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China and India: challenges and opportunities for poverty eradication and moderating inequality in Malaysia

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Abstract

Malaysia has employed the mechanism of growth with equity in an effort to eradicate poverty and ameliorate inequality. During the New Economic Policy period, the government intervened extensively to ensure that all levels of society benefited from economic development and thereby maintain social cohesion. However, the increasing pace of liberalization coupled with developments in the region, such as the rise of China and India, has eroded the government's ability to ensure the equitable sharing of the economic pie.

The objective of this paper is to look at the challenges as well as opportunities posed by the rise of China and India with respect to poverty eradication and reducing income inequality. The challenges include competition for markets with the Malaysian small and medium producers, and competition for foreign direct investment. This has serious implications on employment opportunities and efforts at eradicating poverty and narrowing income disparity. On the other hand, the rise of these two giants also gives Malaysia opportunities in its effort to tackle poverty and inequality through the "prosper thy neighbour" effects, as there will be spillover from their growth and wealth accumulation. Furthermore, as China becomes integrated into the multinational regional production network, it will contribute to the improvement of trade through increased intra-trade, thus expanding exports and growth.

JEL classification: I38, D63
Keywords: Poverty, inequality, growth, trade intensity, non tariff barriers, foreign direct investment.

1. Introduction

The New Economic Policy 1971-1990 (NEP), introduced after Malaysia was traumatized by the worst racial riots in its history, was hailed as a successful model of redistributing income without sacrificing growth. It was launched with the objective of attaining national unity and fostering nation building through poverty eradication

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and economic restructuring so as to eliminate the identification of race with economic functions. Since the policy's implementation, Malaysia has achieved growth, structural transformation, poverty alleviation, and improved income distribution in an ethnically diverse society. More specifically, studies on income distribution during this period (see, for example, Ishak and Ragayah [1990]; Bhalla and Kharas [1992]; World Bank [1993]; Ragayah [1994]; Zainal Aznam [1994]) have shown that growth was also accompanied by improved income distribution.

The NEP was succeeded by the National Development Policy 1991-2000 (NDP), which retains the NEP's basic strategy of growth with equity. This in turn is followed by the current National Vision Policy contained in the Third Outline Perspective Plan 2001-2010 (NVP). In essence, the NVP represents the consolidation of all past development efforts (NEP and NDP) to attain a united, progressive, and prosperous Malaysian society. Malaysia seeks to become a developed nation in its own mould. To meet the challenges toward this end, the NVP will deepen the same strategies expounded in the NEP and NDP of building a resilient, competitive nation and an equitable society to ensure national cohesion and social stability. While poverty reduction continued unabated during the NDP and NVP, except for the glitch as a consequence of the 1997-1998 financial crisis, income inequality has suffered a U-turn since the end of the NEP period.

The process of liberalization and globalization would be more likely to cause a financial crisis such as that experienced in 1997-1998, which resulted in financial volatility and economic insecurity. It is this onslaught of the globalization process that is changing the economies, environments, cultures, and societies, which would adversely affect the urban poor. These people do not have the capital and access to information, or the ability to translate information into economic, political, and social gain [UNESCAP 2000]. Hence, the economic situation tends to be unstable and hinders the poverty-eradication effort by causing retrenchment, inability to find employment, and thus less transfers to assist their families. Moreover, devaluation also raised the prices of imported goods, thus lowering the real income of their purchasers, particularly of the urban poor. And the crisis of 1997-1998 is not an exception, as McGee and Scott [2000:235] quoted what Brad Glosserman wrote on the comment of Stephen Roach, chief economist of Morgan Stanley Dean Witter: "There is little talk that the crisis could ever recur. Yet that flies in the face of painful reality. From 1975 to 1997, the IMF identified 158 specific country crises, 54 banking crises, and 32 instances where a country experienced a combined currency/banking crisis. Financial crises have become the rule, not the exception."

As if this was not enough, Malaysia, together with the rest of the world (with ASEAN countries in particular), is now forced to deal with the awakening of the two giants, China and India.[1] Tham and Kwek [2005] note that many economies, including a developed country like Japan, view China's rise with trepidation and fear. Japan's apprehension is founded on the fact that industrial upgrading in China

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[1]The discussion in this paper focuses more on the impact of the rise of China rather than India due to the constraint in information on the latter.

with the assistance of Japanese multinational corporations (MNCs) will keep moving continuously upstream until China has acquired a full industrial structure, at the expense of Japan. Increasing anxiety is also felt by ASEAN member countries, including Malaysia, which employ the path of foreign direct investment (FDI) and export promotion to further their development goals as Chinese exports flood the world. Amid this unease, they also see that the growth of China may offer increasing opportunities in trade and investment, especially with the accession of China to the World Trade Organization (WTO) in 2001. The growth and development of China and India will provide Malaysia with opportunities in its effort to tackle poverty and inequality through the "prosper thy neighbor" effects, as there will be spillover from their growth and wealth accumulation. Moreover, as China becomes integrated into the multinational regional production network, it will contribute to improving trade in the region through increase in intra-trade, thus expanding exports and growth.

