



## ISIS PRAXIS SEMINAR 2012

### Knowledge for Action in the Coming Year

November 23, 2011,  
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## ABOUT ISIS MALAYSIA

The Institute of Strategic and International Studies (ISIS) Malaysia was established on 8 April 1983, in realization of a decision made by the Malaysian Government to set up an autonomous, not-for-profit research organization, to act as the nation's think-tank. ISIS Malaysia was envisioned to contribute towards sound public policy formulation and discourse.

The research mandate of ISIS therefore spans a wide area. It includes economics, foreign policy, strategic studies, nation building, social policy, technology, innovation and the environment.

ISIS Malaysia today fosters dialogue and promotes the exchange of views and opinions at both national and international levels. It undertakes research in collaboration with national and international organizations, in important areas such as national development and international affairs.

ISIS Malaysia also engages actively in Track Two diplomacy, fostering high-level dialogues at national, bilateral and regional levels, through discussions with influential policymakers and thought leaders.

## RESEARCH

### Economics

Research in this area is generally aimed at promoting rapid and sustained economic growth and equitable development in the nation. We study specific (rather than generic) issues that concern the nation's competitiveness, productivity, growth and income. Areas of research include macroeconomic policy, trade and investment, banking and finance, industrial and infrastructure development and human capital and labour market development. The objective of all our research is to develop actionable policies and to spur institutional change.

### Foreign Policy and Security Studies

The primary aim of this programme is to provide relevant policy analyses on matters pertaining to Malaysia's strategic interests as well as regional and international issues, with a focus on the Asia-Pacific Region. These include security studies, foreign policy, Southeast Asian politics and military affairs.

## Social policy

Demographic and socio-cultural trends are changing Malaysian society and the social policy programme was established to respond to these developments. Research in this area is concerned with effective nation building, and fostering greater national unity. In particular, we look at issues involving the youth, women and underprivileged communities. In conducting its research, ISIS Malaysia networks with non-governmental organizations and civil society groups.

## Technology, Innovation, Environment & Sustainability (TIES)

The TIES programme provides strategic foresight, collaborative research and policy advice to the public sector, businesses and policy audiences, on technology, innovation, environment and sustainable development. Its focus includes green growth as well as energy, water and food security. Towards this end, TIES has been active in organizing dialogues, forums, policy briefs and consultancies.

## HIGHLIGHTS

ISIS Malaysia has, among others, researched and provided concrete policy recommendations for:

- Greater empowerment and revitalization of a national investment promotion agency;
- A strategic plan of action to capitalize on the rapid growth and development of a vibrant Southeast Asian emerging economy;
- A Master Plan to move the Malaysian economy towards knowledge-based sources of output growth;
- The conceptualization of a national vision statement;
- Effective management and right-sizing of the public sector; and
- Strengthening of ASEAN institutions and co-operation processes.

ISIS Malaysia has organized the highly regarded Asia-Pacific Roundtable, an annual conference of high-level security policymakers, implementers and thinkers, since 1986.

## REGIONAL & INTERNATIONAL NETWORKING

As a member of the Track Two community, ISIS Malaysia participates in the following networks:

- ASEAN-ISIS network of policy research institutes;
- Council for Security and Cooperation in Asia and the Pacific (CSCAP);
- Network of East Asian Think Tanks (NEAT); and
- Pacific Economic Cooperation Council (PECC).

It is also a partner institute of the World Economic Forum (WEF).

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# Flight to Safety or Virtue? US, EU, China and Global Economic Growth in 2012

**T**he first session of the ISIS Praxis Seminar 2012 discussed global economic prospects in 2012. The panelists were **Mr Manu Bhaskaran** of Centennial Group Inc. and **Mr Suresh Kumar** of CIMB Group. **Dato' Dr Mahani Zainal Abidin** (ISIS) Malaysia moderated the session. ISIS Researcher, **Nor Izzatina Abdul Aziz** reports.

**Mr Manu Bhaskaran's** presentation covered the global economic outlook for 2012 and its implications for Asia while Mr Suresh Kumar spoke on the currency market's reactions given the 2012 outlook of shorter business cycles and amplified risk aversion.

The trifecta of global economic growth – the United States, European Union and China -- all have internal imbalances that will have negative repercussions on world economic growth in the near future. The current global economic outlook therefore does not look bright.

Doubts about the possibility of the world economy growing in 2012 are increasing due to recent

events like the European Debt Crisis, the downgrading of US debt ratings and the deadlock amongst US policymakers over US debt ceilings. While China currently looks like an oasis, its internal imbalances are yet to rise to shake the international community.

Due to these events Bhaskaran said that substantial downside risks exist for near term economic growth. He pointed out that the global impacts of these events are worse than was expected and they can hurt Asian economies. It is because of the economic weight carried by the US, Eurozone and China in the world economy that the effects of their internal imbalances will spread to other countries (Table 1).



