

ISSUE 04 - APRIL 2018

# DEVELOPMENT DIGEST

FEATURED WORK FROM THE  
WORLD BANK GROUP GLOBAL KNOWLEDGE  
& RESEARCH HUB IN MALAYSIA

## Maximizing Knowledge for Development



**WORLD BANK GROUP**  
Global Knowledge & Research Hub  
in Malaysia

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## ABOUT DEVELOPMENT DIGEST

The Development Digest is a half-yearly publication that features key works from teams based at the World Bank Group Global Knowledge and Research Hub (the Hub) in Malaysia.

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“Old TV Re-Used”

CGAP Photo Contest 2016 Regional Winner:  
East Asia & Pacific

**From the photographer:** “A man works at removing integrated circuits from the main board of an old TV in a warehouse, which requires skillful ability. With a small increase in capital, they could also increase their earnings.”

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# DEVELOPMENT DIGEST: ISSUE 04

Maximizing Knowledge for Development

**The World Bank Group (WBG) is strengthening its partnerships with Upper-Middle-Income Countries and High-Income Countries** to leverage private and public finance, and to create knowledge and new solutions based on the experiences of graduates for the benefit of clients. Malaysia is a leading contributor to a stronger ecosystem of new research and knowledge, through the embedding of the Malaysia Experience in global discussions on development.





**We are in our fourth installment of the Development Digest**, a semi-annual publication showcasing the work arising from the Hub, to share the Malaysian development experience and the research outputs from the Global Research teams.

This digest is widely disseminated to development practitioners and policy-makers in the East Asia and Pacific region and internally within WBG.

We begin this issue with our experience with the Hub as we enter our second year, and how it is a pioneering example of how the Bank is leveraging knowledge for development finance. Then, we move into an update on the Bank's involvement in the recently concluded World Urban Forum 9 in Kuala Lumpur last February. We also delve into topics like Malaysia's lessons from the Asian Financial Crisis. Other articles include South-South exchanges on Malaysia's SME development, education, land administration reform, and a rich selection of pieces from the Development Economics teams based in the Hub.

We are happy to present a snapshot of the rich diversity of work in the Malaysia Hub, and hope you will have an insightful read!

**From the Hub team**



# Leveraging Knowledge for Development Finance

Otaviano Canuto

**The World Bank Group Global Knowledge and Research Hub in Malaysia opened on March 28, 2016.** Two years in, the Hub continues to pursue its path of sharing Malaysia's people-centered development expertise, and creating new innovative policy research on local, regional, and global issues. Otaviano Canuto, Executive Director at the Executive Board of Directors of the World Bank Group and its Affiliates reflects on this journey, and what it means for the institution.



**My admiration for hummingbirds** began in my native Brazil. The hummingbird's flight patterns may seem a mystery as they shift from one flower to the next. But hummingbirds are immensely purposeful, agile, and proficient pollinators – among the most hard-working members of many thriving ecosystems. And they can be found from Alaska to the southernmost regions of South America.

The Bank's efforts to transfer knowledge, germinate ideas, and catalyze change sometimes put me in mind of the hard-working hummingbird. My visit to the World Bank's Global Knowledge and Research Hub in Malaysia last year is a case in point. As I learned about the Bank's partnership with Malaysia and the origins of the Hub, I was struck by the broader relevance for our work with upper-middle-income countries and our efforts to share global lessons and leverage knowledge to maximize financing for development. The visit sparked three main observations.

**First, the Bank's Hub in Malaysia shows the fruit of sustained partnership as countries move up the income spectrum.**

The International Bank for Reconstruction and Development's (IBRD) partnership with Malaysia has been longstanding, beginning with Malaysia's first IBRD first loan in 1957 and continuing through the 1990s in support of the country's institutional development and diversification-led growth. Malaysia's graduation from IBRD lending marked an important milestone that became a platform for new phases in the partnership. After the country's graduation from IBRD, Malaysia later re-engaged with the Bank under a multi-year Reimbursable Advisory Services (RAS) program that continues today. As a thriving upper-middle-income economy, Malaysia has also participated as an IDA contributor since IDA17.



**The International Bank for Reconstruction and Development (IBRD) is a global development cooperative owned by 189 member countries. As the largest development bank in the world, it supports the World Bank Group's mission by providing loans, guarantees, risk management products, and advisory services to middle-income and creditworthy low-income countries, as well as by coordinating responses to regional and global challenges.**

**The launch of the Global Knowledge and Research Hub in Kuala Lumpur in 2016 marks the further fruition of our long-term partnership.<sup>1</sup>**

All costs of the Hub are financed by the Government of Malaysia over five years, and the office also brings together operations teams (five Global Practices) with the Development Economics (DEC) Research Group and Indicators Group.

<sup>1</sup> The Hub was established following the signing of the Establishment and the Facilities (Lease) Agreements on January 27, 2015, and the Office Support Agreement (OSA) on October 1, 2015.

**Second, the Hub demonstrates that, as countries transition up the income spectrum, knowledge sharing is a two-way street.** The Hub reflects the strengths of Malaysia's development journey as well as the ongoing challenges of making the transition from Upper-Middle-Income with High-Income Country status. This is reflected in the Hub's combination of "inbound knowledge" through RASs and policy advice to Malaysia along with "outbound knowledge" – i.e. bringing lessons from the Malaysian experience to countries. The RAS program ranges from engagement on labor market policy and public expenditure management to digital economy, ports, and transport policy – all in support of Malaysia's goal to achieve high-income country status, expected in the next five years. Importantly, the Bank is also leveraging the Malaysia Hub to share Malaysia's development knowledge, know-how, and experience. Demand for South-South exchanges has been high; since 2016, the Hub has hosted over 50 knowledge exchanges/learning activities from more than 40 IDA countries from Africa, Asia, Eastern Europe, and Latin America. In the last six months alone, the Malaysia Hub and government agencies have hosted study visits from Cambodia, Lao PDR, Afghanistan, and Zimbabwe.

**Third, leveraging knowledge is directly relevant for maximizing financing for development.** For example, the Malaysia Hub has supported the launch of the world's first green *sukuk* (Islamic bond) – a game changer in the development finance architecture. The first two issuances amounted to USD58 million and USD236 million respectively and financed solar photovoltaic plants; a third issuance will provide USD473 million for a green office tower project. And the impact continues to widen. The Hub is currently supporting the Government of Indonesia to issue the world's first ever Green Sovereign *Sukuk*.

Through sustained partnership, two-way exchange, and incubating transformational ideas and research, the Malaysia Hub sets a noteworthy example of the Bank's "hummingbird" role in transferring and leveraging knowledge for development finance.



The World Bank Malaysia Hub team



## The World Bank Group Global Knowledge and Research Hub in Malaysia: A Partnership for Global Development Solutions

The Hub serves as a global platform to share and operationalize Malaysia's development expertise for developing country programs (WBG or otherwise), and create innovative policy research on national, regional, and global issues. It is the first office of its kind for WBG, merging three pillars of work, and merging operational work with Development Economics (DEC) research.

**Pillar 1:** Curating and sharing the Malaysia Experience with other WBG borrowers and clients, through embedding the experience into Bank projects, including Malaysian experts in Bank teams, and/or South-South exchanges.

**Pillar 2:** Globalizing the DEC work. The Hub's DEC teams carry out original and innovative development policy research in partnership with local and international research institutions. Through the Development Economics Research Group (DECRG), the Hub conducts original studies, spanning economic growth and risk management, to program evaluation and the implementation of key public services. Through the Development Economics Indicators Group (DECIG), the teams carry out primary data collection, research, and dissemination activities for the Doing Business, Enterprise Surveys, and Enabling the Business of Agriculture surveys.

**Pillar 3:** Reimbursable Advisory Services (RAS) to underpin Malaysia's entry to high-income-country status, and sustainable and inclusive development.

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**OTAVIANO CANUTO** is Executive Director at the Executive Board of Directors of the World Bank Group and its Affiliates.



## Sekalung Penghargaan Heartfelt Appreciation

**Time has flown.** It seems like only yesterday when I and a small group of colleagues arrived in Kuala Lumpur to begin setting up the World Bank Group Knowledge and Research Hub in Malaysia. The Hub was to represent an innovation in terms of the presence of the World Bank Group in non-borrowing and Upper-Middle-Income Countries, as well as a natural evolution of the longstanding relationship with the Government and people of Malaysia. As such, expectations on all sides were high.

Almost three years later, and at the two-year anniversary of the Hub, it seems that all expectations have been exceeded. With around forty staff, secondees, and research fellows from Malaysia and throughout the world, the Malaysia Hub is a vibrant institution, working with partners here and elsewhere on innovative research, financial instruments, and global solutions to our common development challenges.

Putting it into context, the World Bank Group Global Knowledge and Research Hub in Malaysia is the first office of its kind for the World Bank. It is a Knowledge and Research Hub that serves as a global platform, by leveraging local and international expertise and a network of partners.

Having no office presence in Malaysia for decades, this was a collective and bold move to reimagine and rebuild a partnership together with our partners from the government. Today, the Hub is a testament that even though a country no longer borrows from the World Bank, it can still remain very much an integral client and member of the institution. No longer an 'experiment', the Malaysia Hub is a successful model of how we together can maximize knowledge for development.

It has been an honor and privilege for me to serve as the Hub's first Country Manager. This has truly been a journey like no other. As I move to my new assignment as the World Bank's Country Manager and Representative to Nepal, I will take with me many experiences from Malaysia's 'growth storyline'. In my new capacity, I will ensure to reach out to my partners in the Malaysia Hub to inform our policy work for another important client on its quest for sustainable growth, extreme poverty eradication, and shared prosperity.

*Terima kasih* to our hosts, clients, and partners.

**Faris Hadad-Zervos**

World Bank Representative to Malaysia and Country Manager





# Expanding Opportunities for the Urban Poor

Victoria Kwakwa

**Better jobs, higher salaries, and improved access to basic services – the bright lights of cities seem to promise these and more.** But for millions lured to these centers for innovation and prosperity, cities can also lead to a life of squalor. Access to safe drinking water or sanitation may be poor or non-existent. Makeshift homes may flood every time it rains. Keeping families fed may become a daily struggle.



**Across East Asia and the Pacific**, an estimated 250 million people are living in slums. This is the highest number among any region in the world, due to the sheer size of populations in large countries, such as China, Indonesia, and the Philippines.

City leaders and planners from around the world convened at the World Urban Forum 9 (WUF9) in Malaysia to discuss implementing the ‘New Urban Agenda’.

**Addressing inequality and inclusion is at the heart of this agenda – serving as an integral part of urban planning for governments across all regions.**

In East Asia and the Pacific, fast-paced growth has transformed economies, lifted millions out of poverty, and kick-started rapid urbanization. But as cities multiply, so do the challenges in keeping up with commensurate planning and investments in physical infrastructure, affordable housing, and transportation.

Consequently, low-income residents resort to living in poor conditions and in locations that are vulnerable to environmental hazards, such as hazardous waste, or to natural disasters, such as flooding.

Widening inequalities follow and can undermine the sustainability of economic growth and slow poverty reduction, as well as create divisions among cities’ populations, and could breed conflict and crime.

As outlined in the recent *World Bank East Asia and Pacific Cities: Expanding Opportunities for the Urban Poor* report, there are solutions for these multidimensional aspects of urban poverty and inequality, both at the city and country level.

Many of these solutions draw from Singapore, Korea, Japan, and Malaysia – countries that have sustained robust economic growth, and reduced urban poverty and inequality through investments in urban planning, infrastructure, and service provision. They have targeted social programs and fostered participation by citizens. As a result, these countries enjoy a greater degree of shared prosperity.

Other countries are following suit. Indonesia and Vietnam are carrying out robust programs for upgrading slum communities, and China is effectively using rental subsidies to provide housing for low-income residents. These countries show that a sustained effort can reduce inequality, resulting in more inclusive cities and strengthened harmony in communities.



**An ‘inclusive cities’ approach relies on equitable policies that do not leave groups behind. These policies fall into three categories: economic inclusion, spatial inclusion and social inclusion.**

**Economic inclusion** means enacting policies that connect the urban poor with job markets, as has been done in Hanoi through the modernization of road networks, and through linking non-motorized transportation to bus rapid transit systems in Guanzghou, China.

Other approaches include improving access to credit and laws that protect informal workers, and build resilience to external shocks, such as disasters, that can easily wipe out a family’s livelihood and savings in a moment. Disaster planning in Can Tho, Dong Hoi, and early warning systems in China and in Jakarta have been important in preventing shocks, particularly among the urban poor.

Promoting **spatial inclusion** starts with integrated urban planning that focuses on connectivity and affordable transport, to reduce commuting costs and expand employment opportunities. Low-income financing, rental schemes, or tenure security, can broaden land and housing options – thwarting the proliferation of slums and, over time, increasing land values and encouraging prosperity.

As the successful example of Singapore shows, providing equitable access to infrastructure and basic services positively impacts health, productivity, and welfare.

Lastly, **social inclusion** – that is, recognizing the rights of all residents regardless of identity, income status, ethnic status, or place of origin – can be the less-apparent key ingredient. Local governance and citizen participation may seem to be a given in successful cities; however, it is often an important but overlooked element in transparent and fair decision-making and successful implementation of programs and policies on the ground. Overlook vulnerable groups, such as low-income children, the disabled, or the elderly, and inequality will persist.

Countries such as the Philippines and Indonesia have shown that it is possible to provide successful targeted social safety net programs to reach those urban residents in greatest need.

More inclusive and livable cities are achievable goals, and East Asia and the Pacific faces an opportunity to replicate best practices in urban planning across the region. Governments, both national and local, the private sector, and citizens all have a role to play. Let us act now to build inclusive cities in East Asia.

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This article was first published as an op-ed on The Star - [www.thestar.com.my/news/world/2018/02/04/expanding-opportunities-for-urban-poor-in-east-asia-and-pacific-cities](http://www.thestar.com.my/news/world/2018/02/04/expanding-opportunities-for-urban-poor-in-east-asia-and-pacific-cities). To download the report *World Bank East Asia and Pacific Cities: Expanding Opportunities* visit [hdl.handle.net/10986/27614](http://hdl.handle.net/10986/27614)

**VICTORIA KWAKWA** is World Bank Group's Vice President for East Asia and Pacific.

## BOX 1

# 3 Big Ideas to Achieve Sustainable Cities and Communities

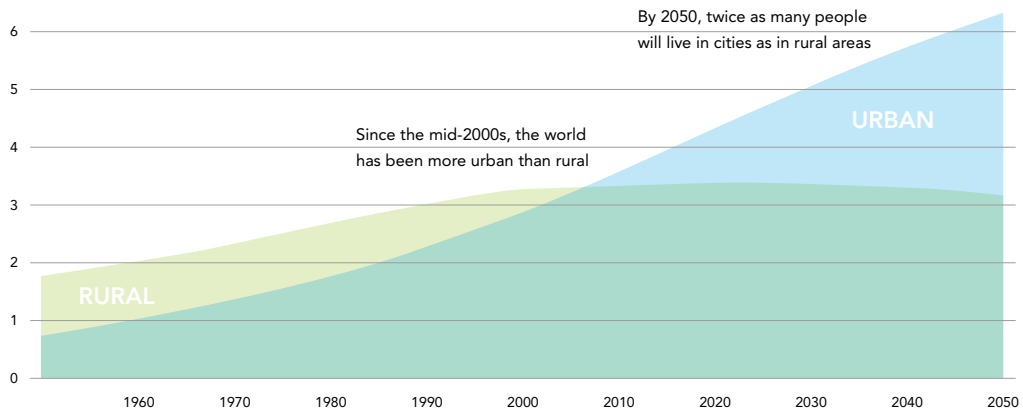
Sameh Wahba

**Today, over four billion people around the world – almost 55 percent of the global population – live in cities.** In East Asia and the Pacific alone, for example, cities house 1.2 billion people – almost rivaling the population of India. And that number is still fast growing, most rapidly in Asia and Africa, as individuals and families continue migrating to urban areas to seek better livelihoods. By 2050, with the urban population doubling its current size, nearly two-thirds of people in the world will live in cities.

