

**SPECIAL ADDRESS
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*SCALING THE EFFICIENCY FRONTIER :
A PERSPECTIVE ON MALAYSIA*

Bismillahi Rahmani Rahim

Assalamualaikum Warahmatullahi Wabarakatuh

Distinguished guests, ladies and gentlemen.

1. It is a great pleasure for me to deliver this address at the Khazanah Megatrends Forum. Over the years, this forum has become a leading platform in Malaysia for intellectual discourse on issues impacting both governments and businesses. I am pleased to note the consistently high calibre and diversity of the speakers and I trust that the discussions taking place over the next two days will be as robust and thought-provoking as ever.

2. The selection of “Scaling the Efficiency Frontier” as the theme of this forum is both excellent and profound. It illuminates one of the

challenges central to the mandate of modern-day businesses and policymakers, which is to consistently deliver growth in an age of intensifying competition.

3. Furthermore, such growth must be achieved as decision-makers contend with not only finite but *depleting* resources, as forces of globalisation drive the migration of financial and human capital across borders. Hence, to scale the efficiency frontier, it is vital for an economy to first arrest this depletion by addressing the host of “push” and “pull” factors driving the exodus of such internationally-mobile resources.

4. This illustrates one of the many challenges we face in our everyday pursuits, and I do not profess to have the solutions. Instead, I would like to take some time this morning to offer a few observations on recent global developments, and also identify three distinct paradigms which – in my view – must be altered for us to transition to a truly sustainable growth trajectory.

The pursuit of sustainable and inclusive development

5. Today, we stand on the brink of an era proclaimed by many to be the *Asian century*. Over the next few decades, many fast-growing Asian economies are anticipated to achieve convergence with much of the developed world, and with it, garner greater global influence and higher living standards for its citizens.

6. Indeed, their performance over the last decade lends credence to such optimism, with the gross domestic product of emerging Asian economies growing more than twice as fast as world GDP.¹

7. Having established this, what then shall be Malaysia's place in this new world order – *whither are we bound?*

8. In the 57 years since Independence, the nation has developed into a modern and diversified upper middle-income economy, whose expansion was supported by a sophisticated and resilient

¹ IMF World Economic Outlook database April 2014; cumulative annual growth rate (CAGR) calculated using nominal GDP in US dollars for 2004-2013

financial sector. This is certainly a very impressive achievement, and a testament to the contributions of all Malaysians who have each played a role in their own individual way.

9. However, to build upon this progress, we cannot rely on the same thinking that has brought us here. As the world around us changes, so too must we re-orientate our developmental philosophy to the eventualities which lay ahead – lest we become what Harold Wilson, former Prime Minister of Great Britain, referred to as “architects of decay” in a speech to the Consultative Assembly of the Council of Europe².

10. As we move forward, I believe that it is important for this country to continue to be a home for all. As the rising tide of the Asian century lifts our collective fortunes, such fruits of prosperity should be equitably shared. This means that access to opportunities must be made more *inclusive* by transcending socioeconomic barriers, particularly the chasm of poverty. At the same time, growth must also be *sustainable* across generations and be able to support

² Harold Wilson (1967) “*He who rejects change is the architect of decay. The only human institution which rejects progress is the cemetery.*” in a speech to the Consultative Assembly of the Council of Europe, Strasbourg, France

an optimal quality of life for those living within this economic ecosystem.

11. Therefore, the ethos of inclusiveness and sustainability should form the lynchpin of our economic philosophy in the years to come. At the same time, Malaysia must be equipped with the innovative and institutional capabilities to capitalise on our own growing fortunes as well as that of the region, which would pose both a source of opportunities and competitive challenges.

Global challenges: lessons for Malaysia

12. Given that we stand at a critical juncture, not only in the history of Malaysia but also for the global economy, our actions – or even inaction – over the upcoming decade will be a crucial determinant of the long-term success of this country. Seizing the impetus for change is therefore of utmost importance.

13. While I strongly believe that Malaysia has the fortitude to fulfil its long-term developmental goals, just as no man is an island, so is no country a complete autarky. Hence, it would serve us well to be mindful of certain developments taking place across the globe,

which may be of concern to us as well as other countries within this region. Allow me to now share a few of my observations regarding these common challenges.