(From left) Suresh Kumar, Mahani Zainal Abidin and Manu Bhaskaran



Table 1

Country	% World GDP	Outlook
United States	23.1	Unclear sustainability
Eurozone	19.3	Recession and debt crisis spreading to core countries like Italy
China	9.3	Informal financing unraveled due to 2011 credit tightening. Lower 2012 inflation
Japan	8.7	Rebound less than hoped
Other emerging countries	8.3	Clear signs of slowdown

Apart from country-related problems that dampen the future economic outlook, there are several other cross-cutting factors that continue to hamper future growth, such as tight global credit mechanisms, volatile capital flows and oil prices, slower industrial commodities growth, higher food prices and weakening tech spending. These factors alongside imbalances in the world's three biggest economic regions, will affect Asia's growth potential in the coming years.

It is natural for oil prices to be low during an economic slowdown. However with the current geo-political situation in the Middle East, world oil price is highly dictated by the risk premium attached to it. Political risk in oil-producing Middle East countries like Libya will not stabilize quickly given the lack of strong institutions and leadership.

Recent economic improvements experienced by the United States will not last as these were achieved by borrowing growth momentum from 2012. The US savings rate, for example has fallen from eight per cent in January 2010 to 3.6 per cent in late 2011. Sources of growth such as private investments are also expected to be low in the future given the expiry of incentives on capital expenditure investment in December 2011. There is also a high possibility that losses from European branches of US financial firms' will be transferred to the US, affecting domestic credit market confidence.

At the same time, the US government's fiscal situation has not been fully resolved and the outcome will be highly dependent on the willingness of political parties to consolidate differences on stimulus and government spending so as to ignite US growth potential. The impasse has resulted in the downgrading of the US sovereign bond rating. Markets have been reacting erratically to the impasse while policymakers in the US decided to calm the market with the implementation of Operation Twist.

The aim of that Operation was to flatten the yield curve of the US and among its repercussions has been an increase in the dollar value internationally, leading to an increase in trade's financing cost in the Asian asset market. Given the lack of success of QE1 and QE2, the efficacy of Operation Twist is questionable and it has been unable to inspire confidence.

The sovereign debt crisis experienced by smaller EU economies like Greece is now likely to spread to other bigger economies like Italy and Spain. With dim growth prospects, and the implementation of austerity packages to improve credit-worthiness, the downward spiral trend of these economies is expected to continue. Increasing political backlash in the region has also restricted government policy space. As a result, troubled EU economies found it harder to establish credit lines from private lenders and now

have to turn to the European Union and its Central Bank to pull them out from the spiral.

The EU's inability to address its current crisis stems from its unification design flaws. Any solution proposed could create a new problem because it can weaken the EU mandate. Because of the EU's centralized monetary policies but decentralized fiscal policies, member countries cannot make necessary adjustments if the other members' policy actions are ineffective. Bhaskaran explained that while the EU has a safeguard mechanism, the European Financial Stability Facility, its ability to bail out members is limited.

Bhaskaran said that the EU is likely to evolve into a 2-tier Eurozone — North and South — the northern states like France and Germany will follow the ideals of the Maastricht Treaty while the rest will be left to deal with their own financial losses and political problems.

Kumar said that while the temporary separation from the EU will give monetary policy autonomy to troubled economies, it will also create currency risks in the international financial market. To substantiate his point, he pointed out that the European Investment Bank's issue of long-term financial instruments has started to factor in currency risk premium in Euro-denominated commercial papers, expecting the temporary break of these economies from the EU.

In the case of China, Bhaskaran believes it is reaching the turning point in its internal imbalances and that will determine whether the nation will undergo a soft or hard landing in 2012. The expected downturn in China will originate in imbalances in its input, and external and capital markets. Its input market is facing power shortage and the rising cost of wages while its ability to grow through external factors looks doubtful due to weaker demand from importing countries like the US and Eurozone. The expected huge impacts of the corrective monetary policy actions of 2011 to counter inflation, bubbles and excess capacities will only be felt in 2012.



*Manu Bhaskaran*

Kumar agreed with Bhaskaran's view that China's economy will undergo either a soft or hard landing in 2012. He added the exchange rate dimension to China's economic assessment by pointing out the yuan's unique situation. The main reason for this is the difference in Yuan values between Mainland China and its offshore market, Hong Kong. The Yuan value in Mainland China has been very stable but its value in Hong Kong factored in activities like forwarding and call options by corporations.