**Being such huge magnets for talent and investment,** it is no wonder that cities have become the world's major growth engine, generating an estimated 80 percent of global GDP, while helping hundreds of millions lift themselves out of extreme poverty.

## The Global Rise of City Dwellers

Worldwide urban and rural population (billions)



Source: UN World Urbanization Prospects

However, the speed and scale of urbanization brings tremendous challenges. Widening income gaps, worsening pollution, and aging buildings and bridges are all telltale signs that today's cities are struggling to keep up with city dwellers' growing dreams for a sustainable, prosperous future.

Nearly one billion urban poor still live in slums and informal settlements, mostly in Asia, Africa, and Latin America, and are often excluded from access to affordable housing, good-quality basic services, and better jobs. Climate change further complicates the urbanization challenge. By 2030, climate change and natural disasters may cost cities worldwide USD314 billion each year, and push 77 million more urban residents into poverty.

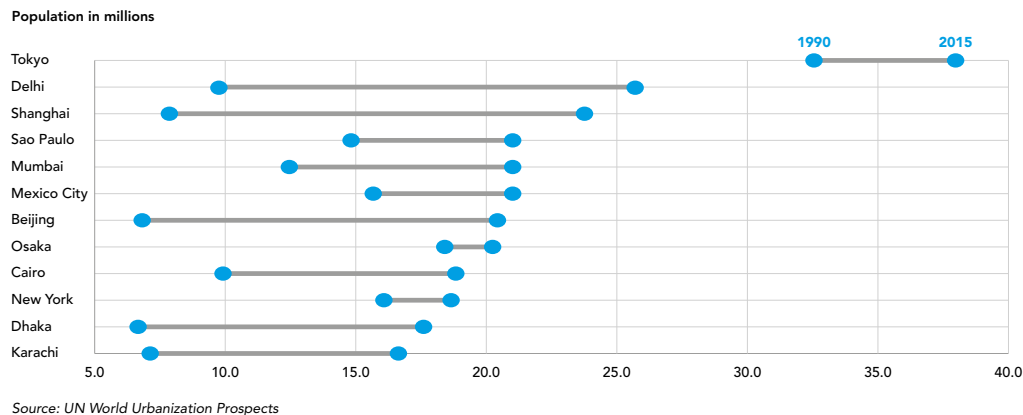


## The New Urban Agenda

All is not lost. With 60 percent of the places that will be urbanized by 2030 yet to be built, we still have the chance to help the urban poor unlock economic potential – and safeguard hard-won development gains for generations to come. But what happens next is up to us.

The good news is that, as the stakes of urbanization are growing higher, so is the global commitment to making urbanization right.

### 25 years of growth in the world's largest cities





In October 2016, at the once-in-20-years Habitat III conference, countries around the world endorsed the New Urban Agenda, an important political commitment that sets a new and ambitious global standard for sustainable urban development and guides global efforts to achieve the Sustainable Development Goals in the era of climate change.

FORUM BANDAR SEDUNIA



KUALA LUMPUR • 7-13 FEB 2018

In February 2018, national and city leaders convened again at the Ninth Session of the World Urban Forum (WUF9) in Kuala Lumpur, Malaysia, to move forward with more in-depth discussions around the theme Cities 2030, Cities for All: Implementing the New Urban Agenda. The World Bank offered three big ideas that are essential for successfully implementing the New Urban Agenda at WUF9:

- 1. Financing the New Urban Agenda**
- 2. Promoting territorial development**
- 3. Enhancing urban resilience to climate change and disaster risks**

The Bank also showcased some of the innovative knowledge and transformative actions that have proven to help end extreme poverty and boost shared prosperity in cities around the world.



## The World Bank: Working to build sustainable cities and communities

World Bank-supported operations and technical assistance contribute to Sustainable Development Goal No. 11, and the implementation of the New Urban Agenda, to make cities inclusive, safe, resilient, and sustainable for all.

At the World Bank, we work with the private sector, governments, civil society, and other partners to build inclusive, resilient, and sustainable cities and communities for all worldwide – and to help create competitive economies that provide new kinds of jobs, especially for the urban poor.

As the world's leading development financier, the World Bank has invested an average of USD6 billion per year in urban development and resilience worldwide. More than ever, the Bank is committed to helping countries meet critical urbanization demands, and make cities and communities inclusive, resilient, productive, and sustainable for all.

Globally, USD4.5 – USD5.4 trillion is needed to fill the urban infrastructure finance gap. Only three percent of this amount is available through official development assistance. This means that cities must strengthen municipal finance, while finding new ways to scale up urban infrastructure finance. The World Bank provides funding and helps cities and national governments put in place the financial framework to enable them to attract investments to grow in a sustainable manner.

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To access World Bank content on the World Bank Forum, visit [www.worldbank.org/worldurbanforum](http://www.worldbank.org/worldurbanforum). Follow @WBG\_Cities on Twitter.

**SAMEH WAHBA** is the Global Director for Urban and Territorial Development, Disaster Risk Management and Resilience at the World Bank Group's Social, Rural, Urban and Resilience Global Practice. Follow @SamehNWahba on Twitter.





# Riding the Wave: An East Asian Miracle for the 21st Century

Caterina Ruggeri Laderchi and Sudhir Shetty

**Developing East Asia and Pacific (EAP) has seen a dramatic reduction in poverty, thanks to rapid and broadly-shared growth over the past quarter century.** However, disparities of income and wealth are becoming more apparent, while uncertain growth prospects, aging populations and rapid urbanization pose new challenges. Countries in the region now need to reconsider their policies to achieve inclusive growth – one that eliminates poverty, and promotes upward mobility and economic security for all. Policy makers will need to design and implement a selective set of interventions that are customized to their country's circumstances, and the needs and aspirations of the different segments of their populations.



**Rapid growth if broadly shared can improve the lives of millions.** That is the essence of East Asia's development experience over the past two decades as a wave of prosperity lifted over 40 percent of its population out of poverty. Underpinning this successful “growth with equity” model were two pillars – labor-intensive growth and the accumulation of basic human capital. A third element – social protection – was restricted to those too disadvantaged to benefit from growth.

A recent World Bank publication, *Riding the Wave: An East Asian Miracle for the 21st Century*<sup>1</sup> looks at the prospects for developing East Asia and Pacific (EAP) to achieve inclusive growth – growth that eliminates poverty, and promotes economic mobility and economic security for all.

**Now that EAP is a region of middle-income countries, new challenges are emerging alongside high expectations of continued progress.**

These include rising perceptions of inequality and concerns that export-oriented manufacturing could be a less powerful growth engine in the future with slowing global trade, growing competition and labor-saving technological change. Also, longer-term trends such as aging populations and rapid urbanization could be turning into handicaps. Much of the region is “getting old before getting rich”. Urban growth in many countries is bringing with it growing congestion and pollution, and greater exposure to natural disasters.



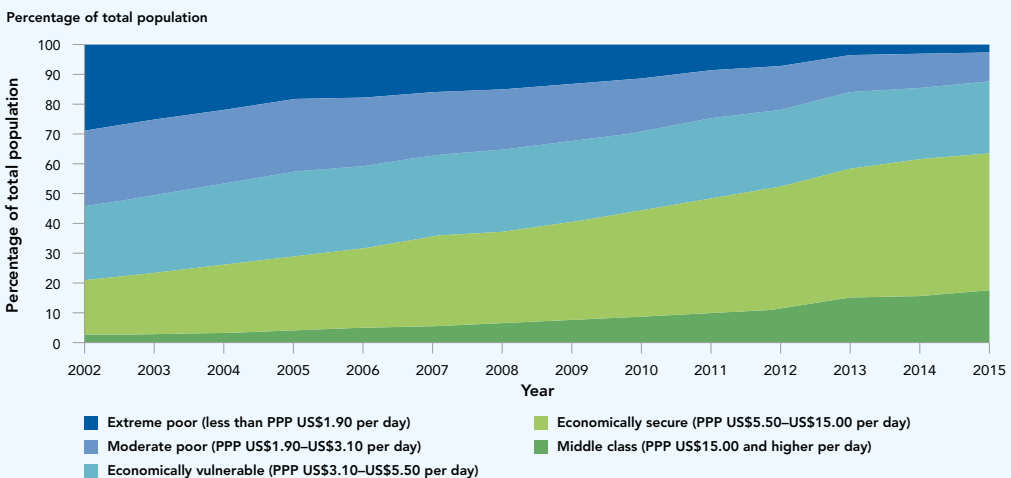
<sup>1</sup> The report's focus is Developing East Asia and Pacific (EAP), which includes Cambodia, China, Indonesia, Lao People's Democratic Republic (PDR), Malaysia, Mongolia, Myanmar, Papua New Guinea, the Philippines, Thailand, Timor-Leste, Vietnam, and the Pacific Island Countries (PICs). The PICs in turn comprise Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

## Analytical approach

The analysis has three main features. First, the entire income distribution is analyzed by separating households into five economic classes.<sup>2</sup> Second, inclusive growth is characterized so as to highlight a policy agenda centered on the three pillars of enhancing upward mobility, ensuring economic security, and strengthening institutions to deliver inclusive growth. Finally, the analysis of economic class is used to classify countries according to how their income distributions have evolved, and to identify the elements of the policy agenda that can underpin a new social contract.

The report identifies five economic classes and traces their evolution over time (Figure 1).

**Figure 1. Developing East Asia and Pacific, 2002–15: A wave of prosperity and the evolution of economic class in the region**



Source: World Bank EAP Team for Statistical Development  
Note: PPP = purchasing power parity. Appendix B provides details on the methodology underlying this figure

Those living in **extreme poverty**, who used to account for roughly 30 percent of the population in 2002 and now for less than three percent, are now concentrated in poorer countries, such as Lao PDR, Papua New Guinea, and the Solomon Islands, and, among specific population groups, such as ethnic minorities and those in geographically remote areas in some richer countries, such as China, Indonesia, the Philippines, and Vietnam. In countries where progress has been lagging, as well as in most PICs, broad-based growth can still be effective in eradicating extreme poverty. However, where extreme poverty is associated with ethnicity or remoteness, tackling the barriers that prevent specific groups from benefiting from economic opportunities is also needed. Such barriers can be physical, such as lack of roads; administrative, as with lack of documentation; legal, as with access to services; and cultural, such as prejudice or discrimination.

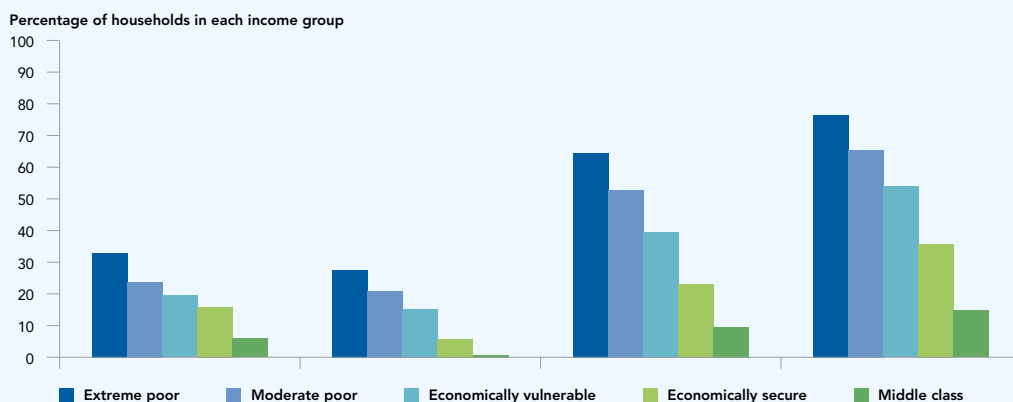
<sup>2</sup> The economic classes are defined (in terms of per capita daily consumption expenditures, or PCE, in 2011 PPPs) as follows: extreme poor: PCE less than USD1.90; moderate poor: PCE between USD1.90 and USD3.10; economically vulnerable: PCE between USD3.10 and USD5.50; economically secure: PCE between USD5.50 and USD15.00; and middle class: PCE over USD15.00.



The two groups that live on either side of the moderate poverty line have many similarities. While **those living in moderate poverty** have declined from about one quarter of the population to less than 10 percent, about a quarter of the population continues to be **economically vulnerable** with a high likelihood of falling back into poverty. These groups are not static, with movements both in and out of moderate poverty. For example, in Indonesia, 21 percent of those considered economically vulnerable in 2008 were in moderate poverty by 2010, while 35 percent of the moderate poor had climbed into the economically vulnerable class. Despite their dynamism, including their ability to purchase small consumer durables, their progress is hindered by lack of services, and of assets and mechanisms to manage risks and cope with the consequences of shocks. And in many countries, women's participation in the labor force is particularly low among the moderate poor and economically vulnerable.

The **economically secure and middle classes** in the region have grown spectacularly over the last 20 years, going from roughly one fifth to almost two thirds of the population. These groups are at low risk of sliding back into poverty, but generally still lack access to quality public services. One-third of the economically secure and 15 percent of the region's middle class (outside of China), lack access to one or more of good quality housing, clean water, and to a lesser degree, modern sanitation (Figure 2). This failure to deliver on some of these classes' needs and priorities carries with it the risk of these groups turning inwards to a world of private service provision, and disengaging from the national policy dialogue on service delivery at a time when their higher aspirations could help spur improvements in the quality of these services for all. And in countries where risk management tools remain underprovided, even the middle classes are at risk of sliding down the income ladder.

**Figure 2. Non-monetary poverty by class, selected developing East Asia and Pacific countries, 2012**



Source: Wai-Poi and others 2016

Note: Access to clean water means piped water, protected well water, or water sold by a vendor. Access to proper sanitation means flush toilets or improved pit latrines. Good quality housing means roof that is made of concrete, cement, brick, stone, wood, or tiles; walls that are made of concrete, cement, brick, or stone; and a floor that is nonsoil. The countries sampled here are Cambodia, Indonesia, Lao PDR, Mongolia, the Philippines, Thailand, and Vietnam. Poor on at least one dimension means suffering from at least one deprivation among no access to clean water, no access to proper sanitation, or poor-quality housing.

