In the *Quest for Prosperity*, Lin proposes that governments of poor countries can promote growth by providing the ‘hard’ (power, telecommunications, roads, etc.) and ‘soft’ (education, financial, and legal) infrastructure necessary to support the structural transformation that has to take place continuously for an economy to grow based on its comparative advantage. Moreover, its comparative advantage will change as the economic structure changes.

The new line in Lin’s thinking about the economic growth process that may make some economists uncomfortable is his emphasis on government provision of the ‘hard’ and ‘soft’ infrastructure to reduce the transaction costs for new firms. The justification for such government actions is that the process of industrial upgrading and structural transformation is beset by market failure and, therefore, because of these informational and infrastructural externalities, pioneer firms will underinvest. It is reasonable enough to argue that governments should be in the business of providing these kinds of infrastructure; but Lin goes much further by implying that governments will know what forms of market failure—informational or infrastructural—will exist at any point along the structural transformation route. Economists uncomfortable with the idea of governments attempting to ‘pick winners’ will squirm when Lin talks about ‘encouraging the entry of firms into some industries aligned with the country’s comparative advantage’ (p. 93) and ‘helping the private sector identify the new industries that are consistent with the economy’s comparative advantage, which evolves as the endowment structure changes and to facilitate the entry of firms into industries in which they can prosper’ (p. 101) But do bureaucrats know any better than investors what activities are consistent with a country’s comparative advantage? Economists do not have much of a tool kit for identifying a country’s comparative advantage—especially from an ex ante viewpoint. Apart from broad overall perspectives about of whether a country is labour, land, or capital abundant, all we have is Balassa’s Revealed Comparative Advantage measure, which is an ex post exercise.

Lin bases his proposed new paradigm on his earlier discussion in the book (Chapter 3) on the lessons from the failure in post-World War II attempts by newly independent poor countries to develop by investing hugely in capital-intensive industries. But it is a big stretch to go from observing that countries will fail by investing so far from their comparative advantage to a government knowing what ‘hard’ and ‘soft’ infrastructure and provision of information will be of most use to certain infant industries.

While being critical of Lin’s central thesis, I have to say that this is an enjoyable and instructive book. The reader is treated to a wide range of developing country experiences drawn from Lin’s travel in his World Bank job. These experience are used very well to illustrate important points about the development process—especially about the mistakes made by developing countries in attempting capital-intensive import substitution. There is also an excellent summary of the economic theory of growth (Chapter 5). However, it is a contentious book and hopefully will foster much debate over the growth paradigm.

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**Malaysia’s Development Challenges: Graduating from the Middle**
Hal Hill, Tham Siew Yean, and Ragayah Haji Mat Zin (eds)
Routledge, London and New York, 2012

*Malaysia’s Development Challenges: Graduating from the Middle* is an edited collection of 13 chapters on various aspects of Malaysia’s political economy, including politics and governance, corporate ownership and performance, policy responses to economic crises, the financial sector, public finance, regulatory reform, the service sector, the electronics industry, educational policy, poverty and inequality, demography, and the environment. In spite of the wide diversity of topics, the chapters cohere with a common theme: the contrast between the extraordinary progress of the Malaysian economy since Independence and the major obstacles that may retard continued progress from middle income to high income status by 2020—the stated goal of Malaysian policymakers. The editors, Hal Hill of The Australian National University and Tham Siew Yean and Ragayah Haji Mat Zin of the National University of Malaysia selected a virtual who’s who of leading Malaysia specialists as the chapter authors.
Overall, the chapters are of very high quality, typically characterised by critical reviews of prior research, presentation of time series trends (often consisting of secondary data from government reports), and discussion of government policies and programs. The volume begins with an excellent overview of Malaysian development by Hill—presented in the form of six stylised facts, or generalisations about Malaysian economic progress and policymaking: rapid growth, rapid structural change, consistent openness, competent macroeconomic management, social progress, and ‘institutional quality, political economy, and ownership structures’ (a grab-bag of loosely related thoughts). My only lament is the lack of a concluding chapter that summarises the major findings and the overall significance of volume.

Although Malaysia’s progress has been less spectacular than the Asian miracle economies of South Korea, Taiwan, and Singapore, Malaysia’s average annual per capita GDP growth rate of 3.5 per cent for the last three decades has still been one of the best in the world. This record is all the more impressive given periodic economic crises—the decline in commodity prices in the late 1980s, the Asian Financial Crisis of the late 1990s, and the Global Financial Crises of 2007–09—and population growth rates of over 2 per cent per annum. Each economic recession has been V-shaped: a major dip followed by a rapid recovery. And in a world beset by wars of succession and ethnic strife, Malaysia’s precariously balanced regional and ethnic divisions have been remarkably peaceful. These divisions have not disappeared and some think that social relations have worsened; but the safety valve of emigration and rising economic levels for most Malaysians has generated more moderation than conflict. These achievements are acknowledged by the chapter authors, but their primary focus is on the shortcomings of Malaysian governance and economic policies that are likely to slow Malaysia’s progress into a high-income status in the coming years.

In his hard-hitting preface, Mohamed Ariff charges that government policies allowing large-scale immigration (about 25 per cent of the Malaysian workforce is foreign born) have kept wages low and stifled innovation. He also begins the volume’s critique of the New Economic Policy (NEP) with the charge that its implementation, if not its intent, has led to corruption, rent seeking, and cost overruns that have put the Malaysian economy into a Gordian knot that must be cut if progress is to be made. Because the debate over the NEP is at the heart of almost every chapter in this volume (and national politics), a brief digression is required before addressing the major contributions of the volume.