This paper's objective is to outline the Malaysian experience in absolute poverty eradication and managing income distribution or relative poverty, and look at the challenges posed by the rise of China and India as well as opportunities they provide with respect to poverty eradication and reducing income inequality. For this purpose, the next section will provide a description of the achievements in poverty eradication while section 3 presents a mixed picture in the success of reducing income inequality. Section 4 touches on the pattern of Malaysian trade with China and India while section 5 describes some of the opportunities and challenges faced by Malaysia in achieving growth and, in turn, poverty eradication and income inequality reduction in the midst of the awakening giants. Section 6 concludes the paper.

2. The structure of poverty

2.1. *Definition of poverty line income*[2]

Poverty incidence in Malaysia is estimated on the basis of poverty line income (PLI). The Eighth Malaysia Plan [Malaysia 2001] stated that the PLI was estimated based on the minimum requirements of a household for three major components: (a) food, (b) clothing and footwear, and (c) other nonfood items such as rent, fuel, and power; furniture and household equipment; medical care and health expenses; transport and communications; and recreation, education, and cultural services. For the food component, the minimum expenditure was based on a daily requirement of 9,910 calories for a family of five while the minimum requirements for clothing and footwear were based on standards set by the Department of Social Welfare to welfare homes. The other nonfood items are based on the level of expenditure of the lower-income households, as reported in the Household Expenditure Survey 1998/1999. The poverty line income is updated annually to reflect changes in the levels of prices by taking into account changes in consumer price indices.

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[2]For a definition of income, sources, and comparability of the data used to estimate poverty incidence and income distribution in Malaysia, see Ragayah [2003].

Researchers on the Malaysian poverty situation had been concerned with the appropriateness of using the same poverty line, adjusted for inflation, for over two decades (Shireen [1998]; Ragayah [2001]) and the fact that the same poverty line is utilized for both urban and rural areas, although separate poverty lines are employed for Peninsular Malaysia, Sabah, and Sarawak. While the approach of adjusting the PLI to inflation is adequate for absolute deprivation, its relevance as a measure of relative deprivation is questionable. Shireen has shown that poverty in Malaysia is officially seen as a situation of relative rather than absolute deprivation and argued that a PLI updated for inflation over a long period of time ceases to reflect relative deprivation since the Malaysian standard of living had not remained constant over the period [1998:161]. Second, a separate PLI for urban and rural areas is more accurate because the relationship between food energy intake and consumption expenditure varies by region, activity level, relative price, and taste. This would result in an underestimation of the incidence of urban poverty since the income level required to sustain a household subsistence level in the rural areas would not be adequate for a similar household in the urban areas. Third, the Malaysian PLI does not take into account the differences in household size. A measure that takes into account the differences in the composition of the household, especially in terms of age and sex, would be more accurate. Similarly, the PLI also neglects the regional differences in food consumption pattern and the changes in consumption patterns as income grows. Finally, it also does not allow for economies of scale in consumption. Hence, one must bear in mind these flaws in looking at the Malaysian poverty data.[3]

Using the current method of calculation, the PLI for 1987 was RM 350 per month for a household size of 5.14 in Peninsular Malaysia, RM 429 for a household size of 5.24 in Sarawak, and RM 533 for a household size of 5.36 in Sabah [Malaysia 1989]. The poverty line was adjusted in 1993 to RM 405 per month for a household size of 4.8 in Peninsular Malaysia, RM 582 for a household size of 5.1 in Sabah, and RM 495 for a household size of 5.1 in Sarawak. The Seventh Malaysia Plan [Malaysia 1996] revised the poverty line for 1995 to RM 425 monthly for a household size of 4.6 in Peninsular Malaysia, RM 601 for a household size of 4.9 in Sabah, and RM 516 for a household size of 4.8 in Sarawak. In 1997, these were revised to RM 460 per month for a household in Peninsular Malaysia, RM 633 for a household in Sabah, and RM 543 for a household in Sarawak. In 1998, these PLIs were RM 493, RM 667, and RM 572, respectively, while in 1999 the PLIs were RM 510, RM 685, and RM 584, respectively, for Peninsular Malaysia, Sabah, and Sarawak for similar household sizes. The PLI in 2002 was RM 529, RM 690, and RM 600, respectively, for each of the three regions.