For East Asia to sustain inclusive growth, *Riding the Wave* suggests a policy agenda with three pillars: fostering economic mobility; providing greater economic security across the distribution; and strengthening the capacity of the state to deliver.

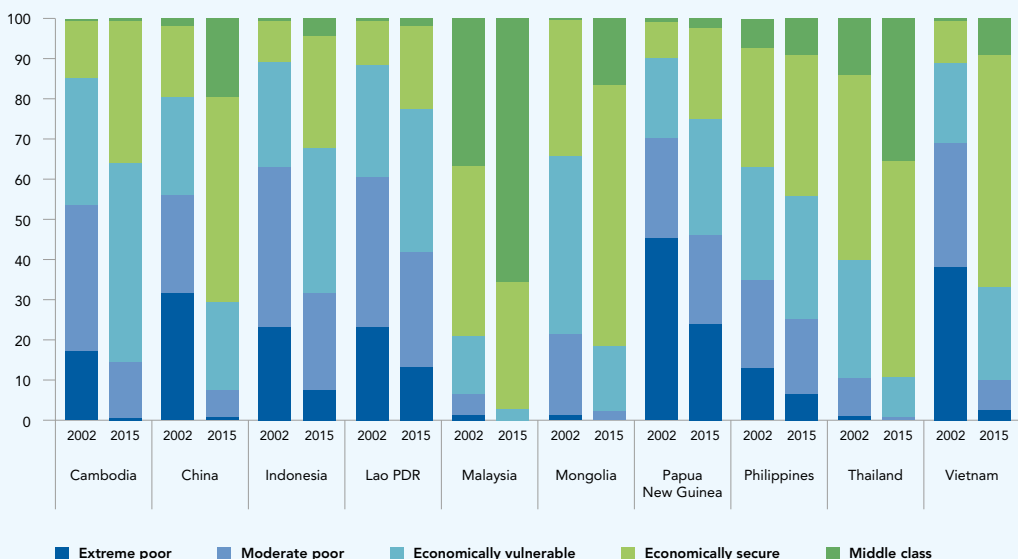
- **Fostering economic mobility** requires closing gaps in access to jobs and services, improving the quality of jobs, and promoting financial inclusion.
- **Providing greater economic security** includes bolstering social assistance systems, expanding social insurance, and increasing resilience to shocks.
- **Strengthening institutions** covers more progressive taxation policies to raise resources, improvements in the effectiveness of inclusive spending programs, better management of rapid aging and urbanization, and promotion of competition.

## Country-specific elements of a new social contract for inclusive growth

This policy agenda can be customized to a five-part grouping of countries, which emerges from the trends in country-level data (Figure 3).

**Figure 3. Distribution by economic class and country, 2002 and 2015**

Percentage of households in each income group



Source: EAP Team for Statistical Development



Malaysia, and Thailand – **progressive prosperity** countries that have largely eliminated extreme poverty and fostered a large middle class – can prioritize meeting the growing aspirations of the middle classes, while mobilizing and using resources to address remaining disparities. China and Vietnam – **out-of-poverty into prosperity** countries where most people are economically secure or middle class – should address the aspirations of their middle classes as well as the needs of the vulnerable, while preparing for rapid aging. Indonesia and the Philippines – **out-of-extreme-poverty** countries that have low levels of extreme poverty but still-small middle classes – should prioritize improving economic mobility and integrating social protection programs. Lao PDR and Papua New Guinea – **lagging progress** countries where extreme poverty remains high – should strive to reduce poverty more quickly by investing in basic education and promoting financial inclusion, while also strengthening social assistance and resilience. The **Pacific Island Countries** are distinct and will need to focus on exploiting existing economic opportunities such as tourism and fishing, leveraging labor migration opportunities, and investing in disaster mitigation and prevention.

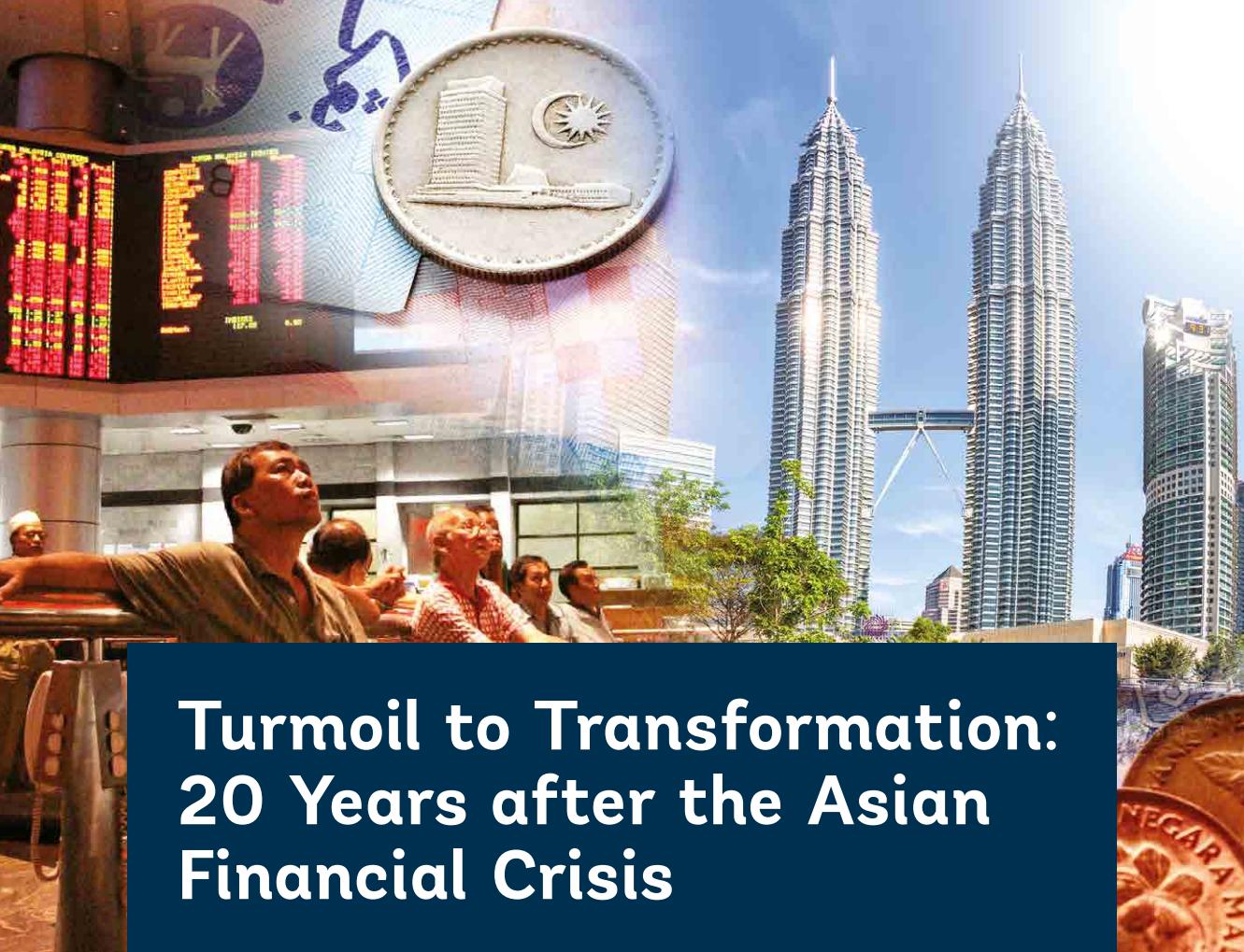
Implementing this policy agenda will not be easy, especially in a global context that remains challenging and is evolving rapidly. Nevertheless, this agenda could form the basis for a new social contract, if governments address the priorities of each economic class while remaining fiscally responsible and mobilizing additional revenues efficiently and equitably. These policies will allow the countries of developing East Asia and the Pacific to continue to ride the wave of prosperity to improve the lives of their citizens well into the 21st century.

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The report *Riding the Wave: An East Asian Miracle for the 21st century* can be downloaded from [hdl.handle.net/10986/28878](https://hdl.handle.net/10986/28878)

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# Turmoil to Transformation: 20 Years after the Asian Financial Crisis

Richard Record

**The Asian Financial Crisis (AFC), which spread through Southeast Asia 20 years ago, resulted in severe economic stress across the affected countries, including Malaysia.**

However, policymakers across the region learned many important lessons from the experience of the AFC, and adopted reforms that laid the foundations for a much more resilient Southeast Asia of today. Deep macro-financial reforms in Malaysia began with the National Economic Recovery Plan. This included measures to restore market confidence, restructure corporate debt, recapitalize the banking sector, and stimulate the economy through countercyclical fiscal and monetary policies. Dealing with the AFC, and subsequently implementing financial sector reforms, has since transformed Malaysia's financial sector into one that is sound, resilient, and diversified.



**Malaysia's progress over the last 20 years** owes much to the sound policies being adopted during and since the AFC. There have been many lessons learned, as a result of responding to the effects of the AFC, which could be of particular relevance for similar small and open developing economies around the world.

## **The 1997–98 AFC stood out as the first full-blown contagion currency crisis in the developing world.**

It was the result of accumulating financial imbalances that spiraled out of control in an environment of weak financial regulation and rapid financial account liberalization. Rapid capital inflows created mismatches between the currency of borrowing and the currency of investment returns. Fixed exchange rates also built up risks. Financial risks were exacerbated by mismatches in the maturity of loans compared to investment projects.

### **The Malaysian Response**

Compared to other countries in the region, capital account liberalization proceeded more slowly in Malaysia, and external debt challenges were less severe.

As such, Malaysia stood out as the only country in the region that did not request the International Monetary Fund (IMF) for a bailout package.

The country's initial response was to implement tight monetary and fiscal policies; measures consistent with conventional wisdom then. However, that put significant pressure on the real economy.

Malaysia then changed course and its government announced a new National Economic Recovery Plan. The plan intended to restore market confidence, facilitate corporate debt restructuring, recapitalize and restructure the banking sector, stabilize the ringgit, and stimulate the economy through counter-cyclical fiscal and monetary policies. The central bank reduced interest rates and reserve requirements to inject more liquidity into the financial system. Expansionary fiscal policy was introduced to support the economic recovery during the crisis. New institutional structures were established to streamline the management of Malaysia's response to the crisis.

At the same time, Malaysia introduced selective capital controls. The purpose of these measures was to prevent speculation and capital flight in the short run, while safeguarding the interest of long-term investors. They were considered unorthodox at the time, heavily criticized by the international financial community. However, the move alleviated the credit crunch and bought the economy time to recover. This resulted in fewer bankruptcies, and reduced the costs of financial sector restructuring and recapitalization.

**Many of these policies and lessons learnt have since been incorporated into toolkits for policymakers in developing as well as developed countries.**

They have proved to be effective, and today are considered good practice for countries around the world, even while recognizing the importance of customizing policies to a country's own specific situation, resources, and institutional capacity.

These include:

- Flexible exchange rate regimes that lower the risk of currency crashes;
- Large international reserves to serve as a good insurance against future crises;
- Selective and temporary capital controls to stabilize capital flows;
- More controlled financial account liberalization; and
- Careful prudential regulation of the domestic financial sector.



## The Malaysian Outcome

The approach adopted during the crisis has transformed the level of resilience of Malaysia's financial sector. The country emerged with no bank closures, a high recovery rate on non-performing loans (NPLs), and stronger banking institutions. Effective regulation and supervision has underpinned the stability of Malaysia's financial system. The sector has adopted internationally-accepted practices, with a high degree of compliance with global standards for supervision and regulation of financial institutions.

Malaysia adopted an institutional framework to deal with the rising level of NPLs. The Government decided to assist domestic corporations and financial institutions that were facing financial difficulties or imminent insolvency. The AFC expedited planned reforms, resulting in a stronger, more diversified, and inclusive financial system.

Malaysia's bond market expanded significantly after the crisis to become a major financing source for corporations. There is now significantly less reliance by corporates on banks for funding requirements, which was one of the banking sector vulnerabilities highlighted during the crisis.

Malaysia has also become a global leader in Islamic finance, in parallel to and complementing the conventional financial system. With well-established Islamic capital markets and regulatory frameworks, as well as relevant incentives to motivate market participants, Malaysia has been able to support financial innovation in Islamic finance.

Malaysia has moved to a more flexible exchange rate regime. Holdings of international reserves have grown significantly over time, while reliance on net capital inflows has declined. Exposure to dollar-denominated debt has declined in Malaysia, although reliance on short-term debt has increased somewhat. Today Malaysia is much less exposed to the risk of an exchange rate depreciation triggering increased debt obligations, giving the authorities more space to adjust to external shocks.

**The approach adopted in dealing with the AFC and in implementing the reforms in the financial sector in the last 20 years has served to transform Malaysia's financial sector into what it is today: sound, resilient, and diversified.**



## Future Outlook

However, Malaysia should remain attentive to new challenges and emerging areas of risk. Financial sector vulnerabilities and risks to economic stability may develop as the economy becomes significantly larger (three times larger since the AFC), and more closely integrated into the global economy. At the same time, an increasingly sophisticated financial sector, with new instruments and financial innovations, bring constant challenges to the overall risk oversight framework.

The balance sheets of households and corporations will need to be carefully monitored for signs of stress. Although the slowdown in credit growth has stabilized the ratio of credit to the private sector to GDP, and it has not reached levels observed during the AFC, close monitoring is necessary to avoid systemic problems, particularly given the rapid increases in real house prices since 2008.

Efforts to further strengthen governance of financial institutions will need to continue. Overall, the post-crisis reforms have strengthened the financial system, but sustained measures are needed to address new systemic risks from a more modern financial sector. The transition to a digital economy introduces new cybersecurity risks from technology-enabled innovation in financial services.

Finally, efforts to strengthen fiscal space should continue in order to preserve flexibility for future contractionary shocks. While the Government has made significant progress toward fiscal consolidation since the GFC, the overall public debt stock has remained relatively elevated, due to continued accumulation of fiscal deficits and increased public infrastructure spending.

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For full report of the *Malaysia Economic Monitor* December 2017: *Turmoil to Transformation, 20 Years after the Asian Financial Crisis*, visit <http://hdl.handle.net/10986/28990>



# TURMOIL TO TRANSFORMATION

## 20 Years After the Asian Financial Crisis

### THIS LED TO:



20 years ago, the **Asian Financial Crisis** shook the region of East Asia, engulfing many economies in the process.



01

Plunging currencies and **severe recession**



02

**Bankruptcies** in the business sector



03

Job losses



04

Severe **financial sector damage**

But out of **CRISIS**, East Asia created **OPPORTUNITY**.  
Since then, countries in the region have:



Strengthened **macro-economic** management



Moved towards **floating exchange rates**



Built up **defenses** against speculative attacks



Reduced dependence on **external capital**



Rebuilt **domestic capital markets**

### MALAYSIA'S POLICY RESPONSE



Malaysia stood out among the East Asian countries.

