser, 2006; Stevens, 2003). The inclusion of Malaysia in this group has no doubt been based on its record on economic growth, diversified export base, poverty alleviation and political stability. Indeed since independence until the present, Malaysia's dominant political party the United Malay National Organisation (UMNO) has been in continuous power as the major force in the ruling coalition, the National Front.

Stevens (2003) sought to establish which countries that have large oil, gas and mineral revenues might be part of the list of those who avoided 'the curse', the so-called 'usual suspects'. First a target group of 54 countries was identified as being vulnerable to the resource curse on the basis that their fuel and mineral exports exceeded 30 percent of merchandise exports in the period 1965–1995. Then two criteria are applied, the rise in non-oil, gas or mineral traded GDP and the achievements on reducing infant mortality, illiteracy and increasing life expectancy. The results provide strong support for the fact that Botswana, Chile, Indonesia, Malaysia and Norway avoided the curse.

The Asian financial crisis caused a disjuncture in the Malaysian growth trajectory with investment in particular, slipping to much

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lower levels than in the previous decade. Investment levels plummeted from 44.5 percent of GDP in 1996 to 26.2 percent of GDP in 2012. In 2009 the Malaysian government expressed concern that the economy was caught in a middle income trap indicating that it has been unable to successfully upgrade to higher value added manufacturing activities unlike its resource poor East Asian counterparts that have successfully completed this transition and are now high income countries.

Malaysia's oil revenues have been managed by the National Oil company Petronas since 1974 and the expenditure of those revenues was solely under the control of the Malaysian government. The aim of this paper is to examine the political economy of oil revenue management and expenditures and to draw some implications for Malaysia's continued ability to avoid the resource curse. The first section of this paper discusses the resource curse literature. The second section sets the stage by first discussing Malaysia's evolving political economy and then the management and expenditure of oil revenues. Section three focuses on Malaysia's economic performance since the Asian financial crisis and addresses the question of whether Malaysia can continue to evade the resource curse while section four concludes by examining the policy implications of these findings.

The resource curse literature

A voluminous literature has been spawned on the phenomenon of the resource curse. It has been summarized by several researchers including Ross (1999), Stevens (2003, 2006), ODI (2006), Rosser (2006), Weinthal and Luong (2006). The rationale for the poor economic performance of resource rich countries has evolved over the decades. Stevens (2003) documents this trend and states that in the 1950s and 1960s it commenced with development economists such as Prebisch (1950, 1964) and Singer (1950) who argued that primary product exporters (the periphery) would be disadvantaged vis-à-vis industrialized countries (the center) due to the declining terms of trade, while others argued that this outcome could be caused by the linkages from primary product exports to the rest of the economy being far fewer than compared to manufacturing (see Lewis, 1989).

In the aftermath of the first oil shock of the 1970s, focus began to shift to the impact of oil gas and mineral projects and the emphasis was now on the macroeconomic transmission mechanisms such as Dutch disease which occurs when resource exports results in currency appreciation which reduces the competitiveness of the lagging non-mining sector. Gelb (1988) summarizes four critical economic problems in managing the mineral sector and resource booms; the Dutch disease; inadequate savings during booms, the establishment of unsustainable patterns of consumption and investment during booms, and tardy adjustment to post-boom downswing.

In the 1990s explanations placed greater emphasis on the political economy within oil and other mineral exporting countries. As Stevens (2003) states this change of focus came about because many countries have continuously failed to pursue the policy actions which economists had identified for countering the various macroeconomic transmission mechanisms. The key question here is what motivates countries to pursue poor economic policies and the explanations can be grouped into structural and agency based arguments.

Structural explanations have been based on the notion of rentier states. In this context oil revenues allow the government to keep domestic taxes down and thereby reduce the pressure for greater accountability and political representation. Further, governments can also undertake unproductive redistributive spending to satisfy political constituencies and they can employ internal security to control domestic opponents.

Agency-based explanations in turn have argued that those holding power in resource-abundant countries engage in rent seeking and corrupt political and business practices and appropriate the benefits of the resource wealth for themselves. There is now a growing body of literature that links rent-seeking, corruption and natural resource (e.g. Bannon and Collier, 2003; Mehlum et al., 2002; Presbisch, 1964; Robinson et al., 2006; Woolcock et al., 2001; World Bank, 2003). Tornell and Lane (1999) established that resource-rich economies are more subject to rent-seeking and corruption than resource-poor economies. Natural resource wealth provides incentives for rent-seeking behavior and corruption that generate an environment which perpetuates these institutions.

Natural resource wealth has also been linked to violence and conflict (e.g. Bannon and Collier, 2003; Collier and Hoeffler, 2000; Sala-i-Martin and Subramaniam, 2003). Sala-i-Martin and Subramaniam (2003) indicates that there is an increase in the probability of civil conflict when countries possess resource wealth. One source of natural resource-related conflict is establishing who owns the rights to the resource.

Finally, natural resource revenue can simply be wasted because the quality of formal institutions and mechanisms to manage the revenue is weak (see Ascher, 1999). Spending an influx of natural resource wealth is tempting, particularly when the amount is above annual budget expenditure requirements. When there is extra liquidity, it would appear legitimate to spend the extra revenue, and there may be pressure to do so. Yet rash decisions and poor expenditure may not achieve long-term goals (e.g. saving for future generations when the natural resource is exhausted).

While there is much focus on how an abundance of resources can turn out to be a curse, there is also a strand in the literature which emphasizes the view that resources can be a blessing. Economic historians, Wright and Czelusta (2002) cite a number of successful cases of resource based development including the U.S. and Australia. They argue that the key features critical to their success were that mineral production was expanded through ongoing advances in technology, strong linkages were built between resource and other more dynamic sectors and substantial knowledge spillovers arose from extraction and industrial use of resource in the economy.

Other contributions that challenge the conventional wisdom on the resource curse are those that emphasize the view that variations of the resource export variable have cast substantial doubt on the resource curse hypothesis. Ledermann and Maloney (2003) find positive growth effects using the share of primary exports to total exports and primary exports over total labor force. Davis (1995) used the share of mineral exports to total merchandise exports as a natural resource proxy and found a positive relationship between this proxy and economic growth. More recently Brunnschweiler (2008) re-examined the effects of natural resource abundance on economic growth using new measures of resource endowments and institutional quality and found a positive relationship between these variables between 1970 and 2000.

The evolving political economy

In 1970 Malaysia introduced the New Economic Policy (NEP) which was designed to reduce poverty and inter-ethnic economic disparities between the indigenous Bumiputeras[2] (mostly Malay in Peninsula Malaysia) and non-Bumiputeras, the Chinese and Indian communities.

[2] The word Bumiputera literally means “sons of the soil" and refers to the indigenous peoples of Malaysia.In this article the term Bumiputera and Malay is used interchangeably.

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