

## Is Malaysia's Economic Growth Associated with the Creation and Expansion of the Middle Class in Malaysia?

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### Abstract

It has been argued in the development literature that a sizeable and stable middle class in the society is imperative to foster economic growth and democracy. The creation and expansion of the middle class will stimulate the demand for better quality consumer goods, induce investment, and hence increase and sustain economic growth. The middle-class is also regarded as an important foundation for the emergence and development of a strong democratic civil society, that will induce the demand not only for better public services, but also for a more effective, accountable and transparent government. Furthermore, a large and expanding middle class will also lessen polarisation between the poor and the rich, reduce social tension and conflict, and hence foster socio-political stability. In this regards, the objective of this paper is therefore to measure the size of the middle-class in Malaysia. Examining the size of the middle class seems plausible since Malaysia aspires to transform her economy not only towards a high income, inclusive, and sustainable economy, but also towards a matured democratic society. Besides, in the last four decades Malaysia has been generally successful in sustaining rapid economic growth. In this regards, the objective of this paper is to examine whether the rapid economic growth in the past decades is associated with the enlargement of the size of the middle class society in Malaysia. Towards this end, we measure the size of the middle class by the percentage of household whose income falls within the range of 25% below to 25% above the median household income. Here, in our analysis we employ data from the Household Expenditure Survey (HES). Our findings show that, quite surprisingly, the middle class in Malaysia is relatively small, constituting only about 30% of the total households, and it is declining, albeit marginally. We conclude that, the middle class is relatively small and it seems that the rapid economic growth is not coupled with the enlargement of the middle class society in Malaysia.

**Keywords:** economic growth, middle class, size of middle class, Malaysia

### 1. Introduction

It has been argued in the development literature that a sizeable and stable middle class in the society is imperative to foster economic growth and democracy. The creation and expansion of the middle class will stimulate the demand for better quality consumer goods, induce investment, and hence increase and sustain economic growth (Murphy, Shleifer, and Vishny, 1989). Easterly (2001) argued that a higher share of income for the middle class is associated with higher growth, more education, better health and less political instability in the society, while Ozbudun (2005) argued that the middle-class is important for the emergence and consolidation of a solid democratic civil society. The decline of the middle class in the society on the other hand could pose a threat to economic growth and socio-political stability, i.e. a small or weaker middle class in the society could result in a higher probability of social conflict (Esteban and Ray, 1999). Furthermore, the middle-class is also perceived to play a major role in the socio-political stability of a country (Embong, 1999a, 1999b). Therefore, it appears that the enlargement of the middle-class is not only important for rapid growth and transformation of the economy, but also will lessen polarisation between the poor and the rich, reduce social tension and conflict, and hence foster socio-political stability. Indeed, the middle-class is also regarded important as the foundation for the emergence and development of a strong democratic civil society, which will induce the demand not only for better public services, but also for a more effective, accountable and transparent government.

In this regards, it is not surprising to find that the desire to create and expand the middle-class in the Malaysian society becomes one of the underlying aspirations of Malaysia's development policies. Indeed, this aspiration or desire could be traced back to the New Economic Policy (NEP), which was introduced in 1971.

Tun Abdul Razak, the Prime Minister during which the NEP was launched, has stated on the desire to create "a society with a middle class, like in Switzerland, Holland and Japan", i.e. referring to the creation of a (Malay) middle-class society (Torii, 1997, pp. 225-226; Milne, 1976, p. 259). The Vision 2020, the New Economic Model (NEM) and the 11th Malaysia Plan 2015-2020 are also articulated with a similar aspiration. In the 11th Malaysia Plan 2015-2020, enlarging the middle-class society is given attention through various strategies that are designed to uplift the income of the bottom 40 group, one of which is through the improvement in their skills and knowledge which will enable them to secure high-pay jobs.