2.2. *Incidence and trends of poverty*

Since the implementation of the NEP, Malaysia has achieved outstanding progress in poverty eradication. In this effort, greater emphasis was given to

[3]The Malaysian government has responded and has revised the methodology of calculating the PLIs to be used in the coming Ninth Malaysia Plan 2006-2010.

eradicating poverty in the rural areas compared to the urban areas. This focus on the former is justified since the incidence of poverty has always been much higher in the rural areas than in the urban areas. The progress in poverty eradication according to region and strata between 1970 and 2002 is shown in Table 1. For the whole of Malaysia, the total number of poor households decreased from one million to 267,900 households over the period, resulting in the plunge of poverty incidence from 52.4 percent to 5.1 percent. Over the same period, urban poverty incidence shrank to 2.0 percent while rural poverty incidence fell to 11.4 percent.[4] Urban poor households numbered 111,800 in 1976 but dropped to 69,600 in 2002, while poor rural households, which totalled 864,100 in 1976, shrank to 198,300 over the same period. As can be seen, poverty in Malaysia is mainly a rural phenomenon, but the Malaysian government had not neglected the problem of urban poverty since the urban poor was identified as one of the seven poverty-reduction target groups [Malaysia 1976].

A critical dimension of poverty in Malaysia is from the ethnic point of view. Table 2 shows that poverty is concentrated among the Malays and other Bumiputeras. Although poverty incidence among all ethnic groups has been reduced, it is still relatively high among the Malays and other Bumiputeras.

3. Trends in income inequality

The impacts of the changes in Malaysian development policies and external influences on overall income distribution as well as rural and urban household income distribution are shown in Table 3. Income inequality rose between 1970 and 1976, and fell continuously till the end of the NEP period. However, the Gini ratio has shown a trend reversal in the 1990s. This U-turn in income inequality almost wiped out all the gains that were made under the NEP. The crisis managed to bring down the Gini ratio to 0.443 in 1999, but it rose again, except for the moderating impact of the 1997-1998 financial crisis, to 0.4607 in 2002 [Malaysia 2003].

The state of income distribution, both in the rural and the urban areas, also exhibited similar trends over the NEP period. It can be seen that the Gini ratio for rural households rose between 1970 and 1976 but fell thereafter before rising again after 1990. However, the trends in income distribution in rural and urban areas diverged during the 1990s. The trend in the rural areas replicates the overall trend, where there is also a U-turn in income inequalities. Nevertheless, inequality moderated slightly in the rural areas after that. In the urban areas, the Gini ratio first rose in 1976 but fell continuously thereafter till 1999, at which point it rose again. This high inequality, one of the highest in East Asia, is worrying since for any given rate of growth, high inequality would impede poverty reduction and human development, which implies exclusion for many in the society.

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[4]The figures for 2002 are from the Mid-term Review of the Eighth Malaysia Plan [Malaysia 2003], which provides figures for Malaysian citizens only.

Table 2. Poverty incidence by ethnic groups, 1970-2002

	1970	1976	1984	1987	1990	1997	2002
Malays	64.8	56.4	25.8	23.8	20.4	7.7	7.3
Other Bumiputera	NA	NA	NA	NA	36.8	17.3	NA
Chinese	26.0	19.2	7.8	7.1	5.4	1.1	1.5
Indian	39.2	28.3	10.1	9.7	7.6	1.3	1.9
Others	44.8	44.6	22.0	24.3	22.8	13.0	NA
Total	49.3	35.1	18.4	17.3	16.5	6.1	5.1

NA – not available.
Source: Various "Malaysia Plans".

Ethnic inequality is the most sensitive issue in Malaysian income distribution, thus information on this subject is often unavailable to the public. This is why the patterns and changes in income distributions for the three main ethnic groups in Peninsular Malaysia shown in Table 4 are rather scanty in recent years. In 1970, the degree of inequality among the major ethnic groups in Peninsular Malaysia was highest among the Malays, followed by the Indians and the Chinese. Between 1970 and 1976, the Gini coefficients indicate that the income distribution of all the three ethnic groups deteriorated, with the inequality among Chinese households exceeding that of the Malay and Indian households. The income shares of the first two ethnic groups show that while the top income groups increased their shares of the total income, the lower two groups suffered losses. Income inequality actually improved among the Indian households.

All three ethnic groups show declining trends after 1976 until 1990. The Chinese trend shows that the disparity continued to narrow until 1999, after which it has jumped to be the most unequal among all three groups. Inequality among the Indians remained the lowest; it increased slightly after 1990. Although inequality among the Bumiputera also narrowed, the reduction proceeded extremely slowly, resulting in this group having the most unequal distribution in these years, except in 2002.

Table 4 also illustrates that non-Bumiputera mean incomes continue to outstrip that of the Bumiputera mean income. However, while the growth rate of non-Bumiputera household incomes far exceeded that of the Bumiputera before 1970, this trend reversed during the NEP period. The later disparity in relative growth rates meant that interethnic group gap in incomes had narrowed. This amelioration in the disparity ratios can also be seen in Table 3. The income disparity ratios between Chinese and Bumiputera households fell from 2.29 in 1970 to 1.90 in 1980 and 1.74 in 1990. In contrast, the Indian-Bumiputera disparity ratio fell from 1.77 in 1970 to 1.29 in 1980, and it remained at that level till 1990. This decline in interethnic income disparity, together with the reduction in inequalities within all major ethnic groups, accounted for the overall improvement in the size distribution of income during the NEP period.