The conditions affecting the EU, US and China will have negative impacts on Asian economies given the latter's interdependency and connectivity. Key differences from the 2008 Crisis include:

- Strong credit mechanism (especially for trade financing). However, as exhibited in 2008, this situation can flip quickly;
- Limited policy responses from the US, EU, and China. It is not feasible for them to undergo another round of massive stimulus packages given worsening government finance and hostile political moods and social unrest.

The expected recession in advanced countries, and the growth slowdown in China and the rest of Asia point to a new trend of shorter business cycles that run between six and nine months and greater uncertainty. Economic agents will somehow need to adapt their strategies to this new reality Kumar said.



*Suresh Kumar*

While the risk of a downturn exists, the majority of Asian countries observed by Bhaskaran have shown improved resilience in their preparedness to face a global slowdown compared to their responses during the 1997 and 2008 crises. While the resilience index measuring these countries on average is high, the resilience indices of several countries like China, Hong Kong, Malaysia, Philippines and Vietnam have fallen slightly since the 2008 crisis.

Reasons for the decline can be found in the rise of private and public sector debt. Within Asean, the situation in Vietnam looks the worst as resilience tests have shown the nation is at critical levels in its preparations for an inflation surge, currency stress or financial shock.

Asian economies have not fully decoupled from the important trifecta of economic growth — the US, EU and China. They have a relatively high exposure to the Eurozone crisis via trade and financial channels. 21.2% of China's trade flows for example went to Europe while countries like Singapore and South Korea have greater exposure due to the high proportion of loans originating from the EU.

Political situations will also influence financial markets, as several important elections such as those in the United States, Russia and France will be held in 2012. In Asia, political changes are expected in China, Taiwan and Korea either due to natural transition as in China or elections.

A downside is expected in the Asian currency market given the expected rise of the US dollar said Kumar. A shortage of dollars is expected in Malaysia, India and Korea due mostly due to central banks' strategy of maintaining a mixed basket of currencies by lowering the US dollar holding. The situation in the EU has also reduced the Euro's value. As the value of the dollar increases, the risk in Asia's credit market is expected to increase as well due to debt denomination and increasing interest rates spread.

The session ended with the general conclusion that due to troubles in the EU, US and China, Asia will not be fully shielded from the downturn that is expected in 2012. On a positive note, Asian economies are now better prepared than they were during the crises of 2008 and 1997.

## Country Focus Thailand Post-2011: New Directions

**S**ession Two of the ISIS Praxis Seminar was entitled 'Country Focus: Thailand Post 2011 – New Directions.' It was moderated by **Dato' Ku Jaafar Ku Shaari** Director General, Institute of Diplomacy and Foreign Relations (IDFR) Malaysia. The panelists were **Dr Pongsak Hoontrakul**, Senior Research Fellow, Sasin Graduate School of Business Administration, Chulalongkorn University, Thailand, **Major General Surasit Thanadtang**, Director General, Strategic Studies Center, National Defense Studies Institute, Thailand, and **Mr Bunn Negara**, Associate Editor, The Star Publications (M) Bhd, Malaysia. ISIS Analyst **Zarina Zainuddin** reports.



(From left) Pongsak Hoontrakul, Ku Jaafar Ku Shaari, Surasit Thanadtang and Bunn Negara

In his introduction, **Dato' Ku Jaafar** outlined the significance of the year 2011 for Thailand, the novelty of its first woman Prime Minister and the familiarity of the Thai people with her family background, the challenges posed by the massive flooding, as well as the simmering tensions in the South, and finally, the ailing state of Thailand's much respected monarch, King Bhumibol. These themes would largely shape Thailand's outlook for the year 2012.

### 'All Politics are Local'

**Dr Pongsak Hoontrakul** stressed that an understanding of local politics, such as the evolution of Thai politics, the economic interplay at work, as well as the role of the monarchy and

the military, are needed before any sound judgment on Thailand can be made.

The Thai political scene is unique in many ways; to date it has had 18 coups and about as many changes in its constitutions and yet all its important institutions have managed to stay intact. While there has been violence and bloodshed, Thailand has a built-in stopper, either in the form of the monarchy, the military or the people, that manages the crisis before it goes too far. However, despite the Thais' dislike of drastic change and their willingness to compromise, Pongsak said change is nevertheless coming. Thailand is gradually embracing democratic processes, and the declining frequency of coups and royal interventions attest to this fact.

*He blamed the lack of  
egalitarianism on the failure of  
Thailand's educational reforms*

Thailand is not an egalitarian society said Pongsak -- where you are born would likely determine what your life would be in terms of your occupation, level of education and income. He blamed the lack of egalitarianism on the failure of Thailand's educational reforms.

He has had the opportunity to meet and observe Thailand's two most recent leaders — former Prime Minister Abhisit Vejjajiva and current Prime Minister Yingluck Shinawatra. He found Abhisit capable but with a tendency to micro manage, which Pongsak thinks is a mistake. It is difficult enough to govern during normal times let alone during a crisis such as the red shirts versus yellow shirts riots.