Since its Independence in 1957, Malaysia has been very fortunate to experience quite an impressive economic growth. Despite facing many business cycles and economic downturns, Malaysia seemed to be able to sustain her economic growth quite incredibly. The average real GDP growth rate of Malaysia was 5.2% in the 1960s, 7.5% in the 1970s, 5.8% in the 1980s and 7.1% in the 1990s. In fact, Malaysia has been able to sustain her annual economic growth of more than 8% for almost 10 years, i.e. from 1986 up to before the Asian financial crisis which commenced in September 1997. Since the year 2000, Malaysia has recorded an average growth rate of more than 5%. Along with this rapid economic growth, the structure of the Malaysian economy has been transformed from an agriculture-resource-based economy to an industrial-based economy (Department of Statistics, Bank Negara Malaysia and Economic Planning Unit).

Given the impressive growth and development of the Malaysian economy in the past few decades, the question examined in this paper is whether it can be translated into the creation and expansion of the middle class in Malaysia, in line with Tun Abdul Razak's intention. This question appears important since the expansion of the middle-class seems to have important bearing on future growth and development in Malaysia – economically and politically. Besides, examining the size of the middle class seems plausible since in the New Economic Model launched in Malaysia aspires to transform her economy into the one with high income, inclusive and sustainable growth (NEAC, 2010). Against this backdrop, this paper seeks to measure the magnitude of the middle-class in Malaysia. Since the middle class is usually thought to constitute a large bulk of the population, say, 40%, it is therefore quite sensible to expect that its magnitude would not only be more than 40%, but it is also growing.

## **2. Malaysia's Economic Growth and Development Performance**

As a developing country, Malaysia's economic growth is quite impressive. Despite facing many business cycles and economic downturns, Malaysia has shown her ability to sustain economic growth quite incredibly. Figure 1 shows Malaysia's economic growth during the period 1961-2015. In the 1960s, Malaysia recorded an average growth rate of 5.2%; the figure rose to 7.5% in the 1970s. In the 1980s, Malaysia's economy recorded an average growth rate of 5.8%, despite experiencing economic recession in 1985/1986 due to the lower commodity prices. In the 1990s, Malaysia managed to record an average growth rate of 7.1%, despite being hit hard by the Asian financial crisis in 1997. Since the year 2000, Malaysia has recorded an average growth rate of more than 5%. Along with the rapid economic growth, the structure of the Malaysian economy has also been transformed from a commodity-based into an industrial-based economy. For instance, between 1970 and 2015, the contribution of agriculture to GDP declined from 29.0% to 8.8%, while the contribution of the manufacturing and services sector increased from 13.9% to 23% and 36.2% to 53.8%, respectively. Furthermore, the rapid growth of the Malaysian economy has been accompanied by relatively low inflation and unemployment rates (Malaysia Five Year Plans, Bank Negara Malaysia). The rapid growth of the economy has been reflected in rising per capita income. The Real Gross Domestic Product (GDP) per capita was RM1087 in 1970, but increased significantly to RM6578 in 1990 and further to RM15196 in 2000. In 2014, the GDP per capita was estimated about RM36165 (Department of Statistics).