Table 3. Distribution of household income by strata: Malaysia 1970-2002

	Income share (percentage)										
Percentage of households	1970	1976	1979	1984	1987	1990	1993	1995	1997	1999	2002
Overall											
Top 20%	55.7	57.7	55.8	53.2	51.2	50.4	NA	51.3	52.4	50.5	51.3
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	5202	6854	6268	7745
Middle 40%	32.9	31.2	32.4	34.0	35.0	35.3	NA	35.0	34.4	35.5	35.2
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	1777	2250	2204	2660
Bottom 40%	11.5	11.1	11.9	12.8	13.8	14.3	NA	13.7	13.2	14.0	13.5
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	693	867	865	1019
Gini ratio	0.513	0.529	0.505	0.483	0.458	0.446	0.459	0.464	0.47	0.443	0.461
Mean household income (RM)	264	514	763	1095	1074	1163	1563	2020	2606	2472	3011
Rural											
Top 20%	51.0	54.5	53.2	49.5	48.3	47.1	NA	47.4	48.2	47.9	49.6
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	3153	4130	4124	4057
Middle 40%	35.9	33.7	34.4	36.4	36.7	37.1	NA	37.1	36.6	36.5	35.7
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	1235	1564	1577	1612
Bottom 40%	13.1	11.8	12.4	14.1	15.0	15.8	NA	15.5	15.2	15.6	14.7
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	515	649	670	699
Gini ratio	0.469	0.5	0.482	0.444	0.427	0.409	NA	0.414	0.424	0.418	0.405
Mean household income (RM)	200	392	550	824	852	927	NA	1326	1704	1718	1729

Table 3. Distribution of household income by strata: Malaysia 1970-2002 (continued)

Percentage of households	1970	1976	1979	1984	1987	1990	1993	1995	1997	1999	2002
					Income share (percentage)						
Urban											
Top 20%	55.0	55.9	55.6	52.1	50.8	50.6	NA	49.8	50.2	48.7	46.7
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	6474	8470	7580	9085
Middle 40%	32.8	32.2	32.1	34.5	35.0	35.1	NA	35.7	35.6	36.5	37.2
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	2323	3000	2844	3265
Bottom 40%	12.2	11.9	12.3	13.4	14.2	14.3	NA	14.5	14.2	14.8	16.1
Mean household income (RM)	NA	NA	NA	NA	NA	NA	NA	842	1193	1155	1344
Gini ratio	0.503	0.512	0.501	0.466	0.449	0.445	NA	0.431	0.427	0.416	0.439
Mean household income (RM)	407	830	975	1541	1467	1591	NA	2589	3357	3103	3652
Disparity ratio:											
Urban : Rural	2.14	2.19	1.9	1.87	1.72	1.7	1.75	1.95	2.04	1.81	2.11
Chinese : Bumiputera	2.25	2.28	2.13	1.76	1.65	1.7	1.78	1.8	1.83	1.74	1.8
Indian : Bumiputera	1.75	1.56	1.51	1.28	1.25	1.29	1.29	1.33	1.42	1.36	1.28

NA – not available.

Sources: Anand [1983]; Malaysia [1981, 1986, 1989, 1991b, 1993, 1996, 1999, 2001]; mean household incomes of income classes for Malaysia, urban and rural, were provided by EPU.

Table 4. Distribution of household income by ethnic group: Malaysia* 1970-2002

	Percentage of income share											
	Malay/Bumiputera				*Chinese*				*Indian*			
Percentage of households	1970	1976	1979	1984	1970	1976	1979	1984	1970	1976	1979	1984
Top 20%	52.5	53.9	52.6	51.9	52.6	56.1	52.8	51.1	54.2	52.6	50.8	48.4
Middle 40%	34.8	34.3	35.5	34.8	33.5	31.3	35.3	34.9	31.3	32.7	36.3	35.3
Bottom 40%	12.7	11.8	11.9	13.3	13.9	12.6	11.9	14.0	14.3	14.7	12.8	16.3
Mean income* (RM per month)	172	345	513	852	399	787	1094	1502	310	538	776	1094
Median income* (RM per month)	122	233	332	581	269	480	636	1024	196	360	522	770
Gini ratio : overall	0.466	0.494	0.47	0.469	0.455	0.505	0.473	0.452	0.463	0.458	0.452	0.417
Rural	0.419	0.471	NA	0.447	0.399	0.486	NA	0.412	0.363	0.388	NA	0.347
Urban	0.445	0.478	NA	0.462	0.474	0.507	NA	0.456	0.502	0.504	NA	0.441
% of Households	1987	1990	1997	2002	1987	1990	1997	2002	1987	1990	1997	2002
Top 20%	50.2	49.5	NA	NA	49.2	48.9	NA	NA	47.2	47.7	NA	NA
Middle 40%	35.7	35.7	NA	NA	35.7	36.0	NA	NA	35.9	35.8	NA	NA
Bottom 40%	14.1	14.8	NA	NA	15.1	14.2	NA	NA	16.9	16.5	NA	NA
Mean income* (RM per month)	868	931	2052	2376	1430	1582	3743	4279	1089	1201	2887	3044
Median income* (RM per month)	612	677	NA	NA	1021	1137	NA	NA	799	881	NA	NA
Gini ratio: overall	0.447	0.429	0.448	0.4351	0.43	0.419	0.416	0.4552	0.402	0.390	0.409	0.3989
Rural	0.426	0.410	0.408	NA	0.399	0.392	0.420	NA	0.350	0.341	0.362	NA
Urban	0.437	0.435	0.431	NA	0.44	0.428	0.402	NA	0.435	0.424	0.403	NA