The country adopted the following approaches:

01

Temporarily **fixing the exchange rate**

02

Temporarily imposing **capital controls**

03

Adopting **counter-cyclical** monetary & fiscal policies

The economy rebounded strongly after the crisis, driven by restored dynamism in export manufacturing

# A FINANCIAL SYSTEM REVAMPED

In the following years, Malaysia went through **major financial sector reforms** with significant government intervention and support to the banking sector and local businesses. As a result:

01

It formed a **stronger financial system** anchored by **domestic banking groups**



02

The **bond market** expanded to become a **major financing source** for businesses

03

Malaysia is now a **global leader** in **Islamic finance**



## 5 IMPORTANT LESSONS FROM THE ASIAN FINANCIAL CRISIS

The lessons learned from Malaysia's experience have contributed to an **improved understanding** of how **developing countries** can respond to financial crises

1

**Flexible exchange rate** regimes tend to lower the risk of currency crashes



2

**Large international reserves** can be good insurance against a future crisis



3

Selective, temporary **capital controls** may help stabilize capital flows during a crisis



4

Rapid **financial account liberalization** can be dangerous



5

Strong oversight institutions and **prudent regulation** of the domestic financial sector are essential





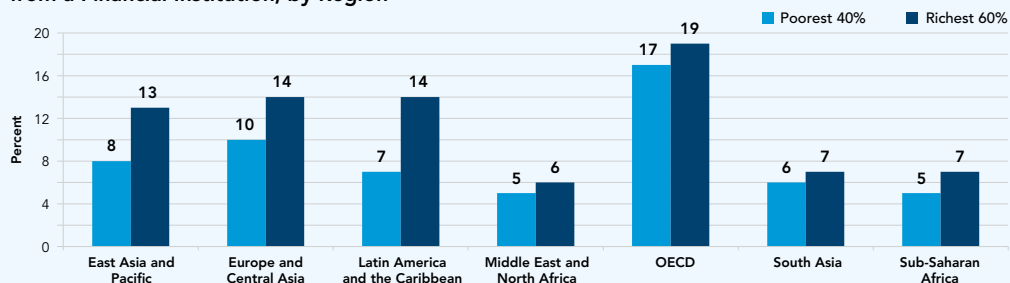
# A New Role for Development Banks?

Sergio L. Schmukler

**There is widespread consensus that not all firms and individuals have good access to financial services.** Problems of access to finance can arise from both principal-agent problems and transaction costs. Traditionally, the role of governments in enhancing access to finance has fallen into one of the two opposing views. The interventionist view argues that governments should directly intervene in the financial sector. In contrast, the laissez-faire view argues that the role of governments should only be restricted to improving the enabling environment. Recently, a third view incorporating elements of both approaches has emerged. The pro-market activism view argues that, while governments should mainly focus on improving the enabling environment, direct intervention might be warranted to address market failures.

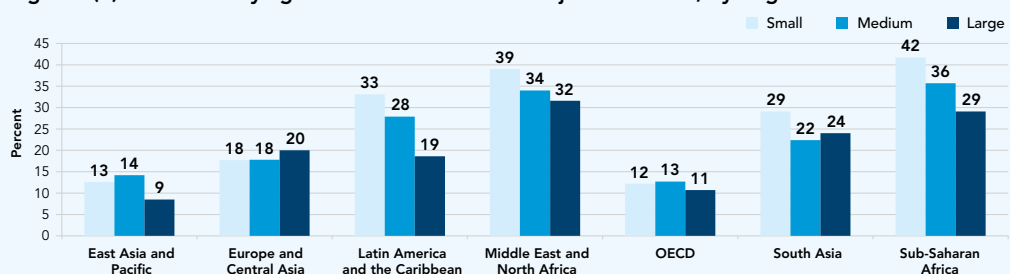
**Access to credit financing is important** because it allows individuals to invest in human capital and new businesses to emerge, creating jobs and fostering productivity growth. However, evidence indicates that not all firms and individuals have good access to financial services, particularly lower income households and smaller firms (Figure 1).

**Figure 1(a) Share of Adults in the Bottom 40 Percent and Top 60 Percent Who Have Borrowed from a Financial Institution, by Region**



Source: World Bank Global Findex Database

**Figure 1(b) Firms Identifying Access to Finance as a Major Constraint, by Region**



Source: World Bank Enterprise Survey

Figure 1(a) shows the cross-country average of the percentage of adults (age 15 or older) that borrowed from a financial institution per group in 2014. Figure 1(b) shows the cross-country average of the percentage of firms identifying access to finance as a major constraint, according to firm size. Firm size levels are 5–19 (small), 20–99 (medium), and 100+ employees (large firms). For each country, data for the last available date was considered. OECD = Organisation of Economic Co-operation and Development.

**Problems of access to finance exist when households and firms cannot obtain enough external funds for an investment project that they would have financed on their own if they could. Such problems are different from problems of access to other financial services, and require different solutions.**

Problems of access to finance typically emerge in the presence of principal-agent problems and transaction costs. Principal-agent problems can arise when creditors lack information about potential borrowers or when creditor protection laws are weak. In these cases, creditors might face difficulties in assessing the quality of investment projects, monitoring the use of funds by borrowers, or enforcing repayments, which might result in creditors limiting lending to creditworthy borrowers. Furthermore, lending involves transaction and



operational costs, which creditors need to cover. Thus, the interest rate creditors require to finance a project might be above the expected return of profitable investment projects.

Two highly contrasting views have traditionally dominated the debate regarding the role of the state in promoting access. However, these two views have not been fully satisfying and, as a result, a new third view has emerged. This new view, proposed by de la Torre, Gozzi, and Schmukler (2017), recognizes that development banks can have an important – although selective – role in promoting access.

## The Two Traditional Views

The **interventionist view** emerged during the 1950s. It argues that market forces alone cannot overcome problems of access to finance. If the government wants to expand finance, it must assume a direct role to address market failures and allocate financial resources.

One of the main instruments for state intervention in the financial sector is state-owned banks. State ownership of banks allows savings to be mobilized for projects with high social returns. This view also proposes that, in addition to managing its own banks, the state should tightly control private banks. This could be done, for example, through imposing direct lending requirements to private banks or capping interest rates.

However, state intervention in the financial sector has mostly failed to produce the expected results. Public banks have often lent to unprofitable companies, been prone to political influence and corruption, and had little incentive to effectively address market failures. Greater state participation in bank ownership is typically associated with lower financial development, slower economic growth, less fiscal discipline, and higher incidence of financial crises. Other state interventions have also been associated with significant costs in terms of efficiency and growth.

After the failure of the interventionist view, in the 1970s and 1980s academics and policy makers turned towards the *laissez-faire view*. This view argues that direct government intervention can do more harm than good. Hence, the state should limit its role only to improving the enabling environment, with the goal of mitigating principal-agent problems and reducing transaction costs. Under an adequate environment, private agents would be able to address problems of access on their own.

Implementing the *laissez-faire* view requires liberalizing the financial system. On the domestic front, this includes privatizing state-owned banks, eliminating direct lending programs, and deregulating interest rates. On the international front, this includes eliminating capital controls. Liberalization reforms need to be complemented by reforms that create an environment that encourages private agents to develop financial markets. These reforms include enhancing creditor rights, promoting credit information systems, modernizing collateral laws, and adopting international accounting standards, among others.

Empirical evidence suggests that financial liberalization and reforms to the enabling environment were successful in reducing credit constraints and expanding access to finance. But empirical studies have also shown that it can increase financial fragility, by increasing the probability that a country will face banking and currency crises. Hence, the overall perception regarding the *laissez-faire* view is mixed.

## A Third View: Pro-Market Activism

In a context in which the two traditional views are not fully satisfactory, a new view has emerged. This third view is not yet completely coherent and fully articulated, and is based on experiences with innovative development policies over the last years. This emerging **pro-market activism** view argues that the state's main focus is to improve the enabling environment, but direct state intervention might be warranted to address short-term market failures while institutional reforms are taking hold.

This third view proposes that rather than increasing the use of financial services per se, interventions should target the underlying causes of problems of access. Interventions should also be cost-effective and not displace the private sector, but rather work with it. The state can play a catalytic role, addressing collective action problems and partnering with the private sector in developing these initiatives. Thus, policy intervention under this view requires some experimentation, and learning by doing.



## A Role for Development Banks

Development banks could play a key role in implementing the pro-market activism view. By working closely with the private sector, they can develop specialized knowledge and tools to address access problems. As a result, they can be well-suited to detect unexploited opportunities and complete financial markets.

This requires that development banks are professionally managed and independent, with proper institutional mandates and management practices. To impose discipline, these banks need to be subjected to hard budget constraints. In addition, their scope of action should be limited to playing a supporting role to private agents, backing “market friendly” interventions that help private-sector actors develop solutions to ameliorate access problems.

The role development banks can have under the pro-market activism view is illustrated by several innovative experiences in Latin America.

In Brazil, Caixa Econômica Federal (CEF) and Banco do Brasil have set up large correspondent banking networks with commercial businesses, which proved to be less costly compared to establishing bank branches. In Chile, BancoEstado, the largest state-owned bank, provides credit guarantees to small and microenterprises through FOGAPE (Fondo de Garantía para Pequeños Empresarios, the Small Enterprise Guarantee Fund) while sustaining good performance and financial stability. In Mexico, the development bank FIRA (Fideicomisos Instituidos en Relación con la Agricultura, Agriculture-Related Trust Funds) was reformed from providing credit to rural areas to arranging sophisticated structured finance instruments that promote private financing to the agriculture, livestock, and fishing sectors.

## Conclusion

New initiatives in development finance suggest that a third view about the state’s role in finance has emerged. This view moves beyond the traditional debate, recognizing the need to avoid one-size-fits-all strategies.

However, this means that implementing this view in practice can be less straightforward. First, it might be difficult to determine when the state should intervene, beyond proving a good enabling environment, and what type of intervention is more appropriate. Second, once state intervention is ongoing, it is difficult to evaluate the success of these initiatives and decide how best to proceed. A final concern is how to resolve the tension between establishing development banks that fulfill a social role while maintaining their financial sustainability.

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To download the report “*Innovative experiences in access to finance: Market-friendly roles for the visible hand?*” visit <http://hdl.handle.net/10986/27529>

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## BOX 2



# Global Symposium on Development Financial Institutions

José De Luna-Martínez

**Are national development financial institutions (DFIs) still relevant?** What are the critical factors that make these institutions succeed? What are concrete examples of sound, well-administered, and innovative DFIs? Why do they still remain in business in countries with large and sophisticated financial systems? How can we assess their economic and social impact? Have our views on DFIs evolved in the past decades?

**All these interesting questions** were discussed during the Global Symposium on Development Financial Institutions, an event jointly organized by Bank Negara Malaysia and the World Bank Group on September 19 and 20 in Kuala Lumpur, Malaysia. With the theme “Balancing Sustainability and Social Mandate: Development Financial Institutions in a New World”, the Global Symposium brought together 500 participants from Malaysia and around the world to discuss the challenges and opportunities faced by DFIs.

## These are my three main takeaways from the Global Symposium:

**Development financial institutions remain relevant.** Historically, DFIs have been created by governments around the world to promote economic growth and support social development. They typically provide credit and a wide range of capacity-building programs to households, SMEs, and even larger private corporations whose financial needs are not sufficiently served by private banks or local capital markets. In doing so, they seek to promote strategic sectors of the economy, such as agriculture, international trade, housing, tourism, infrastructure, and green industries, among other sectors.

Although many of the institutions were created several decades ago, data shows that many governments around the world still see them as a relevant instrument to pursue economic goals. It is estimated that around 20 percent of all DFIs currently in operation around the world were created in the past 17 years. A further 33 percent were set up during the 80s and 90s – the decades in which mass privatizations took place in various parts of the world.

**Views towards national development financial institutions have evolved over the years.** For decades, the World Bank Group has worked with DFIs in many countries by providing lines of credit, guarantees, and technical assistance programs. Our approach towards these institutions have changed from full support for their establishment during the 60s and 70s to a more cautious approach during the 80s and 90s, which saw more closures and/or privatizations of state-owned financial institutions. Since the global financial crisis of 2008, we are seeing a more balanced appreciation of their role and mandate.

During the 2008 Global Financial Crisis (GFC), DFIs played an important countercyclical role in many jurisdictions, by scaling up their lending operations when private financial institutions experienced temporary difficulties in granting credit. Moreover, in the aftermath of the GFC, the loan portfolios of more than two thirds of DFIs have continued to expand at double digit growth rates, thus contributing to global economic recovery efforts.

**Financial sustainability and good governance are critical elements for the success of DFIs.** It is a risky activity to finance projects in strategic sectors of the economy where there is insufficient financing from the private sector. To be effective, DFIs need to have business models that ensure long-term financial sustainability. They also need to have sound risk-management tools and high corporate governance standards that insulate them from undue political interference.





In the past, we have seen multiple examples of poorly-performing DFIs that have become a heavy fiscal burden. Their poor performance has led to credit market distortions that displace and crowd out private financial institutions. When they are weak, they also become vulnerable to political interests, resulting in high numbers of NPL rates and wasting of taxpayers' money.

During the Global Symposium, it was clear that we all needed to learn lessons from the past. Financial sustainability and good governance of DFIs are critical elements that cannot be compromised. To achieve that, the institutions need to have well-defined mandates, be subject to high standards on corporate governance and transparency, and be regulated and supervised with standards applicable to other financial institutions. Moreover, owners of DFIs need to have the ability to properly monitor their business activities, assess their social and economic impact, and compare their interventions versus other public policy alternatives.

The timing of this global symposium could not be better. We need to think of innovative instruments to attract and channel new resources to finance our developmental aspirations, as outlined in the 2030 Sustainable Development Goals, now more than ever. Reliable and well-administered DFIs with a well-defined mandate and sound governance framework will continue to be an important vehicle to accelerate economic and social development. They can create new channels to crowd in the private sector. Moreover, they can play a catalytical role by generating new knowledge, convening stakeholders, and providing technical assistance to build capacity in the private and public sectors.

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To access content from the Global Symposium on Development Financial Institutions, visit [www.wbg.org/en/events/2017/09/19/global-dfi-symposium](http://www.wbg.org/en/events/2017/09/19/global-dfi-symposium)

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# Enhancing Public Sector Performance: Malaysia's Experience with Transforming Land Administration

Kathrine Kelm and Jana Kunicova

**Land policies and land administration services are key for good governance.** However, much of the world's population lack access to affordable land administration systems to secure their property rights. In Malaysia, the institutional and legal context for land administration spans both Federal and State mandates, as well as multiple institutions and agencies. Malaysia delivers efficient land administration services, which include the introduction of qualified titles, business process re-engineering, the use of information and communications technology (ICT), and public-private partnerships (PPPs).