In the aftermath of the 13 May 1969 race riots in Kuala Lumpur, the NEP was crafted as a 20-year government program to eliminate poverty among all groups in Malaysia and an affirmative action program to bring the Malay majority into economic parity with the more urban and well-educated Chinese and Indian minorities. Since 1990, the NEP has been successively re-packaged as the National Development Policy, the National Vision Policy, and the New Economic Model, but the essential elements of the original program have continued. Many supporters of affirmative action, such as Ariff, are very critical of the use of the NEP agenda to provide subsidies (scholarships, credit, jobs, and corporate wealth) to the families of very wealthy Malays and those connected to positions of power in the government and politics. Although low-income Malays (and some Chinese and Indians) have also gained from NEP programs, there is little doubt that the benefits have been skewed to the Malay elite under the guise of inter-ethnic equity.

The primary criticisms of the NEP in this volume are that government cronyism has distorted the discipline of the market economy and has corrupted the integrity of public institutions. Over the years, the government has sponsored a number of public (or semipublic) corporations that have had preferential access to capital, natural resources, no-bid government contracts, and protected markets. With a few notable exceptions, most of these enterprises have been failures. There has been little accountability for the mis-management or for the diversion of public funds into the pockets of the new Malay tycoons, who are often working closely with Chinese businesses. Inter-ethnic class alliances, along with ethnic patronage, are the key dimensions of the post-NEP Malaysian economy.

Another major theme of several chapters is the decline in the professionalism and competence of the civil service and of the Malaysian government, including regulatory agencies and the courts. In spite of Malay preference during the pre-NEP era, the Malaysian government sector had traditionally been multi-ethnic in composition and also had a reputation for integrity and
fair play. In recent years, few non-Malays have risen to positions of authority and visibility in the public sector. Perhaps fears of discrimination are exaggerated, but there is a widespread perception among Malaysian Chinese and Indians that the private sector, overseas education, and emigration are the only choices available to talented and ambitious youth. In his chapter on demographic trends, Gavin Jones (ch. 12) notes that most of the senior people in the Singapore medical establishments are from Malaysia.

In spite of these problems of mismanagement, misallocation of resources, and rising inequities, there is little doubt that the lives of Malaysians of all ethnic communities are much better than those of their parents 25 years ago, and infinitely better than those of their grandparents, 50 years ago at the time of Independence. How was it possible to mismanage so many resources and still accomplish so much? The chapters in this volume suggest that the key to Malaysia’s good fortune owes much to the growth of employment in the electronics and other manufacturing factories, the discovery of petroleum and gas resources, high levels of government spending, and the sound management of some critical government and private institutions.

In the mid to late 1980s as commodity prices were declining and the economy was in a tailspin, the Malaysian manufacturing sector began to take off. The electronics industry had established a strong foothold in the 1970s, primarily through the assembly plants set up by foreign multinationals. Although still plagued with problems of moving up the value-added chain, the Malaysian electronics industry continued to grow during the 1980s and 1990s. By 2000, the electronics industry accounted for over half of Malaysian manufacturing exports, and Malaysian products accounted for over 5 per cent of world electronic exports (Rasiah, ch. 9). The growth of foreign direct investment in electronics was complemented by a major shift of export-oriented firms from East Asia to Malaysia in the late 1980s (Athukorala, ch. 4). The severe recession of 1985–86 was followed by a rapid return to high growth in GDP and employment in the late 1980s, led by the manufacturing sector.

The discovery of immense oil and gas reserves in the 1970s cannot be overestimated as a source of Malaysian economic growth and development. Petronas, the semigovernment corporation in charge of all petroleum assets in Malaysia, contributes about half of all government revenues (Narayanan, ch. 6). These funds have allowed the Malaysian government to invest heavily in the physical infrastructure, healthcare, and education that have contributed enormously to Malaysia’s continued development.

One of the most important chapters in this volume does not directly focus on Malaysia. Joan Nelson (ch. 2) reviews the lessons of the political crises that accompanied South Korean and Taiwanese economic miracles. In both cases, economic development led to severe conflict between autocratic elites (in the military and in favoured industries) and the demands of workers, managers, and entrepreneurs in the emerging modern economy for an end to corruption. In a side note, Nelson cites World Bank estimates that corruption in Malaysia may cost RM 10 billion per year or up to 1–2 per cent of GDP.

Both Korea and Taiwan went through political crises that challenged the system of money politics that was bankrolling political interests and parties. One of the key reforms in both countries was the emergence of strong unions that bargained for higher wages and the expansion of social security and unemployment insurance for all workers. The standard accounts of the East Asian Economic Miracle emphasise export-led industrialisation and investments in human capital as the major causes of economic development. Careful readers of this volume will learn that a broad-based political coalition pressing for an end to money politics and corruption is also necessary. In the case of Malaysia, this will require a multi-ethnic political movement to challenge the system that is more effective in creating ethnic antagonisms than in its stated goal of reducing inequality.

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The Indonesian Economy: Entering a New Era
Aris Ananta, Muljana Soekarni, and Sjamsul Arifin (eds)
Bank Indonesia, Jakarta, and Institute of Southeast Asian Studies, Singapore, 2011
P. 427. ISBN 978 9814 31165 6

This book is an edited volume of a collection of research papers on economic policy issues in Indonesia written within a political economy context.