*Figures from 1970 to 1987 refer to Peninsular Malaysia only.
Sources: Compiled from Ishak and Ragayah [1990]; Kumpulan Penelitian Sosial UKM [1990]; Ishak [2000]; and Ismail [2004].

Unfortunately, the developments after this period, while still upholding "growth with equity", had resulted in the reemergence of inequalities among the ethnic groups to almost the level before the NEP. The reason is that, in the 1990s, the speed in the rate of increase of household income among ethnic groups changed again. Table 5 shows the average annual rate of increase of household income for the different ethnic groups between 1990 and 1997. In terms of the overall increase, the Indians had the fastest rate of increase, followed by the Chinese and the Bumiputeras. The table also reveals that the Indians are in the top 20 percent income group followed by the Indians in the 40 percent middle-income group, followed by the Chinese in the top 20 percent income group that are having the biggest jumps in their household incomes. Among the urban dwellers, it was the Chinese in the 40 percent middle-income group that were experiencing the fastest rise. In the rural areas, the Indians in the top 20 percent income group led the pack. Thus, it is not surprising that the disparity ratios between the Bumiputeras and the Indians and particularly the Chinese widened again in 1990s, to be moderated only by the financial crisis (see Table 4).

Table 5. Average rate of increase of household income by ethnic groups 1990-1997 (average annual growth rate)

Ethnic group	*Highest -20%*	*Middle -40%*	*Bottom -40%*	*Overall average*
Malaysia	11.4	10	9.1	10.6
Bumiputera	11.1	10.1	8.9	10.3
Chinese	11.3	11.0	10.0	10.9
Indian	12.1	11.4	9.9	11.4
Others	-4.8	-10.3	3.0	9.9
Urban	10.2	9.6	9	9.8
Bumiputera	10.3	10.0	9.3	9.8
Chinese	9.4	11.8	9.9	10.3
Indian	10.1	10.0	10.0	10.0
Others	1.9	-14.7	-3.9	7.9
Rural	7.6	7.3	6.9	7.3
Bumiputera	7.9	7.9	7.6	7.7
Chinese	9.7	7.8	7.5	8.6
Indian	10.0	9.6	8.0	9.4
Others	-8.7	0.8	6.6	5.1

Source: Economic Planning Unit.

4. Trade with China and India

Table 6 shows the trends of rapid expansion in trade between China and the ASEAN-5 countries from 1999 to 2004, which accounts for about 90 percent of the total ASEAN trade with China. It can be seen that the total exports of the ASEAN-5 countries to China jumped from US$ 10.59 billion to US$ 38.12 billion over the five-year period. Over the same period, the total imports of these countries from China leapt to US$ 41.36 billion from US$ 12.6 billion. Singapore ranks top in both its exports to and imports from China. This is followed by Malaysia whose exports rose by about three-and-a-half times, but its imports climbed almost fivefold, quickly turning it from a net exporter to a net importer. Only Indonesia has consistently been a net exporter during the period.

In terms of products, ASEAN's pattern of trade with China has shifted out of primary resources into manufactured goods over the years. Tham and Kwek [2005] have shown the increasing importance of electrical and electronic (E&E) products in both ASEAN's exports to and imports from China. For example, in 2000, E&E goods constituted 27.6 percent and 45.5 percent, respectively, of total exports and imports to China; by 2003, these have risen to 31.9 percent and 46.3 percent, respectively, of total exports and imports to China. The authors argue that the rise in E&E trade with China reflects the integration of China into the international production networks as a result of increasing multinational production in China. In turn, the use of China as an export platform for these goods is facilitated by the relatively lower labor costs in the country as well as by the use of selective trade liberalization policies that have provided duty exemptions for selected categories of imports in export-promotion industries [Lemoine and Unal-Kesenci 2002]. Moreover, Weiss [2004] noted that falling trade costs (import tariffs, transport, and freight charges, time in transit, the cost of information and of managing international supply chains) have facilitated rapid regional integration in trade and capital flows within the East-Southeast Asian region, resulting in increasing trade ties between ASEAN and China.