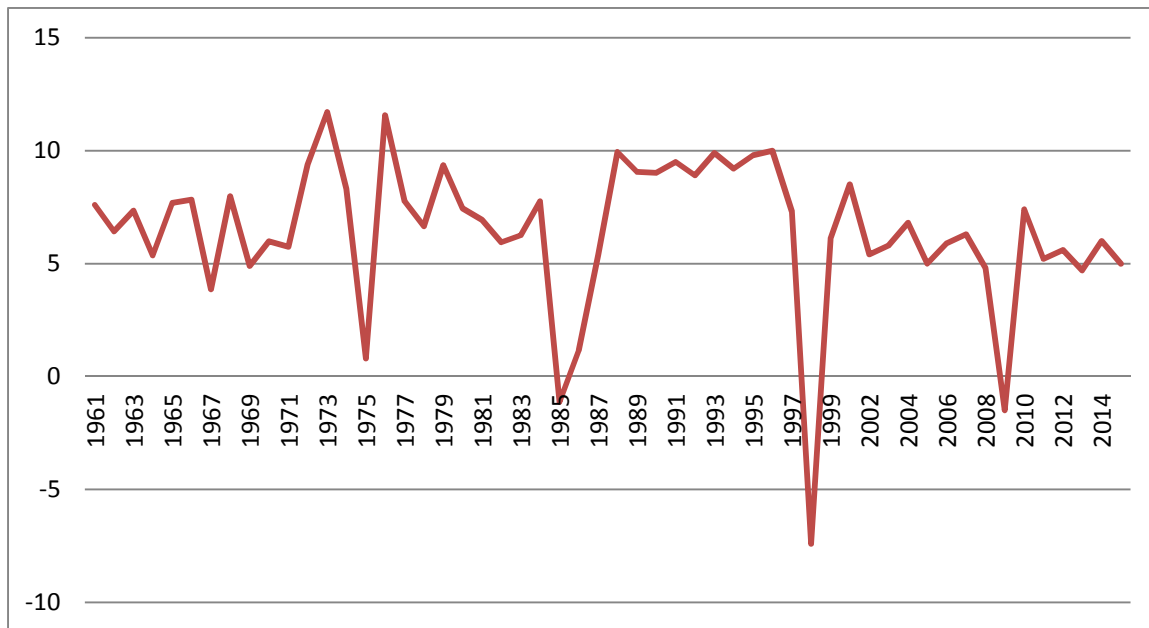


Figure 1: Malaysia: Real GDP Growth Rate

Source: (i) Bank Negara Malaysia (1994, 1999, 2002, 2007, 2015)

What is more interesting is the fact that the rapid economic growth has been accompanied by a reduction in poverty. Figure 2 shows the trend of overall poverty incidence in Malaysia. It is clear that poverty incidence in Malaysia had significantly reduced from 52.4% in 1970 to 17.1% in 1990, and continued to reduce further to 0.6% in 2014. Thus, it is worthy to note that the outstanding economic growth achieved in the past decades has enabled Malaysia to significantly reduce the incidence of poverty.

Besides, the rising income and reduction in poverty has also been reflected in the rising quality of life of Malaysians as reflected in the trend of well-being index. The Malaysian well-being index, which is a comprehensive measure of welfare and human being, includes not only the economic but other aspects of life as well such as working life, family life, transport and communications, health, education and public safety. Figure 3 shows that between the years 2000 to 2014, the economic well-being and the composite well-being indices are on an increasing trend. This implies that Malaysian in general is experiencing improvement in their quality of life.

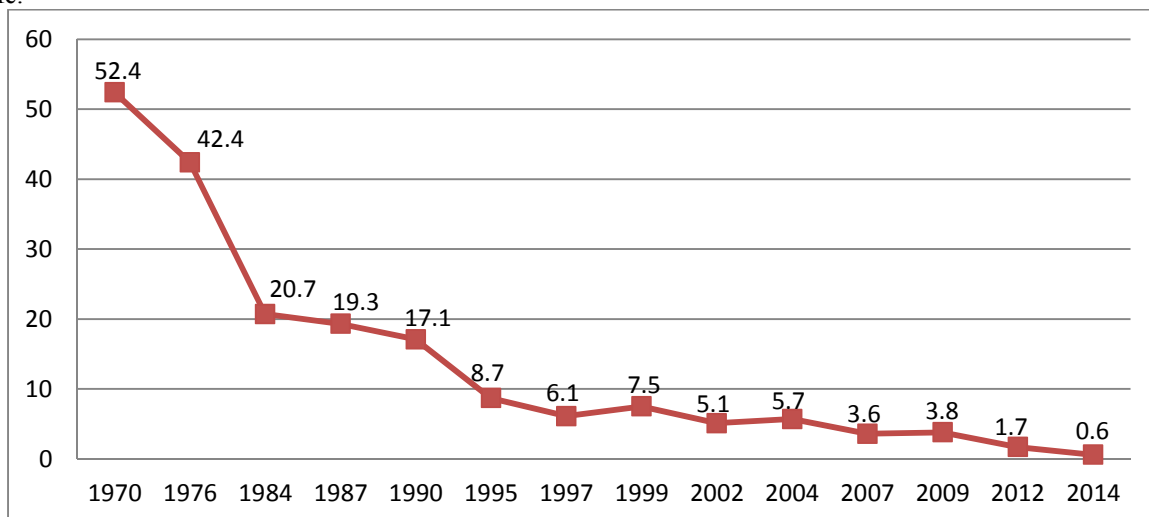


Figure 2: Malaysia: Poverty Rate (%), 1970 - 2014

Source: Economic Planning Unit (EPU), (<http://www.epu.gov.my/household-income-poverty>)