14. First: notwithstanding various causes for optimism, I must counsel against premature jubilation, for the *anticipated convergence between advanced and emerging economies remains neither inevitable nor preordained*. While the global expansion of supply chain-oriented trade and high commodity prices have contributed towards the rapid expansion of emerging economies, particularly over the previous decade, there are indications that the impact of such growth drivers may have begun to diminish.³

15. While it was previously estimated that emerging economies would be able to “catch up” with their more developed counterparts within a generation, should this dampening persist, the convergence process would require more than a century.⁴ Hence, this development should provide emerging economies with a greater sense of urgency to pursue innovation as an alternative, yet more sustainable driver of growth.

³ The Economist (2014) *The headwinds return* <http://www.economist.com/news/briefing/21616891-ten-years-ago-developing-economies-were-catching-up-developed-ones-remarkably-quickly-it>

⁴ See previous

16. My second observation concerns the apparent divergence between the absolute size of emerging economies and how *at the individual level, average incomes and living standards continue to be well below those in advanced economies*. For example, it would be illustrative to consider that per capita GDP in China is one-fifth that of the United States, while the corresponding figure for Malaysia is one-third.⁵

17. This suggests that while several emerging economies now rank among the largest in the world, given the sheer size of their population – with China and India alone accounting for more than one-third of global population – they also require significantly more growth to experience similar living standards as the developed world. If socio-political pressures lead to the adoption of unsustainable developmental models that generate incremental growth at the expense of increasingly higher systemic risks, we would do well to be wary of potential avenues for contagion.

18. To gain a deeper understanding of the dynamics of wealth and income, it is also essential to look beyond averages and closely examine international and intra-economy distributional patterns.

⁵ IMF World Economic Outlook database April 2014; PPP-adjusted per capita GDP

This brings me to my third observation of *widening inequalities in both advanced and emerging economies* which may potentially exacerbate existing socioeconomic fissures.

19. While income and wealth concentration is but one of many factors affecting standards of living, it is particularly powerful as it is linked to other determinants, including access to opportunities in spheres as diverse as education, employment and commerce. Inter-generational mobility, or the ability for offspring to succeed on the basis of their individual merits independently of their parents' socioeconomic status, is a valuable indicator of the “health” of a society. Indeed, it would not be far-fetched to regard social mobility as a critical incentive for innovation and entrepreneurship – both key elements for sustained growth.

20. In this regard, empirical studies have found evidence linking economic equality to higher social mobility, with relatively egalitarian countries such as Denmark, Norway and Finland displaying the greatest level of mobility.⁶ Conversely, more unequal countries are associated with lower social mobility and, arguably, a more sclerotic society.

⁶ Wilkinson and Pickett (2009) *The Spirit Level: Why Equality is Better for Everyone*

21. By inhibiting social mobility, widening inequality therefore has a tangible impact on economic dynamism, as it constraints the ability of an economy to optimally allocate its endowment of human capital to functions that it best serves. Hence, ensuring that growth is inclusive and equitable, thus indirectly facilitating greater social and labour mobility, is crucial for an economy to even reach its efficiency frontier – let alone surmount it.

22. In a world where 1% of the population accounts for almost half of global wealth, and where the poorest 50% owns as much as the 85 richest individuals, such polarisation also risks disenfranchising a significant segment of society, and – if taken to extremes – may even fragment the existing social order.

23. The German sociologist, Ulrich Beck, is deeply cognisant of such risks, having warned that “... conditions of inequality and historical injustice have given rise to a feeling of hate in the world – a deeply-felt hate that cannot easily be overcome with a few good words.” This is a situation that must not be allowed to come to pass in Malaysia.

Challenging existing paradigms

24. In my view, an appreciation of the socioeconomic dimensions of growth are of paramount importance as the success of a nation should be defined not by headline numbers, but rather by individual human outcomes and the well-being of all members of society.

25. By the same token, I posit that for the world to transition to a truly sustainable economic system, we must achieve a fundamental change in the worldviews that we hold, for these paradigms are instrumental in shaping our decisions and reactions to incentives.