**Land and buildings generally represent** between half and three quarters of the national wealth in all countries. As such, land policies and land administration services are fundamental for securing land rights, developing land markets, and managing land resources in a manner that best contributes to economic growth, efficient public-sector service delivery, environmental protection, and social cohesion and security. The importance of secure land rights and good land administration have been recognized in several international forums including the 2030 Sustainable Development Goals (SDGs), the United Nations Committee on Food Security, and the World Bank/International Federation of Surveyors (FIG) Fit for Purpose Land Administration publication.

However, approximately 70 percent of the world's population do not have access to affordable land administration systems to secure their property rights.

**Many governments lack even basic land information systems to secure land rights, support private-sector development, or improve public-sector service delivery.**

Common challenges preventing developing countries from establishing systems to provide quality land administration include complexity and costs in establishing comprehensive land records and maps. Recent advances in surveying, mapping, and ICT tools have made the task of addressing these challenges easier and cheaper. There are many success stories globally to learn from, but each country and its land tenure system is unique, and there is no universal model for land administration. Technical solutions need to be fit-for-purpose, and governance of institutions needs to be sound.

## **Malaysia's land administration ecosystem**

Peninsular Malaysia offers several examples of programs and initiatives that have led to improved land administration systems and services. Other developing countries may find the Malaysian experience instructive, since it is a relatively large country that has implemented a series of reforms to transform from a low- to a middle-income country in a relatively short time period. Malaysia performs well for land administration globally. In the annual World Bank Doing Business ranking, it ranked 42nd out of 190 jurisdictions in terms of the ease of registering property.

The institutional and legal context for land administration in Malaysia spans both Federal and State mandates as well as multiple institutions and agencies. The 1957 Federal Constitution defines the rights and responsibilities of the Federal government, the member states of the Federation, and its citizens. For land administration, the Constitution recognizes a two-tier governmental structure on Peninsular Malaysia and Federal

territories. Land and land-based resources come under the purview of the State, which means that each State government has the authority to legislate on land matters including agriculture, forestry, and the land registry. However, cadastral mapping and systems come under the purview of the Federal government, with both Federal and State governments sharing jurisdiction over other areas such as town and country planning, rehabilitation of mining land, housing, drainage, and irrigation. This complexity has implications for governance of land rights, land market functions, and improving public-sector service delivery. However, while land is predominantly a State matter in Malaysia, the Federal government has the power to make laws for the purpose of uniformity.

**Despite the complex legal and institutional structure, Malaysia is a success story in delivering efficient land administration services.**

## What other countries can learn

In particular, Malaysia has established a cadaster (an official register to define the dimensions, location and ownership of real estate) and land registration system on Peninsular Malaysia that enables efficient provision of land administration services. The key takeaways from the Malaysian successes include:

- The introduction of qualified titles, which allows registration without a formal cadastral survey, was a successful mechanism to overcome key constraints, such as the limited number of government and professional surveyors, and the perceived high cost of formal surveys. Over time, the standards and processes for cadastral surveys have been improved, and a national program for the conversion of qualified titles to final titles has been introduced. This program has been largely successful. Malaysia's experience shows that the issuance of qualified titles can be an effective means of implementing systematic registration, if and where the qualified titles – and any subsequent dealings with these titles – are managed in the same system that registers full or unqualified titles.
- Business-process re-engineering is an effective tool to make significant changes to service delivery. When implemented with strong political support, it provides the means to break down strong 'silos' in systems that have evolved over long periods of time. The effectiveness of these improvements is reflected in Malaysia's improving Doing Business Ranking over time.
- ICT tools can be effective in standardizing processes, improving service delivery, and making spatial and textual data available for broader use in government and society. Going forward, the introduction of the ICT system e-Tanah (e-Land), and



the development of clear interfaces to other systems, particularly the mapping system e-Kadaster, will improve services and help generate the spatial and textual data that Malaysia needs to successfully implement the National Spatial Data Infrastructure (NSDI).

### Learning from Malaysia's limitations as well as successes can be equally instructive.

- PPPs can potentially offer an innovative business model for governments to consider when deciding how to finance the development and modernization of land administration systems. However, due consideration needs to be made around the governance of PPP design, contracting, implementation, monitoring, and impact. Ensuring secure property rights and a well-functioning land market is a cornerstone for economic development and social stability.





## Key lessons for other countries include:

- When possible, it is suggested that countries adopt or switch to an integrated cadaster and registry system. Malaysia has a complex national/state division of the cadaster and land registry. Cadastral and land registry data and systems need to be integrated in order to provide complete and accurate land administration data to both public and private users. In the absence of an integrated institutional structure, a strong coordination mechanism with mandatory compliance for data integration is critical.
- An effective NSDI requires a clear policy and legal framework in order to define the roles and responsibilities of data suppliers and users. Over the past decades, Malaysia has developed its NSDI through guidelines and standards; however, there is still no national NSDI strategy or law. The majority of agencies and organizations that provide or use geospatial data are motivated by their own mission. Sharing information in a fully-transparent manner is not common, and information exchange is limited. While governments may choose to start NSDI development prior to a formal policy and legal framework, developing a mature and efficient SDI requires clear mandates, roles and responsibilities for all parties.

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This article was adapted from the Executive Summary of the report, "Enhancing Public Sector Performance: Malaysia's Experience with Transforming Land Administration", part of the Knowledge and Research report series.

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# Improving Education Sector Performance in Malaysia

Jana Kunicova, Jeevakumar Govindasamy and Lars M. Sondergaard

**In 2009, Malaysia's education system embarked on a transformation.** Although Malaysia reached an adult literacy rate above 90 percent, OECD's PISA scores provided hard evidence of what many Malaysians already knew: more and more students were graduating, with diplomas certifying they had completed more years of schooling, but the education they received – as reflected in the overall poor mastery of English language skills, critical thinking, and analytical reasoning skills – was not of the quality needed for a country with aspirations of reaching a high-income status.

**The government launched the National Transformation Program (NTP), an ambitious effort to transform the country.** One of its original six National Key Results Areas (NKRAs) was “assuring quality of education.” Education’s inclusion in this list reflected two things: Malaysia’s education system was not delivering, and the previous attempts at reforming the sector were not bringing about the desired transformation. A more drastic overhaul was needed.

The more drastic overhaul of the sector was envisioned to come from the application of the delivery unit (DU) approach to transforming sector performance. The national-level Performance Monitoring and Delivery Unit (PEMANDU) introduced its signature “8 steps of transformation” methodology. This approach is designed to take the sector from strategic direction, through operationalizing high-level goals into projects or programs during the Lab phase and setting key performance indicators (KPIs), to monitoring, troubleshooting, and communicating the results to the public. Crucially, the first step along this path – providing strategic direction – is more than just providing direction: PEMANDU supported the Ministry of Education (MOE) in identifying the game-changing initiatives or programs that could help drive the ministry in the desired direction of improving student learning outcomes.

Literacy and Numeracy Screening (LINUS) was one of the five game changers that is worth examining for a number of reasons. First, despite being an upper-middle-income country with a well-developed education system, Malaysia had a sizeable share of its early graders struggling to master basic numeracy and literacy, although the magnitude of the problem was unclear due to lack of systematic measurement of those skills. Malaysia introduced Literacy and Numeracy Screening (LINUS) in 2009 as a systematic and comprehensive



effort to screen and improve literacy and numeracy standards of primary school students. Second, how LINUS was conceptualized is a good example of “evidence-based decision making” at work, with wide-spread applications for other countries and programs. Third, LINUS is also worth examining as it provides good insight on how delivery units like PEMANDU and MOE’s own Education Performance and Delivery Unit (PADU) influenced the program’s design, institutional arrangements and coordination, as well as monitoring. Finally, the challenges that Malaysia encountered during the implementation provide valuable lessons for other countries. This includes challenges in designing a program to enable impact evaluations.

This report describes how the DU method worked in both the design and implementation stages of LINUS. This includes the interface between MOE and PEMANDU, as well as PEMANDU and PADU. The core of the document focuses on implementation details: the institutions, leadership, and incentives that contributed to the program’s success. It also describes how the implementation agencies worked together to implement LINUS.

## **How did the DU approach improve implementation of education programs?**

Including education into the NTP as one of the top national priorities provided the mandate to re-strategize efforts to improve literacy and numeracy. These centered on better collaboration among MOE Divisions, as well as the central, state, district, and school levels. Unlike previous literacy and numeracy interventions, a cross-division task force (LINUS Taskforce) was established to coordinate the different divisions in MOE, including the State Education Departments and District Education Offices to implement LINUS in schools. A more collaborative effort, the LINUS initiative benefited in terms of intellectual capital that shaped its overall program design; screening instruments, learning and teaching modules, and teaching pedagogy. The institutional setup for the implementation of LINUS was complex, but provided the right combination of leadership, accountability, and incentives for the program to succeed. The Curriculum Development Division (BPK) has led the LINUS Task Force and worked closely with other MOE divisions, as well as with PADU and PEMANDU.

**Elevating education to such high priority provided opportunities and incentives for coordination and collaboration.**

The NKRA Education Lab provided a viable platform for the top management of MOE to bring together different MOE Divisions to work more collaboratively. Labs were stakeholder workshops lasting six to nine weeks designed to “unpack” the strategic goal of improving education quality into concrete programs with timelines, KPIs, and responsible agencies.



The way the labs have been designed and implemented by PEMANDU also enabled the top management of MOE to bring together different MOE Divisions to work towards developing a tangible implementation plan by the end of the education lab duration. The education NKRA Lab also provided a good platform for collaboration, as well as to seek out fresh new ideas and validation points. The NKRA Education Lab was instrumental in shaping the program details of LINUS. The lab resulted in the establishment of the LINUS Taskforce to oversee the continuation of the development, implementation, and monitoring efforts of LINUS. The lab also defined the key milestones of LINUS and set the stage for how the performance of the MOE Divisions involved in the LINUS delivery chain is to be measured.

### **Linking the center of government with the education sector entities through the NTP improved monitoring and problem-solving.**

The LINUS Task Force, PEMANDU, and PADU have been successful in providing an effective coordination, tracking, monitoring, and reporting framework for LINUS. The performance management framework is anchored on using the best and leading transformation practices. This involves the introduction of performance tools as follows: (i) Development of granular implementation plans, (ii) Dashboard to track and monitor progress of initiatives, (iii) Mid-Year Review, (iv) End-Year Review, (v) Problem-Solving Meeting



for the issues to be escalated and decided, and (vi) Annual Report that communicated the achievements for the year. In addition, the delivery units infused performance culture into the MOE, with their private-sector ethos, hard deadlines, reporting routines, and breaking down hierarchical thinking. This also created performance incentives for schools and teachers on the ground. The involvement of DUs in the design and implementation of education programs like LINUS also created several adjustment issues within the ministry. These adjustments include how performance is to be accurately measured, interpretation of data, and the validation process.

The LINUS program was well-resourced. The NKRA status of LINUS as well as the launch of the Malaysia Education Blueprint helped in getting the required human, financial, and technical resources required to implement the program. Ample resources were allocated to the LINUS program to finance a strong design, pay for start-up costs, and for its continued implementation.

## **What were the challenges for the DU approach in education?**

No reliable estimate of early grade literacy and numeracy skills existed prior to LINUS, so a dependable baseline was not available. In addition, assessing student learning outcomes is inherently difficult. Are the standards sufficiently hard? Does the assessment accurately measure students' level of mastery of those standards? How are consistent assessment-taking conditions and consistent grading ensured? Although students took repeated screenings to improve the accuracy of results, there were still questions whether LINUS was accurately measuring what students could or could not do. The Deloitte performance audit of LINUS, commissioned by PEMANDU in 2011, revealed several weaknesses in the screening process that resulted in inaccuracies of the assessment of student abilities. Commissioning an external process evaluation of LINUS was an important step toward refining the program and its accuracy, but the LINUS program design did not enable rigorous impact evaluations.

In the absence of impact evaluations, it is unclear whether LINUS was the sole intervention that resulted in improved literacy and/or numeracy skills of early graders. The program was rolled-out nationwide, which did not allow the implementers to specify "treatment" and "control" groups for LINUS. As such, under the current implementation arrangements, it is not possible to ascertain whether LINUS or something else helped improve literacy rates. Also, it is difficult to tell what part of the LINUS program (e.g. FasiLINUS; remedial teachers; or the focus on measuring learning outcomes) was more impactful in improving learning outcomes. While the in-depth process evaluations helped identify strengths and weaknesses of the LINUS implementation and measurement of what students knew at each grade, an impact evaluation would be beneficial to determine which interventions have worked. This would include steps to establish appropriate baselines enabling future efforts (e.g. in the next five years) to undertake a more robust program evaluation.

The lack of targeting and expenditure tracking raises questions about the cost efficiency. The trends in the data seem to suggest that literacy and numeracy might not be a nationwide problem, but rather concentrated in several districts. It is possible that a narrower and much cheaper program focusing on the struggling states and districts could have achieved the same or better results for less. However, it is difficult to say with certainty how much the LINUS program cost. The way the costing information has been pieced together and subsequently tracked, without taking into account the salaries of teachers, makes estimating the actual cost to run a program like LINUS challenging. This is problematic for both establishing the value for money of the program, and for other countries considering to replicate a similar initiative.



## What are the key lessons for other countries?

Malaysia's DU approach to improving education outcomes offers important lessons for other countries, both in its successes and its limitations. On the positive side, this approach improved top-to-bottom incentives to implement LINUS, fostered a performance culture, and enabled adaptive learning. However, it is also important to learn from the pitfalls in measurement, impact evaluation, and cost tracking.

Malaysia's experience with LINUS point to four key lessons that have supported the implementation of LINUS. First, making improving education outcomes a national priority will elevate the profile, the stakes, and the resourcing for the initiative. Second, creating institutional mechanisms to ensure collaboration, coordination, and commitment among all stakeholders, from the highest levels of the ministry to the districts, schools, and teachers, is key for better implementation. Third, fostering a performance culture in the implementing ministry will improve incentives on the ground. Finally, conducting process evaluations and learning from them will help improve programs by iteratively adapting their design.

Malaysia's challenges in implementing LINUS are equally instructive. Before embarking on a national program of this magnitude, it is important to ensure that there are appropriate baselines to track literacy and numeracy rates. Also, it is helpful to build in impact evaluations into the program design to address the issue of attribution and cost effectiveness. Furthermore, before embarking on a nationwide program, countries may wish to consider whether a targeted approach will achieve the same results at a lower cost. Finally, it is critical to track full program costs to establish value for money and flag cost overruns.

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# Learning from Malaysia's SME Story

Djauhari Sitorus and Simon Bell

**Malaysia's experience in addressing access to finance for SMEs has been successful, serving as a learning point for countries like Tanzania and South Africa.** The World Bank Group Global Knowledge and Research Hub played conduit to organize two fruitful visits to promote South-South exchanges on SME development, as part of its outbound knowledge strategy to share and promote the successes and lessons gained from the 'Malaysia Experience' with the world.