Tham and Kwek [2005] also show that the trade intensity index of ASEAN's trade with China, which compares the relative intensity of ASEAN's trade with China to its trade with the rest of the world, has increased noticeably for each of the ASEAN country. As shown in Table 7, the trade intensity between the Philippines and China has increased more than fivefold from 3.14 to 15.8 over the ten-year period. Similarly, Thailand's trade intensity also increased slightly more than five times while Singapore's trade intensity with China rose 3.5 times. Indonesia's and Malaysia's respective trade intensities had the slowest increase—threefold—over the same period.

Table 6. ASEAN-5 trade with China (in billion US$)

	Exports					
	1999	2000	2001	2002	2003	2004
Indonesia	2.01	2.77	2.20	2.90	3.80	4.60
Malaysia	2.32	3.03	3.82	5.25	6.43	8.38
Philippines	0.57	0.66	0.79	1.35	2.14	2.65
Singapore	3.92	5.37	5.32	6.86	10.15	15.40
Thailand	1.77	2.79	2.85	3.54	5.69	7.09
Total ASEAN-5	10.59	14.63	14.99	19.91	28.21	38.12
	Imports					
	1999	2000	2001	2002	2003	2004
Indonesia	1.24	2.03	1.84	2.43	2.96	4.10
Malaysia	2.14	3.24	3.80	6.18	6.73	10.34
Philippines	1.04	0.78	0.98	1.25	1.80	2.53
Singapore	5.70	7.10	7.19	8.87	11.08	16.21
Thailand	2.49	3.37	3.70	4.92	6.06	8.17
Total ASEAN-5	12.60	16.53	17.52	23.64	28.62	41.36

Sources: Suthiphand [2005]; reproduced in Tham and Kwek [2005].

Table 7. ASEAN-5 trade intensity index with China

	1993	1995	2000	2003
Indonesia	3.87	4.46	6.79	12.06
Malaysia	2.01	1.60	2.50	6.04
Philippines	3.14	4.26	3.84	15.77
Singapore	1.27	1.18	2.18	4.40
Thailand	1.45	2.23	4.67	7.40
Korea	2.29	2.49	3.67	6.43
Japan	0.78	0.97	1.51	2.81

Source: Tham and Kwek [2005].

Tham and Kwek [2005] also examine the impact of the increase in trade intensity with China on the growth of the ASEAN-5 economies, and the results of the estimates are summarized in Table 8. They argue that based on these results, the only meaningful interpretation of the findings on multipliers holds true for Indonesia, the Philippines, and Thailand. In the short run, Indonesia benefits the most out of more trading with China; in the long run, the Philippines has the greatest benefits from growing trade with China. Overall, their estimates based on the simple dynamic models and the autoregressive distributed lag models, show that the Philippines would be the largest recipient of any future trade growth with China.

Table 8. Summary benefits of growing trade of ASEAN-5 with China in the short run and long run

1998:Q1–2003:Q4			
Impact multiplier		*Long-run multiplier*	
(R5) Singapore	23.74958	(R5) Malaysia	0.121667
(R4) Malaysia	24.77848	(R4) Indonesia#	0.260996
(R3) Thailand#	27.05174	(R3) Thailand	0.575573
(R2) Philippines#	31.93949	(R2) Singapore#	0.918241
(R1) Indonesia#	31.97633	(R1) Philippines#	2.841518

Note: R is rank and # indicates countries that have statistical meaningful interpretation of the estimated models.
Source: Tham and Kwek [2005].

The rise of India is a more recent phenomenon. Hence, not as much information is available on the impact of the rise of India compared to the rise of China. Malaysia, which accounted for US$ 1.63 billion trade value and 2.3 trade share, was India's seventh-ranked trading partner in 1996. In 2003, although its trade value swelled to US$ 2.64 billion, Malaysia's trade share fell to 2.1, and it became only the tenth-largest trading partner of India. Table 9 shows the major export destinations while Table 10 shows the major sources of imports for India. These two tables show that Malaysia is a more important source of import (11th in 2003) for India than it is an export destination (19th in the same year), i.e., Malaysia is a net exporter to India.

In 1999 Malaysia was India's second-ranked export destination of its E&E products worth US$ 68.21 million. By 2003, the export value has dropped to US$ 44.02 million, and Malaysia was only the ninth most important destination for India's E&E exports. As an import source of E&E products for India, in 1999 Malaysia accounted for US$ 192.73 million with 7 percent share and ranked fourth. However, although India's imports of E&E products from Malaysia expanded to US$ 419.78 million in 2003, Malaysia's share of India's imported E&E market had shrunk to 5.7 percent and its rank fell to fifth.