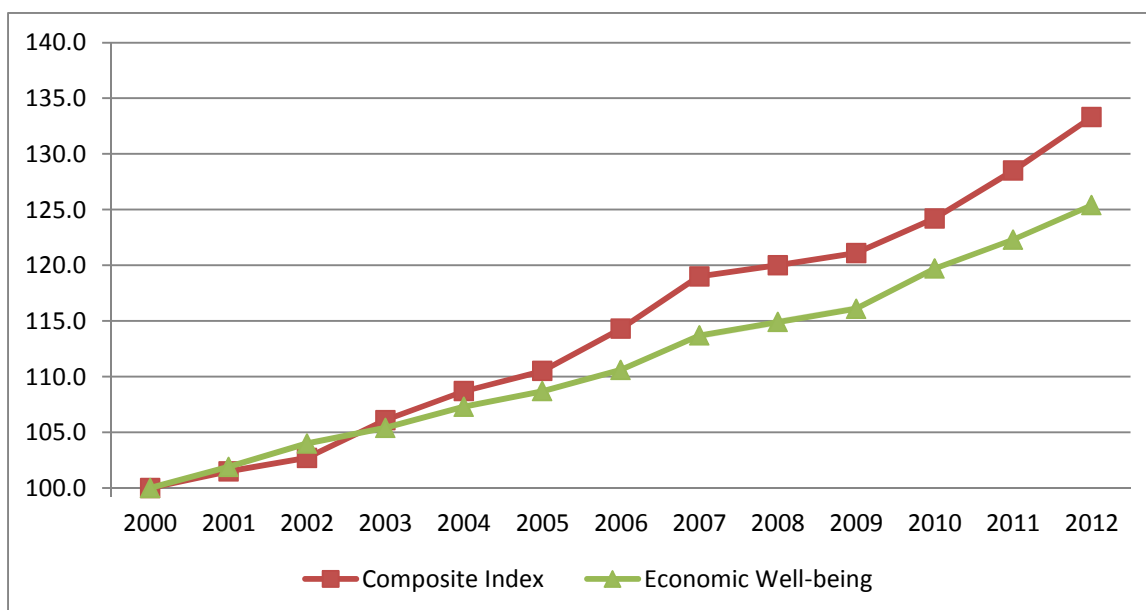


Figure 3: Malaysia: Economic and Composite Well-Being Index, 2000 - 2014

Source: Economic Planning Unit (EPU), (<http://www.epu.gov.my/en/social-indicators>)

The improvement in the quality of life of Malaysian as indicated above could also be confirmed by looking at the Human Development Index (HDI) produced by the United Nation Development Programme (UNDP). Basically Malaysia has shown a good record in terms of HDI and Malaysia has been categorised as ‘high human development’ in terms of her performance with regards to human development. Figure 4 reveals that Malaysia has recorded an improvement in human development, where the HDI has continuously increased from 0.569 in 1980 to 0.779 in 2014. In 2014, Malaysia was ranked 62 out of 188 countries (UNDP, 2014).