**Tanzania is set towards becoming a middle-income country**, as the economy has grown by an average of 6.5 percent per year in the past decade. The “Tanzania Development Vision (TDV) 2025” highlighted small and medium-sized enterprises (SME) sector as one important contributor to the country’s long-term development. It is estimated that Tanzania’s SME sector consists of more than three million enterprises, which contribute to 27 percent of overall GDP. Most of them are in the agricultural sector, and more than half are owned by women.



However, key constraints remain for SME development. This includes unfavorable legal and regulatory frameworks, undeveloped infrastructure, poor business development services, limited access to financing, and ineffective and poorly coordinated institutional support frameworks.

Among these constraints, access to finance is the most critical one. As such, the government of Tanzania is currently working with the World Bank on a new USD150-million financial intermediary lending operation, designed to increase access to finance for SMEs.

These constraints largely resemble those faced by Malaysian SMEs in the past. In the past two decades, the Malaysian government pursued reforms and undertook interventions to address these issues. Now Malaysia is known to have one of the most vibrant SME sectors in the region. The SME sector in Malaysia contributed 37 percent to GDP, 65 percent of employment and 16 percent of exports in 2016. The sector is expected to grow at a rate of at least six percent per year.

The success story of Malaysia in addressing the constraints of access to finance for SMEs has attracted attention from other developing countries, including Tanzania, where recently a delegation from the Ministry of Finance and Planning (MOFP) visited Kuala Lumpur to learn more about its experience.



The delegation from Tanzania's Ministry of Finance and Planning with Faris Hadad-Zervos, Country Manager for Malaysia.



## Some key takeaways from the visit include:

**Good planning and coordination are essential.** A robust SME development strategy requires adequate inter-ministerial coordination, because SMEs operate within many sectors. Policymakers must realize SME development is a long-term undertaking that needs support from the highest level of government. In Malaysia's case, the National SME Development Council (NSDC) was established in 2004, chaired by the Prime Minister. Its members included 18 ministers and the heads of key agencies, with a full-time secretariat, the SME Corporation.

**Good planning is equally important.** The Malaysian government prepared a long-term SME development plan, the SME Master Plan 2012-2020. A good planning document should clearly state its vision and goals, and also describe systematically the interventions needed to strengthen SMEs. It should have a framework to measure results. For example, according to the Master Plan, SMEs in Malaysia were targeted to contribute 41 percent of GDP, 65 percent of employment and 23 percent of exports – with specific result indicators for the interim years – by 2020.

Figure 1: Key Constraints to SME Growth

### INNOVATION & TECHNOLOGY

- Access to national innovation system
- Low commercialization & R&D
- Poor technology update

### HUMAN CAPITAL DEVELOPMENT

- Workforce lacks job readiness
- Low utilization of existing training
- Non-competitive rewards & benefits

### ACCESS TO FINANCING

- Limited non-banking avenues
- Poor creditworthiness
- Lack of know-how and resources



### MARKET ACCESS

- Procurement by Govt/LSIs
- Information barrier to exports
- Limited focus on marketing & branding
- Low bargaining power

### LEGAL & REGULATORY FRAMEWORK

- Licensing/permits
- Complying to regulations
- Legislations disincentivizing formation & growth

### INFRASTRUCTURE

- Trade clearance and facilitation system
- Low and infrequent trade volume

Source: SME Corp



**Address all constraints - not just financing.** Figure 1 shows several constraints which hindered SME growth: market access, legal and regulatory frameworks, infrastructure, human capital, and technology, including access to finance. Therefore, interventions should be a combination of financing, advocacy, advisory, training, and other forms of technical assistance activities. Many governments only focus their interventions on access to finance, but do not address other constraints, and therefore do not achieve optimal outcomes.

**Develop the SME financing ecosystem.** Access to finance itself is a complex and broad topic that goes beyond the provision of credit. Malaysia's government recognized this fact, and built a comprehensive SME financing ecosystem. The ecosystem consists of several distinct but mutually reinforcing elements: institutional arrangements, financing schemes, education and awareness, facilities to seek information and redress, as well as debt resolution programs. Having a financing ecosystem is important, because the needs of SMEs will evolve as they become more sophisticated.

**Provide a wide spectrum of financing services and products.** The SME sector comprises of enterprises with different characteristics. Common differentiating characters are size, sector, location, business life cycle, and ownership profile (gender, education, etc.). SMEs may have different needs for financial services and products according to their characteristics. Malaysia's comprehensive financing landscape combines government grants and soft-loan schemes with commercial loans, credit guarantees, equity-based financing, and other products. Both conventional and Islamic financing services are also available. Service providers range from traditional financial institutions such as development financial institutions, commercial banks, credit guarantee institutions and investment companies, to new players in SME financing; namely, financial technology companies.

The Malaysian experience has had its own challenges and pitfalls. Still, the key takeaways have been useful to help Tanzania's government delegation chart its own journey in SME development with optimism.



## South Africa learns from Malaysia's experience with credit guarantee schemes to finance SMEs

**The global fascination with SMEs**, and their ability to generate jobs, has increased focus on ways commercial banks and other financial institutions can be encouraged to lend to this class of companies. With little credit history, weak accounting standards, a lack of the types of normally accepted collateral, and failure rates which horrify most high-street banks, commercial banks have traditionally steered clear of lending to SMEs, despite the powerful job creation potential of the best ones.

One possible tool, which client governments are increasingly contemplating, is the use of credit guarantee mechanisms. Such schemes reduce commercial bank lending risks by covering a share of the risk (generally between 50 percent to 90 percent of the loan) for a guarantee fee. The demand for World Bank assistance and advice in helping to design or re-design credit guarantee schemes has increased at a rapid rate over the past three years.

Indeed, a well-designed credit guarantee scheme has been shown to deliver positive results in terms of increased SME lending, lower collateral requirements, longer-tenure loans, and in some instances, lower interest rates. On the other hand, poorly-designed CGS schemes have proven to be an expensive drain on resources, with poor commensurate returns on public resources. Consequently, an effective design appears to be the key, and the World Bank's recent development, in conjunction with regional credit guarantee associations, of 16 Key Principles in designing such well-functioning schemes, has played an important role in helping to re-popularize CGSs as well as provide professional guidance on their establishment and design.

Recent work in South Africa illustrates this point. South Africa has an existing public-sector CGS (as well as a smaller privately-operated CGS) with low guarantee volumes due to various operational issues, high levels of NPLs and onerous claim payout procedures. Nevertheless, there is a strong desire by the South African authorities to revisit this tool

and redesign the scheme to make it more effective and sustainable. They approached the World Bank for assistance in these endeavors and technical support is ongoing.



As part of this work, a delegation from South Africa visited the Malaysian Credit Guarantee Corporation (CGC) in Kuala Lumpur for a three-day study tour, under the auspices of the World Bank program with the Government of Malaysia. The study tour also included a half day visit to SME Corp – Malaysia's dynamic SME development agency.

Having been in operation for 45 years, the Malaysian CGC has vast experience in what works and what doesn't with respect to credit guarantee lending for SMEs – and a wealth of experience for other countries in Africa and Asia that are looking to develop their own national schemes. It offers a wide portfolio of products in addition to its traditional SME guarantee product – including *Biz-Mula* for Malaysian start-up companies, *Biz-Wanita* for women headed SMEs, schemes for indigenous Malays, and other schemes in support of businesses that are involved in green technologies. Coverage ratios differ by product type but typically cover between 50 percent to 90 percent of the risk of the loan – for a fee which ranges between two percent to 3.5 percent (although the fee structure is variable and is designed to reward financial institutions with low levels of NPLs, while penalizing banks with deteriorating loan portfolios). It has also established a verified system for paying out claims on the guarantees, which is widely accepted by the banks in Malaysia – an important design issue on which many such schemes have faltered in other countries.

CGC also plans to shortly launch an On-Line SME Aggregator which will act as a one stop center, and safe matching platform, for SME financing products and services – bringing together banks, government agencies, micro-finance institutions, and others onto a single digital space.

The South African participants learned a lot about the Malaysian Credit Guarantee Corporation's comprehensive and established – yet still dynamic – credit guarantee model. Several of the participants noted that such South-South learnings are so important in helping to design their own schemes. The Malaysian experience provides one such robust and potentially useful design for the South African delegates to take home and further test, as they contemplate the next stages of their own CGS design.

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# Financial Development, Growth, and Crisis: Is There a Trade-Off?

Norman Loayza, Amine Ouazad and Romain Ranciere

**Financial deepening leads to a trade-off between higher economic growth and higher crisis risk.** However, for middle-income countries at least, the positive growth effects outweigh the negative crisis risk impact. This balanced view has been revisited recently for advanced economies, where there might be a threshold beyond which financial depth becomes detrimental for economic growth by crowding out other productive activities and misallocating resources. Recognizing the intrinsic trade-offs of financial development can provide a useful framework to design policies targeting financial deepening, diversity, and inclusion. It can also highlight the need for complementary policies to mitigate the risks.



**Finance can both fuel economic growth** and, when excessive and triggered by a shock of some sort, can lead to economic crisis. For decades, these two effects have been studied separately. Since the mid-2000s, however, economics literature recognized that both positive and negative aspects of finance should be considered jointly. This innovation has prompted an exploration of the trade-offs involved in various aspects of financial development, such as depth, inclusion, composition, and variety.

Financial development is a general term. One of the most-commonly-used concepts is that of financial depth, which denotes the extent of credit, financial capital, and financial products in the economy. The most popular empirical proxy for measuring financial depth is the amount of credit extended by commercial banks to the private sector as a percentage of GDP.

However, there are other dimensions of financial development – value, quality, diversity, efficiency, and inclusiveness – and corresponding empirical proxies. Some recently-used proxies with regards to the financial industry, including its value add, share of employment, and wages and wage premia, might be particularly relevant in discussing the allocation or misallocation of factors between the financial sector and the rest of the economy, and to test some model-based hypotheses.

## Finance and Growth

Evidence suggests a strong and robust long-run relationship between financial and economic development. However, there have been two main areas of controversy. The first one deals with the direction of causality, and the second concerns the homogeneity of the impact in various countries, contexts, and levels of development.

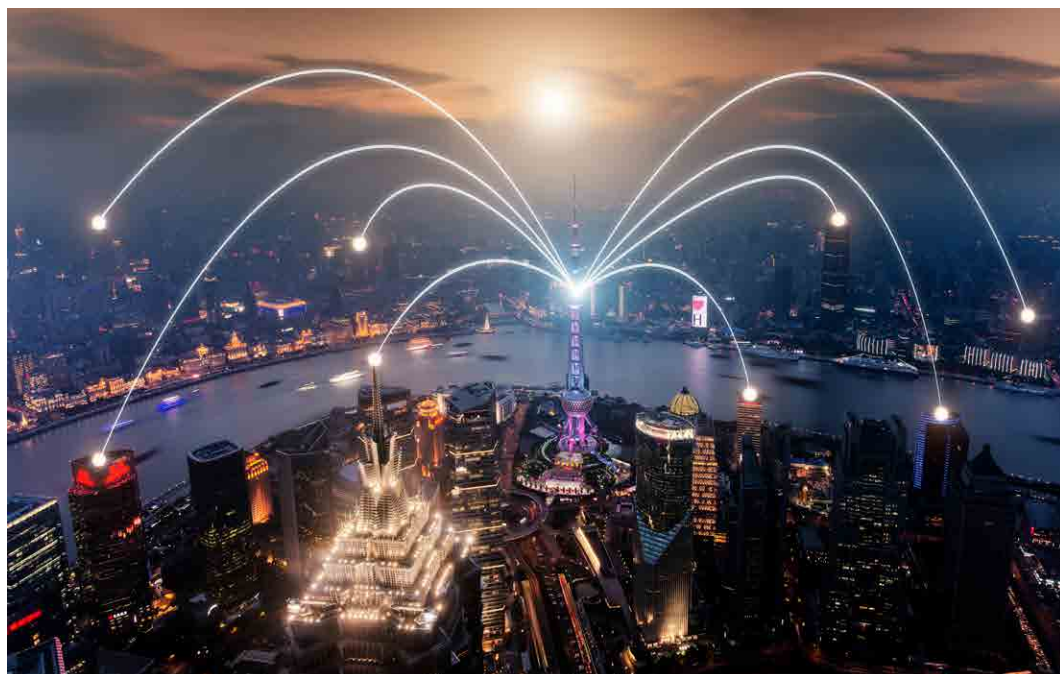
**There is strong, though not uncontroversial, evidence that financial depth generates larger economic growth, mainly through its positive effect on total factor productivity.**

Other studies tend to find that causality may run in both directions. The second area of controversy has been the homogeneity of the growth effect of financial deepening. There is an emerging consensus that the benefits of financial deepening may decrease for large levels and large accelerations of financial depth, posing the possibility of “too much finance.”

## Finance and Crisis

Meanwhile, other studies have focused on the connection between financial deepening and economic crisis. Rapid acceleration of bank credit, sovereign debt, and equity prices are robust predictors of the occurrence and intensity of financial crisis. This rapid acceleration in volumes and prices of financial assets is part of a boom-bust cycle, with the financial bust producing the negative effects on the real economy. This boom-bust phenomenon can be fueled and aggravated in an international economy context, with the bust connected to the “sudden stop” of capital flows.

The evidence suggests that both financial institutions and financial markets influence economic growth and crisis; however, there is little evidence that either a bank-based system or a market-based system is the better one for growth and stability. The insight that there may be a darker side to finance is derived from two often-interrelated aspects: first, some features of finance may be wasteful and crowd out productive activity; and second, certain characteristics of financial development may make the economy more vulnerable to crisis.



## The Integrated Approach

The integrated approach hypothesizes that there is a trade-off associated with the dual effect of policies fostering financial development, potentially leading to both higher growth and higher crisis risk.

**It has been shown that a positive long-run relationship between financial depth and economic growth could co-exist with heterogeneous, country-specific, short-run effects that are, on average, negative.**

Empirical evidence suggests that this trade-off is associated with liberalization policies that foster domestic financial development and international financial openness. The trade-off seems to be mostly relevant for liberalizing middle-income countries. These are countries whose institutions are typically strong enough so that they can benefit from financial liberalization in tranquil times, but weak enough so that the severity of borrowing constraints makes it worthwhile for them to take on crisis risk to boost leverage, investment, and growth.

## Concluding Remarks

This paper reviews the evolving literature that links financial development, financial crises, and economic growth in the past 20 years. The initial disconnect – with one literature focusing on the effect of financial deepening on long-run growth and another studying its impact on volatility and crisis – has given way to a more nuanced approach that analyzes the two phenomena in an integrated framework. The main finding of this literature is that financial deepening leads to a trade-off between higher economic growth and higher crisis risk; and its main conclusion is that, for at least middle-income countries, the positive growth effects outweigh the negative crisis risk impact. This balanced view has been revisited recently for advanced economies, where an emerging and controversial literature supports the notion of "too much finance," suggesting that there might be a threshold beyond which financial depth becomes detrimental for economic growth by crowding out other productive activities and misallocating resources. Nevertheless, the growth/crisis trade-off is alive and strong for a large share of the world economy. Recognizing the intrinsic trade-offs of financial development can provide a useful framework to design policies targeting financial deepening, diversity, and inclusion. In particular, acknowledging the trade-offs can highlight the need for complementary policies to mitigate the risks, from financial macroprudential policies to monetary policy frameworks that monitor the growth of credit and asset prices.