Table 9. Major export destinations for India

Country	1996 Value (US$ billion)	1996 Share (%)	1996 Rank	2003 Value (US$ billion)	2003 Share (%)	2003 Rank
Total exports	33.47	100.0		57.46	100.0	
United States	6.56	19.6	1	10.99	19.1	1
UAE	1.48	4.4	6	4.13	7.2	2
Hong Kong	1.86	5.6	5	3.23	5.6	3
UK	2.05	6.1	2	2.68	4.7	4
China	0.61	1.8	14	2.47	4.3	5
Germany	1.89	5.7	4	2.26	3.9	6
Belgium	1.10	3.3	7	1.74	3.0	7
Singapore	0.98	2.9	8	1.69	2.9	8
Japan	2.01	6.0	3	1.68	2.9	9
Italy	0.93	2.8	9	1.54	2.7	10
Malaysia	0.53	1.6	17	0.78	1.4	19

Source: MATRADE [2004].

Table 10. Major sources of imports for India

Country	1996 Value (US$ billion)	1996 Share (%)	1996 Rank	2003 Value (US$ billion)	2003 Share (%)	2003 Rank
Total imports	39.11	100.0		71.18	100.0	
United States	3.62	9.2	1	4.81	6.8	1
Belgium	2.23	5.7	3	3.66	5.1	2
China	0.76	1.9	17	3.57	5.0	3
Switzerland	1.13	2.9	10	3.10	4.4	4
UK	2.13	5.5	5	2.97	4.2	5
Germany	2.83	7.2	2	2.72	3.8	6
ROK	0.88	2.3	14	2.34	3.3	7
Japan	2.19	5.6	4	2.32	3.3	8
Australia	1.32	3.4	9	2.01	2.8	9
South Africa	0.00	0.0		1.93	2.7	10
Malaysia	1.10	2.8	11	1.86	2.6	11

Source: MATRADE [2004].

5. Opportunities and challenges

The rise of these two giants gives opportunities for Malaysia in its effort to tackle poverty and inequality through the "prosper thy neighbor" effects, as there will be spillover from its growth and wealth accumulation, not only in commodity trade but also trade in services. Furthermore, as China (particularly) becomes integrated into the multinational regional production network, it will contribute to the rise of trade in the region through increase in intra-trade, thus expanding exports and growth. In fact, it was recently reported that Singapore Prime Minister Lee Hsien Loong said that China's growth would "create a favourable environment for other Asian countries to grow" [Qin Jize 2005]. Tham and Kwek [2005] have shown that the share of China in the total exports of ASEAN increased from 3.5 percent in 2000 to 6.4 percent in 2003. Similarly, China's share in the total imports of ASEAN increased from 5.2 percent in 2000 to 7.8 percent in 2003. They concluded that, contrary to the expectations of the doomsayers, China's accession to the WTO has actually increased the trade between ASEAN and China.

In 2002, ASEAN and China signed the Framework Agreement on Comprehensive Economic Cooperation (CEC), which came into effect on July 1, 2003. This includes an agreement on the establishment of an ASEAN-China Free Trade Area (ACFTA) as well as programs for strengthening and promoting economic cooperation in priority sectors[5] as well as cooperation in other areas.[6]

In an FTA, the abolition of trade barriers will allow for trade expansion either through trade creation or trade diversion. Tham and Kwek [2005] have shown that the average tariff rates and nontariff barriers (NTBs) of the ASEAN-6 (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) on China's products are low compared to the tariff rates and NTBs of China on ASEAN products. They conclude that lowering the tariff barriers under the ACFTA will increase ASEAN firms' access to China's market, thus ASEAN firms should seize the opportunities accorded by this agreement to identify the potential customs duty savings arising from the margin of preference between the most favored nation (MFN) tariff rate and the lower preferential ASEAN-China tariff rate. On the other hand, they caution that capturing China's market, especially the domestic market, as opposed to using China as an export platform, will still encounter other challenges in the form of nontariff barriers, direct competition from domestic producers in China as well as competition from other ASEAN producers. The use of special certificates as NTBs for selected products can pose obstacles for ASEAN firms seeking to access China's market. The authors cited the example of the import of electrical goods in China, which requires a certificate of electrical equipment (CCEE) that has to be issued by

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[5]These are agriculture, information and communications technology, human resource development, investment, and Mekong Basin Development.

[6]These include the promotion and facilitation of trade in goods, services and investment, technology transfer, capacity transfer, promotion of e-commerce, and other areas such as banking, finance, tourism, industrial cooperation, transport, telecommunications, intellectual property rights, SMEs, biotechnology, fishery, forestry, mining, energy, and subregional development.

the China Commission for Conformity. Similarly, metals, chemicals, and similar commodities may require a certificate of analysis while animals, plants, their products and items such as animal vaccines and serums also require sanitary health certificates.