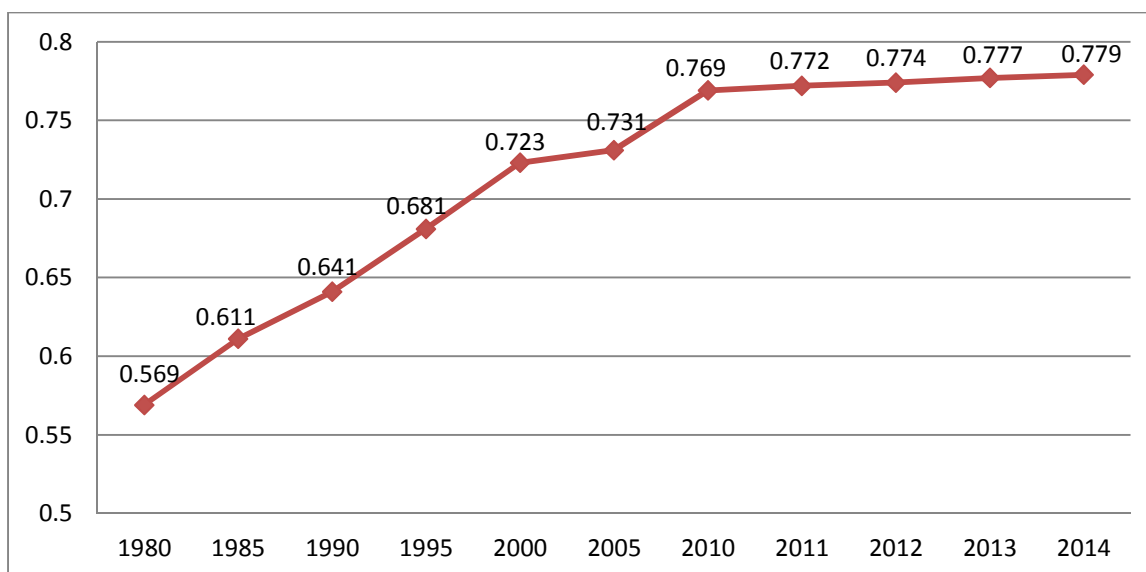


Figure 4: Malaysia: HDI 1980 -2014

Source: UNDP Human Development Report 2015

Thus, the record on growth as well as indices of development performance of Malaysia has shown that in the past decades growth and development in Malaysia has been quite impressive. In this context, the question asked in this paper is whether this remarkable growth and development has been translated into the creation and expansion of the middle class society in Malaysia. As mentioned earlier, the creation and expansion of the middle-class in Malaysia is not only important for rapid industrialisation and transformation of the economy towards achieving a sustainable high-income economy, but the middle-class is also perceived to play a major role in future socio-political stability of a country.

### 3. Method and Data

#### 3.1 Defining and measuring the middle-class

Segregating the middle-class from the rest of the society is quite problematic. Who is really the middle-class? Are they being defined or categorised for instance in terms of their material wealth possession (e.g. income or consumption), by their occupation types or by their held values (e.g. style of living or political views)? Which of these factors is more appropriate to define the middle-class? It seems that it depends on who and which perspectives one is looking at it – economic, sociological or political perspectives. As it is quite problematic to figure out clearly who the middle-class is in the society, naturally it is also quite difficult technically to segregate the middle-class from the rest of the society. Consequently, there is no one measure that will fully capture the concept of middle-class.

In our analysis, the economic factor, i.e. income, is treated as the main factor in defining the middle-class. Thus, we define the middle-class as those households who are categorised as the middle-income group. While defining middle-class in this manner might not be entirely satisfactory, nonetheless we consider this is sufficient for our purpose at hand. Nonetheless, the problem persists: how do we segregate the middle-class based on their income? Fortunately, there are already various ways suggested in the literature to categorise the middle-class based on their income (Ravallion, 2010). For instance, we could divide the total number of households into quintiles. We then simply assume that the middle income group contains those whose income falls between the second, third and fourth quintiles. We may also define middle-class by dividing the total number of households into the top 20%, middle 40% and bottom 40%. However, defining middle-class in this way implies that the size of the middle-class is already fixed, i.e. 60% or 40% of the society.

Another way of categorising the middle-class is to define it by absolute income threshold. For instance, some researchers used income USD2 – USD4 per day as categorising the middle-class, since less than USD2 per day is considered poor. In Malaysia, the Bank Negara Malaysia defines the middle-income group as those who have income threshold between RM2000 (USD667) and RM4000 (USD1333) (Bank Negara Annual Report 2008). Alternatively, we can also measure the middle-class using a relative approach. For instance, Easterly (2001) defines the “middle class” as those lying between the 20th and 80th percentile on the income distribution. Meanwhile, Birdsall, Graham and Pettinato (2000) define the middle class as those whose income is between 75 and 125 percent of median per capita income. Quite a similar definition is suggested by Lester Thurow (1984), where he defines the middle-class by calculating the median income of the society and regards those households with income 25% below and above of the median income as the middle-class. In this study, as we are interested in looking at the changes in the magnitude of the middle-class, we employ the definitions of the middle-class as defined by Thurow (1984) and Birdsall, Graham and Pettinato (2000), i.e. +/- 25% of median income.