Yingluck understood her limitations and surrounded herself with good capable people but while her approach worked well during normal times, her lack of leadership and experience was seen during the flooding crisis, posing a serious obstacle to effective crisis management.

Thailand does not have a class struggle but a power struggle said Pongsak. He said it was amusing that Yingluck's supposed 'people' cabinet had a combined income that was much higher than that of the previous cabinet. Yingluck's populist cabinet had come up with several proposals, some of which Pongsak agreed with, but the important ones he said were those centring on food and wages.

He warned that Thailand being a 'reprocessing' economy depended heavily on labour and thus the labour cost component and any measures that might affect wages and food should be given thorough consideration or Thailand would risk

facing economic problems such as inflation. The current government economic programmes will benefit the very rich and the poor but will squeeze out the middle income group.

Dr Pongsak then elaborated on the flood situation in Thailand. The floods thus far had claimed over 600 lives, affected about 10 million people, leaving an estimated one million unemployed, 300,000 of them perhaps permanent; in a worst case scenario damage incurred would total up to 10 per cent of the GDP. However, the situation would not have been as severe had the Yingluck government acted sooner and more decisively than it did.

The rainfall was not excessive; had the relevant authorities managed the water level of the dams more effectively by releasing the water earlier and were less concerned about preserving the second harvest of the year which would have been destroyed by the water, the damage could have been limited. As a result of this mismanagement the current government has lost credibility.

There is also concern about the status of Yingluck's brother Thailand's former Prime Minister Thaksin and the perceived effort to grant Thaksin amnesty. Pongsak felt there would be trouble should Yingluck try to pursue the Thaksin agenda, particularly given the people's poor perception of her government.

Another problem Pongsak saw was the lack of long term policy vision on the part of the government policy-making body. The flood situation for example could have been avoided had the previous government implemented suggestions proposed by His Majesty the King of

*Another problem ... was the lack of  
long term policy vision on the part  
of the government ...*



Thailand some 15 years ago! Interestingly, said Pongsak, the clear winner from the flood situation has been the military whose tireless efforts to assist distressed citizens garnered them the highest approval rating from Thai citizens.

### **Thailand's Security Outlook**

The world has changed and along with the change comes new forms of security risk. **Major General Surasit** spoke at length about the potential security risks posed by the social network media. Thais in general embraced new 'things' and social media tools such as Facebook, Twitter, and YouTube are particularly popular in Thailand. Mindful of the Arab Spring revolution that was fuelled via the social network media, Surasit feels that despite the millions allocated to military spending, the military is ill-equipped to deal with any security risk that might arise from the social network media.

On regional superpowers, Surasit said that Thailand acknowledged the rise of China and accepted the presence of the US as a regional superpower. From the military standpoint, a superpower intervention can come in several forms — among them diplomatic, political, economic, and finally military. How and when these channels are used is important, and Thailand has to deal with these potential interventions in a prudent manner.

Another increasing threat faced by Thailand is the non-traditional security threat, most of it arising from natural or environmental problems. The recent floods posed a serious food security risk — about 3.5 million tonnes of rice were lost due to the floods. The effect was felt not only in Thailand but also around the region and globally since Thailand is one of the major rice producing countries.

Thailand may also face water shortages in five years' time, a worrisome prospect given the inept way in which the government has dealt with the flood situation. There is also the threat of

climate change which has affected Thailand's agricultural sector. There have been changes in the harvest time for fruit and other food crops due to changes in the climate pattern. Surasit also sees potential threats from energy security — given the existing high energy prices, any external shock such as that presented by the current Arab spring might spike oil prices to a level that would be detrimental to Thailand's economic development.

Surasit commented briefly on several security issues. On the Southern Thai provinces, he proposed that the government proceed with reconciliation efforts by using by His Majesty King Bhumipol's proposals as a guide. He advocated another look at education reform which he said has lost its way. Education reform should gear towards greater participation by the Thai people in the democratic processes instead of accepting the status quo.

As for the problem of drug trafficking existing regional mechanisms are one way of combating the problem. Surasit does not believe the Thai political crisis would hamper the Asean community efforts and lauded the non-interference principle of Asean as a positive element for Thailand and Asean as a whole.

On transparency and governance, Surasit admits that the Thai military has been slow in picking up the idea. Next year's outlook for the economy is not very good compared to that for the rest of the region. Thailand's economic growth is expected to slow down to 1.5 per cent, which could pose a serious challenge for its government.