The ACFTA provides ASEAN producers with a bigger market, but it will also require these producers to compete among fellow ASEAN members for a slice of China's market as well as in their respective countries. While established entrepreneurs with large enterprises might be ready to face competition from other producers, small- and medium-scale industries (SMIs) might face problems, which will have serious implication on employment opportunities and efforts to eradicate poverty as well as reduce income disparity. Since the trade structures of the ASEAN countries, especially among the older ASEAN-4 member countries (Indonesia, Malaysia, Philippines, and Thailand), are similar and fundamentally competitive rather than complementary, Malaysian producers have to look for market niches, such as the "halal products" in the food industry.

Malaysia, like other developing countries in the region, has also been concerned with the fact that China (and maybe India in the future) has been attracting heavy FDI inflows, and this could be at the expense of its neighbors. Table 11 shows that the trend of FDI into Malaysia is falling in recent years, and this could deprive Malaysia of capital, technology, and expertise as well as employment opportunities. At the same time, while the government is expected to play a big role in eliminating poverty and narrowing inequality, the globalization process requires the government to reduce its role and increase that of the private sector in economic development. To attract FDI and improve competitiveness, the government has to scale back on labor rights and welfare, which are regarded as costs that erode a country's competitiveness. At the same time, the government is also pressured to reduce the progressive and corporate tax rates, provide various incentives—for example, tax holidays, exemptions, etc.—and provide infrastructure (both physical and human resource training). This means that there is less resource to be spent on redistribution—that is, on social expenditure, including education, health, and housing.

However, Weiss [2004] argues that this concern is greatly overstated for a number of reasons. First, although FDI in China is huge in absolute terms, once this figure is compared with either population or some measure of economic activity in the country, the ratio is not an outlier in comparison with other countries. Second, the comparison is based on officially recorded FDI flows, which included "round-tripping"—that is, the export of domestically generated funds and its return to its country of origin as FDI—is more significant in China than elsewhere, where it has been estimated to be as high as 40 percent of FDI flows in recent years. Weiss also quotes an econometric study that shows that the level of FDI in the eight neighboring economies is not negatively related to FDI in China and there is FDI creation. Hence, he concludes that it seems preferable to view FDI flows as at least partially endogenous to regional activity, with FDI responding to the profit opportunities generated by regional growth and FDI flows to one economy interacting positively with FDI flows to another as multinational firms exploit regional production sharing in a segmentation of the supply chain.

Table 11. Trend of foreign direct investment in Malaysia, 1991-2004
(RM million)

Year	*Net* FDI in Malaysia*	*Nominal gross domestic product (GDP)*	*FDI as a % of GDP*	*Gross fixed capital formation (GFCF) in current prices*	*FDI as a % of GFCF*
1991	11118	135124	8.2	30599	23.1
1992	13088	150682	8.7	53497	24.5
1993	14799	172194	8.6	63356	23.4
1994	12017	195461	6.1	76357	15.7
1995	14586	222473	6.6	107825	13.5
1996	18356	253732	7.2	121384	15.1
1997	17790	281795	6.3	121494	14.6
1998	10648	283243	3.8	75982	14.0
1999	14801	300764	4.9	65841	22.5
2000	14393	342157	4.2	87729	16.4
2001	2105	334589	0.6	83345	2.5
2002	12173	362012	3.4	83764	14.5
2003	9398	395017	2.4	87089	10.8
2004†	17934	449609	4.0	91818	19.5

*Inflows after taking into account the outflows arising from liquidation of FDI in Malaysia and the loan repayments to related companies.

†Estimated.

Sources: 1991-2001, Tham [2004]; 2003-2004, Data for Net FDI from Bank Negara Annual Report 2004; Data for GDP and GFCF, Economic Report of Malaysia, 2005-2006.

6. Conclusion

The above discussion has shown that Malaysia was successful in moderating income inequalities during the NEP period. However, with the liberalization of the economy and the intensification of the globalization process, inequality has been widening since the early 1990s. While the government is focusing on the eradication of absolute poverty, it must also attend to the reduction of income disparity, which means the reduction of relative poverty. As Malaysia had experienced, unequal income distribution is not conducive to promoting social cohesion and providing an acceptable level of quality of life for all Malaysians. It is also not consistent with our national development strategy of growth with equity.

Economic growth is important in poverty alleviation, particularly emphasized by the experience of the 1997-1998 crisis when negative growth was accompanied by an increase in poverty incidence. It is also crucial for income redistribution since the Malaysian philosophy is to redistribute from the enlarged size of the economic pie and not through the redistribution of income or wealth of one group to another. The unfolding trends in both China and India seem to imply that there are opportunities for mutual benefits. Thus, if Malaysian firms can seize the opportunities and overcome the challenges, then these benefits could trickle down to result in further poverty eradication. A strong growth also makes it easier for the government to maneuver the policies for reducing income disparity, particularly between the different ethnic groups in Malaysia. For all these opportunities to be realized, Malaysian firms need to enhance their competitiveness vis-à-vis their neighbors and create their own niche as well.

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