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The Policy Research Working Paper, *Financial Development, Growth, and Crisis: Is There a Trade-Off?* can be downloaded from [hdl.handle.net/10986/28856](https://hdl.handle.net/10986/28856)

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# Global Trade: Slowdown, Factors, and Policies

Dorina Georgieva, Norman Loayza and Fabian Mendez-Ramos

**Growth in global trade has been slow since 2012.** While global trade downturns are not unprecedented, the observed change in the relationship of trade to GDP poses the question whether the trade slowdown is a transitory deviation or a more long-lasting phenomenon brought about by structural changes. This new dynamic, coupled with the rise of protectionist policies and rhetoric in many countries, positions trade at the forefront of policy discussions. This brief reviews recent patterns in global trade, examines the factors affecting trade – distinguishing between transitory and structural components of the slowdown – and discusses policies shaping the path of future trade.

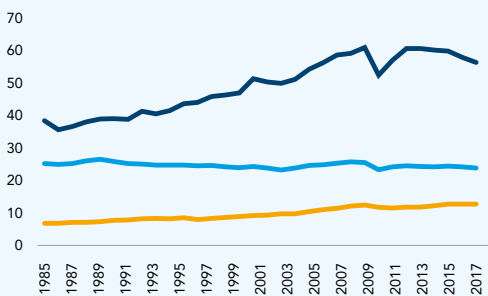


**After the global financial crisis (GFC) of 2008-09**, global trade has grown at a slower rate compared to previous decades. On average, world trade grew six percent from 1985 to 2007, while since 2012, it has been hovering around 3.1 percent (Figure 1). During the GFC, the growth rate of trade in goods and services collapsed around 10 percentage points. This slowdown was particularly pronounced in high-income economies.

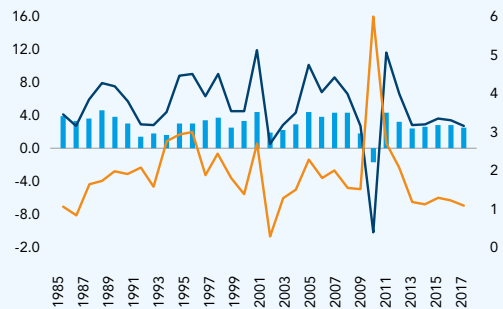
**Figure 1. World Trade and World Trade Growth, 1985–2016**

World trade as a percentage of world GDP has barely moved since 2010, while world trade growth - measured by exports - was flat from 2011 to 2016.

**a. World trade as a percent of world GDP**



**b. World trade growth (annual percent change)**



Source: World Development Indicators and World Bank staff calculations.

From 2010 to 2016, the median growth of exports and imports declined across all regions and regardless of countries' income levels, with 2015 being the worst year for global trade. In 2016, growth improved, driven by Europe, Central Asia, East Asia, and the Pacific. However, global trade remains lackluster.

The decline in trade growth since the GFC is largely due to transitory and structural factors. Transitory factors are short-lived, while structural factors are permanent or long-lasting shifts in the composition or dynamics of the economy.

**While transitory and structural factors are important, weaker economic activity as fallout of the crisis may explain most of the trade slowdown.**

## Transitory Factors

Trade is highly sensitive to changes in economic activity, particularly in the short term. Post-GFC, the decline in income led to a reduction in the demand for consumption imports. Lower expectations and higher uncertainty about future growth caused a fall in investment, reducing the demand for imported capital goods.



Declining commodity prices in 2014 and 2015 were a major factor of trade growth slowdown in developing economies. These lower prices reflected a decline in their demand and trade around the world. They also meant lower income for oil- and mineral-exporting countries, consequently reducing their demand for import goods.

Liquidity conditions during and after the GFC also played a role. Firms trading internationally are more dependent on external financing than domestic-oriented firms, and are therefore more vulnerable to financial contractions. The credit crunch had an impact on all aspects of trade. The trade effects were larger in more credit-constrained countries, for clients of troubled financial institutions, and for sectors more dependent on external financing.

The policy uncertainty that prevailed during and after the GFC affected trade as well. The relationship between policy uncertainty and trade is strong, negative, and nonlinear. If uncertainty passes a threshold, it can lead to a significant decline in trade. One empirical study has discovered that 75 percent of the decline in trade growth rates between 2015 and 2016 can be associated with an increase in policy uncertainty during 2016.

## Structural Factors

Structural factors have also shaped the trade slowdown. This is suggested by changes in the elasticity of trade to GDP (defined as the percentage points by which trade changes for each percentage point increase in income), where higher values illustrate more responsiveness to GDP. Some researchers noted that long-term trade elasticity rose significantly in the 1990s, but started declining in the 2000s, revealing a slower pace of the process of vertical specialization through global supply chains.

The development of global value chains is key to understanding the pattern of trade in an interconnected world. Historically, trade involved transactions between two countries. However, over the past two decades, international trade has involved many countries contributing to the production of finished products. While this initially fostered a sharp jump in trade growth, the maturation and slower pace of global value chain growth has contributed to overall trade slowdown.

**China's growth reduction and "rebalancing" in the last few years has also been a contributing factor. The rebalancing of the Chinese economy involved several interrelated phenomena; more consumption and less investment, fewer imports of capital goods and more production of domestic intermediate goods, and fewer exports to favor consumption.**

Finally, income convergence between developed and developing countries may be a structural determinant behind the long-term evolution of international trade. During the 1990s and 2000s, developing economies converged more quickly, given that they started from a lower income level. In the 2010s, this process is naturally slowing down.



## Policies and the Future of Trade

International trade will be driven by fundamental forces such as demographic changes, technological improvements, energy and natural resource availability, transportation costs, and infrastructure facilities. Future trade will likely be more reliant on digital technologies. Ever-evolving information and communication technologies (ICT) are facilitating the inclusion of more firms in the world economy, opening markets to previously isolated workers and enterprises.

Their success greatly depends on having the right public policies and institutions. These policies can either support the fundamental forces driving trade and improve their social and economic effect, or interfere and disrupt the process of international integration. There are three major possible scenarios. The first scenario sees global trade growth entering an accelerated decline due to increasing protectionism and conservatism. The second scenario considers a trade framework where countries engage more in regional or bilateral agreements. The third scenario involves a reinvigorated World Trade Organization (WTO) with enforcement powers to pursue deepening worldwide integration.

## **The threat of protectionism may worsen the global trade slowdown and change the nature of future trade agreements.**

Increasing protectionist policies will weaken the global trade structure and diminish growth prospects if they materialize. The International Monetary Fund (IMF) emphasizes that protectionist measures that have been implemented, coupled with slower pace of globalization, could reverse the gains achieved from the mid-1980s to the mid-2000s regarding incentives for innovation, productivity growth, and technology diffusion. The WTO points out that 2,978 restrictive measures were put in place from 2008 to 2016, and 2,238 of those were still standing in 2016. Most G20 and all G7 countries have increased trade restrictions since the GFC.

A second possible path for trade policy is the proliferation of new bilateral and multilateral agreements. While bilateral trade agreements are easier to negotiate and go into effect faster, they can generate a series of competing bilateral agreements among other countries. Multilateral trade agreements, on the other hand, may facilitate trade further by standardizing trade and business regulations and enforcing legal procedures among a larger array of trading partners.

Recent preferential trade agreements are deeper and cover a broader spectrum of measures than tariffs alone. Notable regional and intercontinental agreements include MERCOSUR (1991), the ASEAN Free Trade Agreement (1992), NAFTA (1994), and the European Economic Area (1994). Deeper and larger agreements tend to have a bigger impact on trade growth and may reduce trade costs for non-member countries, creating a positive spillover effect. The export gains are higher when emerging markets have trade agreements with advanced markets. Deep preferential trade agreements are also associated with higher trade related to global value chains.

A third trade path involves worldwide trade liberalization, harmonization of procedures, and regulation to promote fair trade. This would require a renewal of the WTO, making it more dynamic and forward-looking, especially in the face of new technologies, and providing it with greater enforcement power to ensure compliance by member states. While it may appear counterintuitive, the threat of protectionism is an opportunity for the WTO to step in, offering an attractive forum for countries to engage in international trade and a credible institution to enforce international rules and policies, temper tensions, and mitigate eventual trade conflicts.

## **Protectionism has increased since the Global Financial Crisis, and it may intensify in the future. Could this threat be an opportunity to reinvigorate the World Trade Organization?**

## Conclusion

International trade in the future will be affected by demographic changes, income convergence across countries, and the use of ever-evolving ICT. One consequence is that trade in services will become increasingly more important. Another is that more people and firms could reach and participate in international markets. The potential beneficial effects of international trade are large, indeed. They are, however, under threat of protectionism. Perhaps paradoxically, this offers an opportunity for regional and global trade agreements, led possibly by a revitalized WTO, to step in and present a pragmatic way to expanding international integration.

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For the full text of the Research Policy Brief, diagrams and reference list, visit <https://goo.gl/QETZRV>

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# The New ASEAN Green Bonds Standards

Ashraf Arshad & José De Luna-Martínez

**Climate change poses a significant threat to the economic development of countries around the world.** The World Bank estimates that up to a 100 million poor people could be pushed back into poverty by 2030 as a result of climate change – in part due to a combination of higher agricultural prices and threats to food security and health – especially in the poorer parts of the world. The Paris Agreement and the 2030 Sustainable Development Goals (SDGs) have provided commitments to tackle the most urgent of these environmental challenges.



The issuance of green bonds run in line with these commitments, as their proceeds support environmentally-friendly projects that can reduce CO2 emissions, promote energy efficiency and renewable energy, and improve water and sanitation management, among others. Globally, this has begun to gain momentum. As of the third quarter of 2017, global green bond issuance stood at USD32.7 billion; an additional USD500 million compared to the previous quarter.

**By the end of 2017, it was expected that total global green bond issuance (year-on-year) would be between USD120 to 130 billion, superseding the 2016 figures.**

This makes the recent introduction of the ASEAN Green Bond Standards (ASEAN GBS) timely. Issued by the ASEAN Capital Markets Forum (ACMF), the ASEAN GBS will help the countries involved implement their commitments under the Paris Agreement and the SDGs, and also push for a standardized set of rules for green bonds across ASEAN member countries. Up to this point, ASEAN countries have either their own green bond standards to follow, or no green bond standards at all.

The ASEAN GBS thus intend to enhance the transparency for issuers of green bonds, reduce due diligence costs, and help investors make informed decisions. It also provides guidance to market participants on the use and management of proceeds, processes for project evaluation and selection, and reporting.

The key additional features of the ASEAN GBS are as follows:

1. **Eligible issuers** – The issuer or issuance of the green bond must have a geographical or economic connection to the region.
2. **Ineligible projects** – Fossil fuel power generation projects are excluded to mitigate the ‘green washing’ of projects.
3. **Continuous accessibility to information** – Issuers are to disclose information on the use of proceeds, evaluation and selection of projects, and its management. This information will be publicly accessible from a website designated by the issuer throughout the tenure of the ASEAN GBS.
4. **Encourages frequent reporting** – Issuers are encouraged to provide more frequent periodic reporting in addition to annual reporting.
5. **External review** – In line with the Green Bond Principles by the International Capital Market Association, the appointment of an external reviewer is voluntary. Nonetheless, the external reviewer must have relevant expertise in the area of review. Their credentials and scope of review must also be made publicly accessible from a website designated by the issuer during the tenure of the ASEAN GBS.



**Green investments in ASEAN have huge potential.** ASEAN economies are expected to grow at 5.2 percent per year between 2016 and 2020, and therefore require infrastructure investments of approximately USD470 billion till 2020. The demand for green investment in ASEAN until the year 2030 stands at approximately USD3 trillion, driven by factors such as an increasing population in ASEAN (108 million more by 2035), consumption (40 percent increase in food demand in the region by 2050), growing environmental consciousness, and value-based (ethical) investors.

Given this meaningful milestone for ASEAN, the challenge now is to ensure a steady stream of green investment projects taking place within the region that adopt the ASEAN GBS.

It is encouraging to observe that the ASEAN GBS have been adopted. A corporation in Malaysia i.e. PNB Merdeka Ventures Sdn Bhd (a wholly-owned subsidiary of Permodalan Nasional Berhad) has pledged to adopt the ASEAN GBS – by raising RM2 billion (USD481.9 million) via a 15-year tenure-secured green *sukuk* – to fund an 83-storey office building. This building will form part of the Merdeka PNB118 Tower project within the Warisan Merdeka precinct in Kuala Lumpur. Upon completion, Merdeka PNB118 will be the third tallest building in the world, and the first building in Malaysia that will satisfy the triple green building platinum accreditations locally and internationally.

## Now in its early stages with more potential adopters in the horizon, the ASEAN GBS are set to be a catalyst for green investments in the region.

As a strong proponent of the green bond and Islamic *sukuk*, the World Bank is in support of this initiative. This can be seen through future collaboration of the World Bank Group Global Knowledge and Research Hub in Malaysia and the Treasury with the ACMF in leveraging our relevant experience and expertise as green bonds begin to grow in ASEAN.

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# Sustainable Development Goals and the Role of Islamic Finance

Abayomi Alawode

**Islamic finance has the potential to play a crucial role in supporting the implementation of the Sustainable Development Goals (SDGs).** In the face of significant financing needs for the SDGs, Islamic finance has untapped potential as a substantial and non-traditional source of financing for the SDGs.

**The growth of Islamic finance has been rapid at 10-12 percent annually over the past two decades.** By 2015, the industry had surpassed USD1.88 trillion in size. Islamic finance has emerged as an effective tool for financing development worldwide, including in non-Muslim countries, and may prove to be an important contributor towards realizing the SDGs.

The Third Annual Symposium on Islamic Finance was held in Kuala Lumpur in November 2017, co-organized by the World Bank Group, Islamic Development Bank, International Center for Education in Islamic Finance (INCEIF), and Guidance Financial Group, to explore the potential contributions that Islamic finance can make to achieving the SDGs.

**The goal of the Symposium was to provide a forum to bring together leading members of the academic, policymaking, private sector, and development communities to discuss new developments and exchange cutting-edge ideas on the rapidly-changing field of Islamic economics and finance.**



This conference was aimed at allowing participants to enhance their practical and professional understanding of this increasingly important field, and clarify the major issues that need to be bridged between conventional and Islamic economics and finance. The Symposium also discussed the roles that governments, Multilateral Development Banks (MDBs), and the private sector can play in using Islamic finance to realize the SDGs.