Apart from traditional conflicts, Thailand is not engaged in any dispute within the region, nor does it wish to be. The armed forces are still seeking to define their role said Surasit. There is the question of where their core function lies in the future: should they concentrate on traditional or conventional security, or should they refocus on a non-traditional security role? Hopefully, said Surasit, security cooperation at the regional level as in the case of the Asean security community,

could provide a direction for the military on its future role in Thailand.

#### **'Ten Questions on the Future of Thailand'**

Bunn Negara posed ten questions that he said are pertinent in ascertaining Thailand's future outlook. These are:

1. How different is the Yingluck government compared to Ahbisit's? Bunn pointed out the similarities in the background of both these leaders ranging from family background to inexperience to good looks and ultimately, the perceived lack of competency and capability in both.
2. The future of Thaksin: will there be a pardon or amnesty and how will the Yingluck government go about accomplishing it?
3. How competent is the Yingluck government in dealing with the bigger issues such as the economy, political polarization and so on?
4. The competency of the government in dealing with immediate issues such as floods and other potential crises.
5. The ailing King Bhumipol; Bunn feels that Thailand would be faced with succession issues in the near future.
6. Will the monarchy be able to face the challenges successfully and confidently particularly given the tension that exists between the palace and the government?
7. What form would the succession take or more to the point, would Thailand have its first female monarch given the popularity of the Crown Princess?
8. How would the role of royal advisors evolve? Bunn thinks it would depend on the government and Prime Minister of the time.
9. What role would the military play in the future? The military appear content to stay in the barracks and seem to prefer to remain uninvolved in politics as much as possible.
10. The issues facing Thailand's Southern provinces which include those of security, political settlement and reconciliation.

What are the likely outcomes for Thailand in 2012 and the foreseeable future? In politics Bunn said, it would largely depend on the main actors — the 8 Ps and 1 M. The eight Ps stand for Parliament, Palace, Privy Council, Police, People (or Public opinion), the Phue Thai Party (PPP) of Yingluck, and two individuals, Pracha Promokand (the Justice Minister who will oversee the royal pardon or amnesty for Thaksin) and Noppadon Pattama (Thaksin's lawyer); the single M naturally stands for the Military. In the immediate future, it is economic issues that are important.

The floods have had a devastating effect on the economy. There is a marked decline in tourism, loss in productivity, disruption in production, damages to infrastructure, and other costs. The subsequent effects include the rise in prices of goods such as food and the loss of employment. According to Bunn, the effectiveness of the government's recovery efforts could very well determine the fate of the economy. Bunn believes that the Thai economy will recover but it is a question of how much, how fast and how far the economic recovery can stay ahead of political development, particular negative political development that will have the potential to drag the economy down.

In Bunn's opinion the political situation does not look too promising; there is little movement towards political reconciliation with political polarization still prevalent. The situation in Southern Thailand, despite the pledges from the recent governments, does not seem to be much better. The government is still Bangkok-centric and the floods further diverted attention away from the south. The neglect in the south is compounded by problems of local corruption, drugs, and violence. The southern provinces therefore could remain a problem area for Thailand in the near future.

## Malaysian Economy in 2012: Risks and Rewards?

**A**t Session Three of the *ISIS Praxis Seminar 2012*, **Dr Nungsari Ahmad Radhi** of *Khazanah Nasional* and **Mr Christian de Guzman** of *Moody's Singapore* discussed the outlook of the Malaysian economy in 2012. *ISIS Analyst Firdaos Rosli* reports.



(From left) Nungsari Ahmad Radhi, Larry Wong and Christian de Guzman

**Dr Nungsari Ahmad Radhi** said he believed the Malaysian economy will get worse before it gets better. *Khazanah Nasional*, the investment holding arm of the Malaysian government is particularly concerned about global economic developments in 2012 and is keeping an eye on external updates.

In 2012, trade, capital flows and equities are expected to decelerate faster than in late 2011. This in turn will affect investments, domestic consumption and the political scenario in Malaysia. Relative to the government's projected GDP growth of five to six per cent, *Khazanah's* 2012 growth figure is lower at around 4.5 to 5.0 per cent.

*Khazanah* has listed three critical factors that policymakers should consider for the next 12 months.

First, the impact of the Eurozone sovereign debt crisis on Malaysia. Malaysia will not be spared the effect of the Eurozone

sovereign debt crisis as the European banks' loans to Asia are higher than those of American banks. Generally, there is still much uncertainty in the Eurozone despite their leaders' reform pledges. Investors are still unsure about the magnitude of the crisis in relation to the European economy and the world as a whole. The economic projections for the next few months are expected to be gloomy as there is doubt about the ability of the European Central Bank to solve the EU's sovereign debt muddle.