26. The first worldview that I would like to address is the *paradigm of production*. In my observation, the modern-day economy has perfected the art of accounting for the value generated by the act of *production* – which is the transformation of resources into output. However, I believe that synonymising growth only with production provides an incomplete perspective, for it implicitly denotes that resources unused are resources idle or wasted, and inadvertently encourages over-production at the expense of sustainability.

27. In this regard, I would like to propose that the decision to *preserve* rather than produce is in itself a sign of progress. But what value do we as a society attach to preservation? How do we quantify the benefits from a crisis averted, be it in the economic or environmental sphere? I believe that our existing worldview is inadequate to account for the value of prudence and pre-emptive safeguards. As a result, at the individual or corporate level, many are tempted into dismissing these as merely a cost of compliance, rather than a source of value creation.

28. Closely related to this worldview is what I would like to call the *paradigm of maximisation*. At present, we appear to be governed by an incentive structure which engenders short-termism. By allocating rewards – and I use the term loosely – primarily on the basis of present performance, we are incentivising economic actors to maximise current output while implicitly penalising those who have calibrated their decisions for a longer horizon.

29. This is by no means a phenomenon unique to developing economies. In the United States, companies have accumulated vast reserves of cash yet this has not translated into higher investments into long-term capacity. Instead, such companies have spent more than half a trillion dollars over the past year on buying back their

own shares – a simple arithmetic tactic to boost earnings per share and executive remuneration – which is closely related to short-term share price performance.⁷

30. Rightly or wrongly, it appears that these executives believe that the long-term future of the company would have little bearing on their individual wealth, and therefore have little incentive to invest in it. I am certain that a similar analogy may also be extended to numerous other areas of our lives.

31. Such short-termism runs contrary to the spirit of sustainability, which aims to maximise not present gains but rather value generated over the long run. It is my belief, therefore, that we must move away from lionising the idea of maximisation and instead, embrace the ethos of *optimisation* – which recognises that for many decisions, there exists an optimal point beyond which expansion would be counter-productive and excessively risky. Optimisers, therefore, contribute towards sustained viability of the economic ecosystem and indeed, mimic the properties of evolutionary biology.

⁷ Edward Luce (2014) *The short-sighted US buyback boom*

32. In a world where the population is estimated to reach 11 billion by the end of the century, finding a sustainable pathway to development is no longer an option but a necessity. However, it is challenging to translate this rhetoric into action so long as we continue to be bound by the *paradigm of resource ownership*.

33. The introduction of private rights over resources inadvertently induces us to regard ourselves as the owners of resources at our command, and therefore dulls incentives to preserve them for future generations. Indeed, while conventional wisdom supposes that private rights will incentivise greater stewardship by ensuring that rights-holders pay for the costs of resource use, empirical studies demonstrate that non-rights owners display more conservative treatment of resources than those who have paid for private rights.⁸

34. Therefore, it is essential for this paradigm to be altered in favour of the worldview of individuals as *stewards*, rather than owners, of resources. Implicit in this view is the proposition that our right to derive profits from these resources are temporary and that it

⁸ Gilmour, Day and Dwyer (2012) *Using Private Rights to Manage Natural Resources: Is Stewardship Linked to Ownership?*

is our duty to ensure that they remain undiminished and uninjured for future generations.⁹

35. If we accept the notion that we are trustees, rather than ultimate controllers, over the resources in existence today, and that we owe an implicit duty for preservation and prudence, then the ethos of sustainability should be at the heart of our pursuit of growth.

36. The transitions in mindset that I have mentioned – from the paradigm of production to one of *preservation*; from the paradigm of maximisation to one of *optimisation*, and from the paradigm of resource ownership to one of *stewardship* – will be one of the greatest tests of our time. Indeed, successfully recalibrating our collective worldview may even take a generation – but it will be a cause which is worth fighting, and a cause which is worth winning.

37. Thank you for your attention and I wish you a very fruitful discussion over the next two days.

⁹ Mohd Sani Badron (2014) *Justice and circulation of one's wealth*