Dr. Mahmoud Mohieldin, Senior Vice President for the 2030 Development Agenda, was one of the keynote speakers for the event.

Photo: World Bank



### Three main lessons emerged from the Symposium:

**Innovations in the use of Islamic financial instruments can go a long way in supporting the SDGs.** Green *sukuk* (Islamic bonds) is one such instrument, paving the way towards more climate-friendly investments. Other notable instruments include the use of Islamic endowment funds for long-term investments, leveraging Islamic Financial Technology (FinTech) and *waqf* (Islamic endowment funds) to provide alternative financing for micro, small, and medium enterprises, as well as the possible use of output-sharing *sukuk* for financing solar energy.

Malaysia has demonstrated leadership in establishing the enabling environment for Islamic socially responsible investing (SRI) and green finance. Over the years, the country has introduced several initiatives in sustainable finance to support the green agenda. In 2014, the Securities Commission formulated Malaysia's SRI Sukuk Framework, under which Malaysia issued its first green *sukuk* in 2017. Other steps to encourage the financing of sustainable and responsible investments include Bursa Malaysia's Sustainability Reporting Framework, and the environmental, social and governance (ESG) index, FTSE4Good. Today, Malaysia is the largest market for sustainable investing in Asia (excluding Japan).

**In order for Islamic finance to fulfil its potential and provide effective support to the SDGs, there is a need to establish an enabling environment.**

At the country level, regulatory and supervisory frameworks should be strengthened, legal underpinnings of Islamic financing instruments need to be more robust, and instruments for liquidity management need to be developed. At the global level, the standardization of contracts and *shari'ah* (Islamic law) rulings is critical, in addition to promoting the adoption of international standards issued by bodies such as the Islamic Financial Services Board (IFSB), and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

**There is substantial potential in deploying Islamic finance instruments to promote inclusive growth, reduce inequality, and accelerate poverty reduction.** Therefore, the World Bank Group is working to support client countries to strengthen the legal, regulatory, and institutional foundations of Islamic finance to gear it towards playing an expanded role in global development. Initiatives are also under way to foster the use of Islamic financing instruments in addressing specific developmental challenges, such as infrastructure provision, and financing for SMEs.

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# Women on Boards in Malaysia

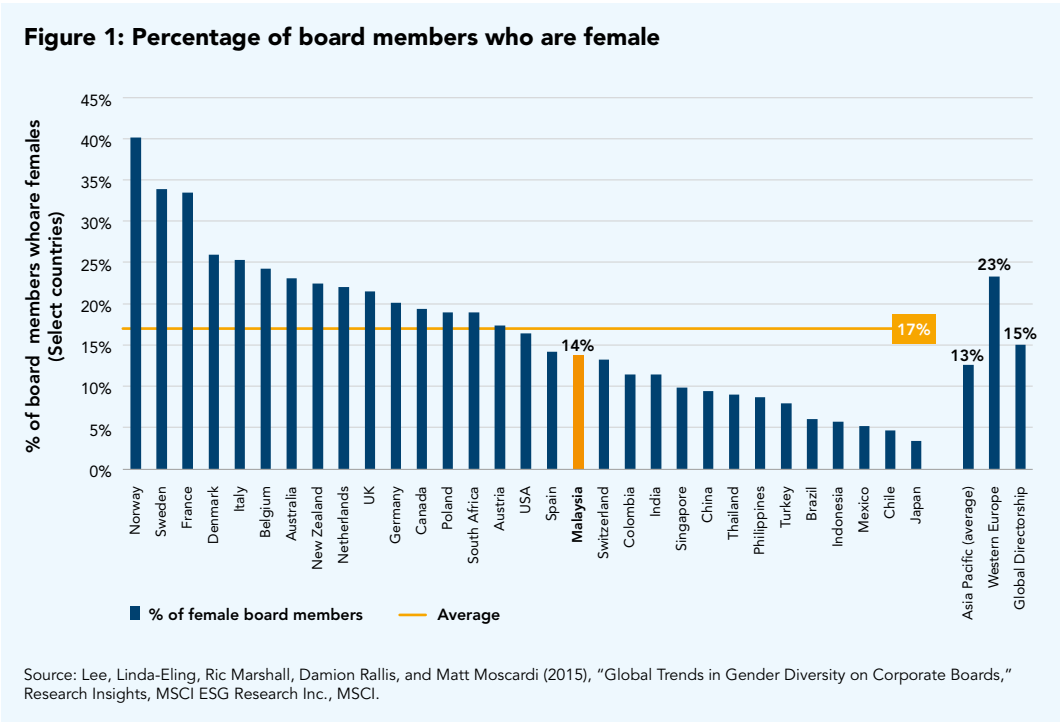
Mohammad Amin and Mei Ling Tan

**Using firm-level data for 806 public-listed companies in Malaysia, we highlight the extent of women's participation as board members in Malaysia benchmarked against other countries.** How this women's participation varies by industry and firm-size is considered, along with its potential impact on the company's performance. About 13 percent of the board positions in Malaysia filled by women and the rest by men in 2017. Moreover, the trend over the last four years reveals a slow pace of increase in the proportion of women board members. The largest 100 firms and some industries such as finance show a greater tendency to have female vs. male board members. The profit rate is significantly positively correlated with proportionately more female board members in a firm, suggesting a "business case" for more women on the boards.

Recent studies show that despite improvements in labor market participation, women tend to be concentrated in low-paying and vulnerable jobs around the globe, and are less likely to be found in dynamic and high-paying positions such as CEOs and board members of companies (World Bank 2011)<sup>1</sup>. This tends to exacerbate gender disparities in incomes and empowerment. This note focuses on the presence of women on the boards (WOB) of 806<sup>2</sup> public-listed firms in Malaysia in 2017, and the impact on firm performance.

A typical Malaysian firm has over 13 percent board members who are female.

In 2017, there are 5,845 board positions, of which 789 or about 13.5 percent were filled by females. The figure has increased only marginally from 10.5 percent in 2014. Similarly, the firm-level average of the proportion of board positions occupied by females is low, equaling 13.3 percent in 2017, marginally up from 10.3 percent in 2014. Malaysia’s performance in terms of board positions in the country filled by females seems below average by international standards. For comparable data for large companies in the MSCI World index, Figure 1 shows that 13.8 percent of the board positions in Malaysia are filled by females. As the figure reveals, this is just below the global average of 15 percent, and much lower than the level in many developed countries such as Norway, Sweden, France etc.

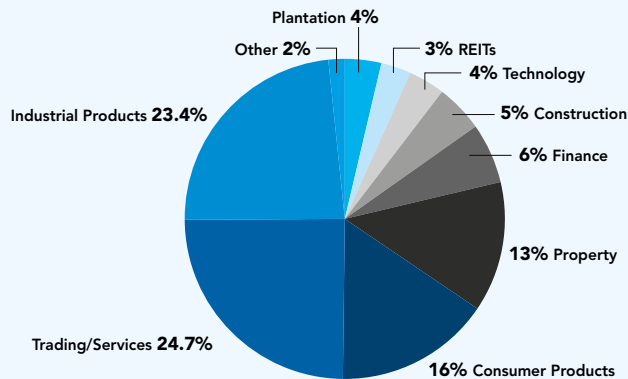


<sup>1</sup> World Bank. 2011. World Development Report 2012: Gender Equality and Development. Washington, DC: World Bank.  
<sup>2</sup> For 2017, there are 806 companies which have most of the variables available for data analysis.

**Relative to other industries, the finance industry stands out for its high proportion of female board members, and the plantation industry for its low proportion.**

There is substantial work on occupational and sectoral segregation of female and male workers. However, not much is known about board members in this regard. Figure 2 shows the distribution of female board members in Malaysia by industry. Trading/services, followed by industrial products, consumer products, and the property industry, account for the largest number of female board members in Malaysia. Of course, this distribution could reflect industry size or tendency to have more females vs. males as board members. Figure 3 shows that there is some difference in the tendency to have females vs. males as board members, with the finance industry leading with about 21 percent of all board positions filled by females in a typical firm; the plantation industry is at the other extreme.

**Figure 2a: Proportion of Female Board positions by Sector**

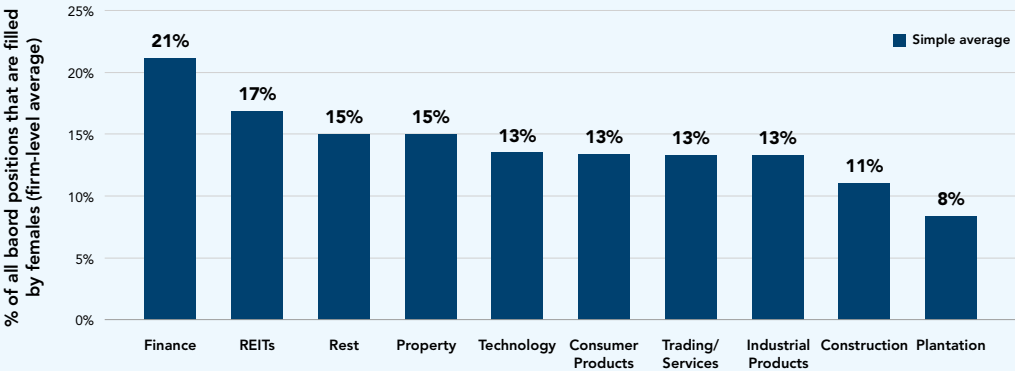


Source: Authors' own calculations using BURSA data.

**Figure 2b: Number and Distribution of Companies by Sector**

	Total Number of Companies	% of Total Number of Companies
Industrial Products	213	26.4
Trading/Services	189	23.4
Consumer Products	124	15.4
Property	98	12.2
Construction	48	6.0
Plantation	42	5.2
Finance	31	3.8
Technology	30	3.7
REITS	18	2.2
Rest	13	1.6
<b>Total</b>	<b>806</b>	<b>100.0</b>

Figure 3: Proportion of board positions occupied by females (firm-level average)

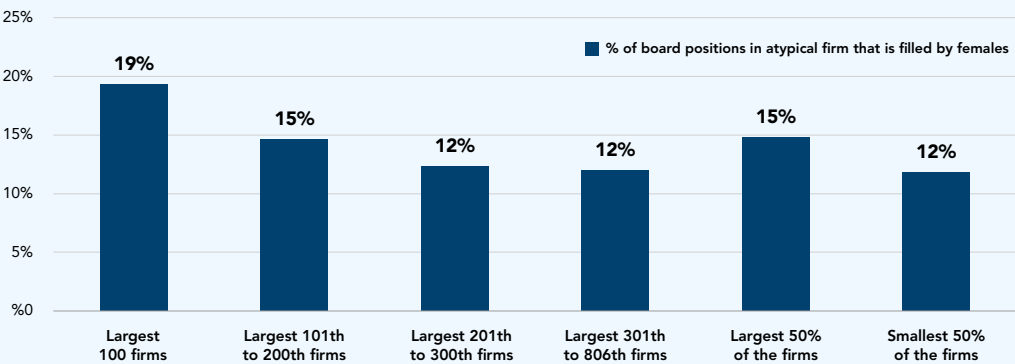


Source: Authors' own calculations using BURSA data.

Large firms in Malaysia tend to have proportionately more female board members than the small firms.

Using market capitalization as a measure of the size of the firm, two results stand out here. First, there is a heavier contribution of large firms in the number of board positions filled by females, but small firms also play a significant role. For instance, the largest 50 percent of the firms provide about 60 percent of all board positions filled by females, while the smallest 50 percent of the firms provide about 40 percent of all board positions filled by females. Second, there is a greater tendency to have females vs. males as board members among large firms, but this tendency is restricted to the largest 100 firms (Figure 4). For a typical firm among the largest 100 firms, about 19 percent of board positions on average are filled by females and the rest by males. This percentage drops to 15 percent for the next 100 largest firms, and 12 percent for the remaining firms.

Figure 4: % of Board positions in a firm filled by females (firm-level average)



Source: Authors' own calculations using BURSA data.



## The profit rate is significantly positively correlated with the presence of females as board members.

Two performance measures are available in the data. First, annual growth rate of sales (compounded) between 2014 and 2017. Second, total profits of the firm as a percentage of total annual sales in 2017 (profit rate). For firms with at least one female board member (in 2014), annual sales grew at the rate of 2.2 percent per annum (median growth rate), compared with only 1.7 percent per annum for firms with all-male board members. However, this result should be treated with due caution, since the difference here is not statistically significant at the conventional levels, and is largely driven by the finance industry.

The profit rate shows a relatively more consistent and discernible positive relationship with the presence of female board members in a firm (Table 1). In 2017, the profit rate for a typical firm with at least one female board member equals 6.5 percent vs. only 4.1 percent for a typical firm with all-male board members. The gap of 2.4 percentage points here is statistically significant; it is economically large given that the average profit rate among all firms is 5.3 percent. Unlike the annual growth rate, the difference in the profit rate discussed, and its statistical significance, is not driven by any single industry. However, it is less robust with respect to firm-size and is largely driven by the top 300 largest firms. For firms smaller than the top 300, there is no difference in the profit rate between firms with no female board member vs. firms with at least one board member (Table 1).

**Table 1a: Total profits as % of annual sales (firm-level average)**

**Table 1b: Number of Companies**

Category	At Least 1 Female Board Member Present	No Female Board Member Present	Number of Companies with No Female Board Member Present	Total Number of Companies
All firms	6.5%	4.1%	291	806
Largest 300	12.5%	7.8%	78	300
Smaller than largest 300 firms	2.7%	2.8%	209	498
Construction	7.9%	3.8%	22	48
Consumer Products	5.1%	4.2%	53	124
Finance	19.2%	27.2%	5	31
Industrial Products	4.2%	3.2%	85	213
Plantation	7.7%	9.6%	22	42
Property	13.0%	7.9%	33	98
Rest	9.4%	365.5%	3	13
REITS	56.3%	55.6%	4	18
Technology	9.3%	2.7%	7	30
Trading/Services	4.8%	1.7%	57	189

Source: Author's own calculations using BURSA data. Profit rates are median values. Total numbers of companies is based on available data as some categories have missing variables.

## Conclusion

Using data on 806 publicly-listed Malaysian companies, this note highlights the extent of women's participation as board members in Malaysia benchmarked against other countries. The results show that while almost two-thirds of the firms have a female board member, only 13-14 percent of all board positions in the country or in a typical firm are filled by females. Further, the rate of increase in the proportion of board positions filled by females in a typical Malaysian firm has been as low as 1 percentage point per annum over the last four years for which data is available. As found in other countries, larger firms in Malaysia tend to have proportionately more females than males as board members. There is variation by industry, with the proportion of all board positions in a firm filled by females being much higher in the finance industry, and much lower in the plantation industry. Firm-performance measured by the profit rate is statistically significantly positively correlated with the presence of female board members, as opposed to their complete absence.

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This article is based on a more detailed Enterprise Note to be published by the Enterprise Analysis Unit of the World Bank Group

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