Secondly, the Malaysian ruling party is expected to announce/undertake several popular decisions in gearing itself for the 13th General Elections expected in the first half of 2012. France, Russia, Taiwan and the United States will also hold their elections in 2012. As such, normalizing fiscal and monetary policies, as well as other structural reform initiatives will be delayed. Political competition will inevitably lead to irrational decisions that will hinder economic growth.

***While ... the Malaysian government's financial strength is high and relatively stable, the nation's sovereign debt has been increasing steadily since 1970 and has increased even more steeply since the 2008 crisis***

Thirdly, the convergence of the Eurozone crisis, the possibility of an early election and the government's fiscal situation should also be taken into account. Despite greater discipline in restraining its deficit growth, in the 2012 Budget, the country's fiscal position is of major concern to investors, particularly when a massive portion of capital flows is in the debt market rather than in equities.

Malaysian government securities account for more than 40 per cent of the instruments in the debt market. Khazanah Nasional is concerned over the short and medium term consequences of any drastic changes in capital flows and their effect on sovereign ratings and the corporate cost of borrowing.

Malaysia's debt-to-GDP ratio is the highest in the region and the forecast for other aggregate numbers is still uncertain. As such, there is limited possibility of a stimulus package to counter-balance the global economic slowdown in 2012.

Malaysia's third quarter GDP was mostly driven by public consumption. Household debt remains high, at around 70 per cent of GDP, and public debt is in excess of 55 per cent of GDP.

However, all is not lost. Policymakers are comforted by the fact that emerging Asia will act largely as a catalyst to cushion the impact of a double dip crisis. China's attempt to rein in inflation and provide a soft landing for investors is beginning to bear fruit. However, the role of its

informal banking sector in boosting its SME capacity is a matter of concern.

The rise of domestic demand and private investments in Malaysia will lead the nation's growth prospects in 2012, meeting the challenges of a more globalised economy. Moody's Investor Service (hereafter Moody's) recently ranked Malaysia's economic strength as 'moderate' due to the nation's predictable GDP growth trend over the years relative to its regional peers. Institutional strength is also ranked as 'moderate' as the economy is hampered by transparency issues and a maturing domestic democracy, more noticeable since the March 2008 elections.

While Moody's is of the opinion that the Malaysian government's financial strength is high and relatively stable, the nation's sovereign debt has been increasing steadily since 1970 and has increased even more steeply since the 2008 crisis. Although the issue of high debt sustainability is in question, a low inflation rate and high domestic savings of around 35 per cent of GDP are deemed favourable.

The government's large deficits underscore the need for consolidation by broadening tax and subsidy reform. Presently, only a million Malaysians out of a 28 million population pay income tax and the government is expected to replace the sales and services tax with a more comprehensive Goods and Services Tax (GST).

In July 2010, the government's subsidy reform started with the removal of energy and sugar subsidies. The idea for subsidy rationalization was not only to reduce the government financial burden but also to readjust subsidies for targeted groups that are deeply affected by higher prices -- the bottom 40 per cent and middle-income groups who live in big cities.

Domestic politics continue to play a major role in the formulation of economic policies and are potentially capable of delaying reform





*Participants at the seminar*

initiatives. In light of an early general election, the implementation modality and timing of the GST and subsidy reform will prove to be a challenging task for the government of the day.

Unlike most of its regional peers, Malaysia's events risk is low. There is minimal risk from natural disasters, apart from seasonal flooding cases outside major industrial towns. Moody's regards Malaysia's corporate and banking sectors' financial event risk favourably; Malaysia's banking system was recently rated the fifth best in the Asia-Pacific region. Furthermore, exposure from the Eurozone is limited due to the low reliance on external sources of funding other than well-established UK-based banks such as HSBC and Standard Chartered.

Moody's believes that the Malaysian government will undertake further initiatives to become less reliant on external financing in order to limit exposure and vulnerability to external sentiments. While the probability of becoming the 'next Greece' is low, Malaysia's debt-to-GDP ratio has been climbing sharply over the last few years.

Apart from the points highlighted by both speakers, there are also other internal considerations that could shape Malaysia's economic outlook in 2012. Firstly, there is a slowing down of private investments in the country, not only due to external economic conditions, but also the lack of initiatives to

stimulate them further in Budget 2012. The Economic Transformation Programme projects may have spurred interest in domestic investments but a real push for structural reform is much needed as a booster to create a more favourable business climate and higher productivity-driven economic growth.

The implementation of the national minimum wage will be another point to consider in 2012. Companies in Malaysia tend to reward capital more than labour and as a result, the rise in the labour market does not get a commensurate return from the country's economic growth.

Malaysia's competitiveness should not be affected by the setting up of a national minimum wage. The implementation of the minimum wage has to be transparent to the public and investors in order to ensure that the wage agreed upon is at an effective level.

All in all, global headwinds against growth and exports will be the key risks in 2012. As the Malaysian economy is not spared from external shocks, 2012 will prove to be yet another uncertain year indeed.

## Minimum Wage: Implementation and Implications

**T**he panelists for this session were **Mr A Sivanathan**, Senior IR Practitioner from the Malaysian Trade Union Congress (MTUC), and **Tuan Hj Samsudin Bardan**, Executive Director of the Malaysia Employers Federation (MEF). The session was moderated by **Mr Steven Wong**, Senior Director (Economics) of ISIS Malaysia. ISIS Senior Analyst **Dr Muhammed Abdul Khalid** reports.

**A Sivanathan** said that the aim of the minimum wage is to reduce poverty; it is not linked to productivity. Subsequent revisions to the minimum wage, however, should be based on productivity. He added that the Malaysian Trades Union Congress (MTUC) is in favour of only one national minimum wage, not sector-based minimum wages, and they want it to cover all workers, including foreigners. Sivanathan also raised the point of the lack of laws covering the welfare of workers in Malaysia; he said that the current laws are retrogressive. There has been little improvement in conditions for workers in Malaysia partly due to the weakening bargaining power and social dialogue between workers and employers.

The MTUC's intense push for the minimum wage was due to the accelerated pace

of globalization, although discussions on implementation have been going on for the past 30 years. The MTUC has suggested RM 900 as the rate for the minimum wage, based on the minimum daily expenditure of an average worker, with an additional RM 300 as the cost of living allowance (COLA). Sivanathan also expressed concern over the widening wage gap between management and the low-level worker. He argued that the productivity growth of the worker is the responsibility of the management. He concluded by reiterating that the minimum wage should not be the average wage, but a wage that allows workers to earn above the poverty rate.

**Tuan Hj Samsudin Bardan** argued that the minimum wage issue re-surfaced because the government is aiming for Malaysia to become a high-income economy nation; otherwise the issue



(From left) A Sivanathan, Steven Wong and Samsudin Bardan

would not have gained prominence. He reiterated that the Malaysian Employers Federation (MEF) opposes the minimum wage as it will reduce Malaysia's competitiveness. He further argued that the minimum wage does not guarantee job creation, but may instead increase unemployment — if the minimum wage is set too high, it will be costlier for employers to hire workers. Samsudin disagreed with the MTUC on the fixing of a single rate for the minimum wage. He proposed that the minimum wage should take into account the type of employment, location, and the economic sector involved.

Nonetheless, he reaffirmed the MEF commitment to the National Wage Consultative Council (NWCC), but cautioned that as the majority of the NWCC members are pro-worker, the impartiality of its members cannot be taken for granted. He further stressed that NWCC members do not have the expertise in these issues as most of them are academicians and researchers.

***He proposed that the minimum wage should take into account the types of employment, location, and economic sectors***

Samsudin said that the introduction of the minimum wage in Malaysia may lead to higher remittances overseas by foreign workers, citing the fact that the current average remittance per foreign worker is RM 750 per month. In concluding, Samsudin reaffirmed the MEF stand on the minimum wage; in principle, the MEF supports the introduction of the minimum wage, but companies should be given a grace period for its implementation. Finally, he suggested that efforts should be made to raise incomes overall; any increase to wages must be determined by the productivity of workers.



*Participants at the seminar*

# Malaysia's Political Outlook 2012

**A**t Session Five of the ISIS Praxis Seminar 2012 the panellists were **Datuk A Kadir Jasin**, Editor-in-Chief Berita Publishing, Sdn, Malaysia, **Ms Rita Sim**, Director, Media Chinese International Ltd. Malaysia, **Mr Wan Saiful Wan Jan**, Chief Executive, Institute of Democracy and Economic Affairs (IDEAS), Malaysia, **Prof James UH Chin**, Professor and Head of the School of Arts and Social Sciences, Monash University, Sunway Campus, Malaysia. The Session was moderated by **Dato' Dr Mahani Zainal Abidin**, Chief Executive, ISIS Malaysia. Report compiled by ISIS research staff.



(From left) Wan Saiful Wan Jan, A. Kadir Jasin, Mahani Zainal Abidin, Rita Sim and James UH Chin

## The Objective

As 2012 is speculated to be an election year, planning for it includes understanding the political environment of the year in order to supplement economic and development forecasts. Calculated projections based on empirical data and analysis shaped this discussion with the hope of shedding light on the main question posed by the moderator at the beginning of the session that discussed Malaysia's Political Outlook in 2012: 'When will the elections be held and how will the voters vote?'

## Backdrop

In 2008, Barisan Nasional (BN) won by 51.4 per cent, securing 79 seats. The ruling coalition was eight seats short of the 2/3<sup>rd</sup> majority; in the previous elections, Prime Minister Abdullah Badawi had secured 61.2 per cent of the votes.

UMNO is the single largest political party and has 239 out of 505 state seats. However in 2008, BN lost its hold on five states because of a swing of five per cent in Malay votes. The second largest party, Pakatan Rakyat (PR) had 31 seats, 18 of which were given by PAS. Therefore, negotiations of seats and the area of contestation are very important for PR as historically opposition parties have always secured more than 40 per cent of the total votes in the country.

Although the three year by-election time-frame period has expired, an unprecedented 16 by-elections were held, with the score standing equally on both sides at 8-8.

The highest number of people who did not vote was recorded from BN majority areas while in the previous elections the highest number of spoilt votes and those who did not register to vote were recorded from those areas too. In Johor



***It was felt that the political dividend was not paid in electing a Deputy Prime Minister from East Malaysia***

three in every 100 votes were spoilt while Malacca and Pahang recorded similar figures.

#### **Implications of the Sarawak Elections**

Sabah and Sarawak have always been BN's 'fixed deposits.' In the last Sarawak Elections, BN secured 55 of the 71 seats contested while DAP doubled their seat count to 12. However it has been observed that there is opposition against the current Sabah Chief Minister, Datuk Seri Panglima Haji Musa bin Haji Aman and the Sarawak Chief Minister Pehin Sri Haji Abdul Taib bin Mahmud. Furthermore, a political transition is taking place within the Kadazan-Dusun community, caused by factions in the PBB and SUPP, while UPKO has been very vocal about its discontent. It was felt that the political dividend was not paid in electing a Deputy Prime Minister from East Malaysia, despite being given the posts of speaker and deputy speakers. Besides that, land issues and the influx of illegals to East Malaysia are significant issues that voters want addressed and resolved.

#### **Prognosis**

The 2012 political outlook hinges on when the general elections will be held and speculation has it that it will be in the first quarter of the year. Based on the 2008 election results, it is clear that the BN no longer monopolises Malaysian politics. The coming elections will be an uphill battle for both political factions; for PKR to attain power and for BN to maintain its hold.

In order to recover its position, the regime has to address the many demands raised by the various communities. This includes issues that the average voter is interested in – the day-to-day

concerns ranging from food shortages, inflation and crime rates to under-employment, unemployment and the increased number of legal and illegal migrant workers.

It was observed that the people are comfortable with a BN government that is not too strong and based on previous election findings, if the BN wins, it will not be because it has improved tremendously but because the opposition has not shown the cohesion it did during the campaigning for the 2008 election.

There is no doubt the media will have a major influence on the election. In the last decade, the traditional media has lost ground while online readership has increased, although it was noted that information available online has a tendency to be not very accurate nor are the purveyors accountable. However some analysts have suggested that 70 per cent of the voters have already made up their minds while 30 per cent remain floating voters. The panelists also observed that political power does not rest in urban areas but depends on rural areas.

While speculation is rife about a looming election, the following will be important factors in determining when the elections will take place.

- I. Political sentiment;
- II. Voting trend of states and cohorts;
- III. Political economy; and
- IV. Readiness of the election machinery

#### **Election Projection**

- Malaysia follows the 'first-past-the-post' system where very small votes can determine a very big outcome;
- 222 parliamentary seats will be contested, matching that of the 12<sup>th</sup> General Elections;
- 28 April 2013 marks the end of the parliamentary term, meaning that the elections can be held as late as mid 2013;
- BN will win but with an even smaller majority;

- By 2020, the demographics of Malaysia will be 70 per cent Malay-Bumiputera and 30 per cent non-Malays. Today that figure stands at 60 per cent Malay-Bumiputera and 40 per cent non-Malays. However the voting population is 55 per cent Malay-Bumiputera and 45 per cent non-Malay voters;
- Many young Malays are eligible to vote but do not register to vote while non-Malays are highly aware of their duty to vote. Eight out of ten Chinese eligible to vote are registered as voters;
- 21-29 year olds show support for BN;
- Chinese support has dropped for BN while PR does not have much Malay support; however Malay support for PKR is brought in by PAS supporters;
- Hindraf caused BN to lose the majority of its Indian supporters; however there are no Indian majority seats but Indians are equally an important component with mixed seats;
- DAP will most likely retain Penang.

#### **Key Issues**

- Chinese education issue;
- Conversion issues;
- Perak constitutional crisis;
- Acquiescence towards Perkasa;
- PPSMI flip-flopping;
- The NFC case; and
- The false 'Freedom of Assembly Bill'.

#### **Wish List**

- Clearer government commitment to implement economic liberalisation and political reforms;
- A shift towards ideology-based debates and less ethno-religious division;
- Government agencies understand that they serve the government of the day and are not biased in pledging allegiance to any one political party.



*Participants at the seminar*





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