#### 3.2 Data Description

In measuring the size, trend, and pattern of the middle-class in Malaysia, we employ three sets of data published by the Department of Statistics, Malaysia. The data sets are obtained from three consecutive reports of the Household Expenditure Survey (HES): 1998/1999, 2004/2005, and 2009/2010. It should be noted that the sample size varies across the reports and the data are made available to the researchers for merely one-third of the sample size for each report. Consequently, the available sample size is 2,761 for HES report 1998/1999, 4,225 for HES report 2004/2005, and 6,495 for HES report 2009/2010. In each case, the household data are divided into three major categories: demographic characteristics, income, and expenditure. The data on household demographic characteristics include household size, number of income earners, number of children, number of dependants as well as household head's characteristics (such as age, gender, ethnicity, education, and occupation). The data on household income are divided into several types such as wage income, self-employed income, rental income, property income, etc. The data on household expenditure are divided into several categories such as food and non-alcoholic beverages, alcoholic beverages and tobacco, clothing and shoes; transportation; etc. In this paper, the investigation of the size, trend and pattern of the middle-class in Malaysia is based on the gross household income of the HES.

### 4. The Findings

In this study we are interested to explore the size of the middle-class in Malaysia. How large is the middle-class in Malaysia? Here, as being mentioned earlier, we measure the size of the middle class using the middle-class definitions by Thurow (1984) and Birdsall, Graham and Pettinato (2000), i.e. +/- 25% of the median income. We estimate the size of the middle-class for three periods: 1988/1999, 2004/2005 and 2009/2010.

Table 1 shows the median income for the respective three periods, 1988/1999, 2004/2005 and 2009/2010. It shows that the median income has risen from RM1852 in 1988/1999, to RM2120 in 2004/2005, and further to RM2762 in 2009/2010. Thus, the income range of the middle-class was RM1389 – RM2310 in 1998/1999, RM1591 – RM2650 in 2004/2005 and RM2072 – RM3453 in 2009/2010. It is interesting to note that the income range of the middle-class in 2009/2010 calculated from the HES data is within the range defined by

the Bank Negara Malaysia; i.e. RM2000 – RM4000.

Table 1. Total Household, Median Income, and Income Range of the Middle Class in 1998/1999, 2004/2005 and 2009/2010

	Total Household	Median Income (RM)	Income Range of the Middle Class (+/- 25% of Median)
HES 1998/1999	2761	1852	1389 - 2310
HES 2004/2005	4225	2120	1590 - 2650
HES 2009/2010	6495	2762	2072 - 3453

In terms of size, our finding reveals that, quite surprisingly, the middle class as a percentage of all households in the sample seems to be relatively small throughout the three periods. Specifically, the middle-class formed 27.5% of the total sample in 1998/1999, 26.4% in 2004/2005, and 25.9% in 2009/2010 (see Table 2). In addition, our findings also reveal another interesting observation; the size of the middle class seems to declining throughout 1988/1999, 2004/2005 and 2009/2010.

Table 2. The Size of the Middle Class - 1998/1999, 2004/2005 and 2009/2010

	Income Range (RM)	Number of Household	Percentage
HES 1998/1999	1389 - 2310	760	27.5
HES 2004/2005	1590 - 2650	1116	26.4
HES 2009/2010	2072 - 3453	1680	25.9

We further explore if there is a significant pattern of the size of the middle-class by strata, i.e. rural and urban. Our findings show that the size of the middle-class is more or less 26% in both the rural and urban areas, which appears to be relatively small (Table 3). Besides, its percentage is also found to be declining, albeit marginally, both in the rural and urban areas. We also further examine the size of the middle-class by ethnic group; i.e. the Malays, Chinese and Indians. Our finding reveals that the size of the middle-class is relatively small for all of them (Table 4). What is more interesting is that there seems to be no significant difference among them in terms of size. In addition, the figures also show that the size of the middle-class for each ethnic group is generally declining.

Table 3. The Size of the Middle Class by Strata - 1998/1999, 2004/2005 and 2009/2010

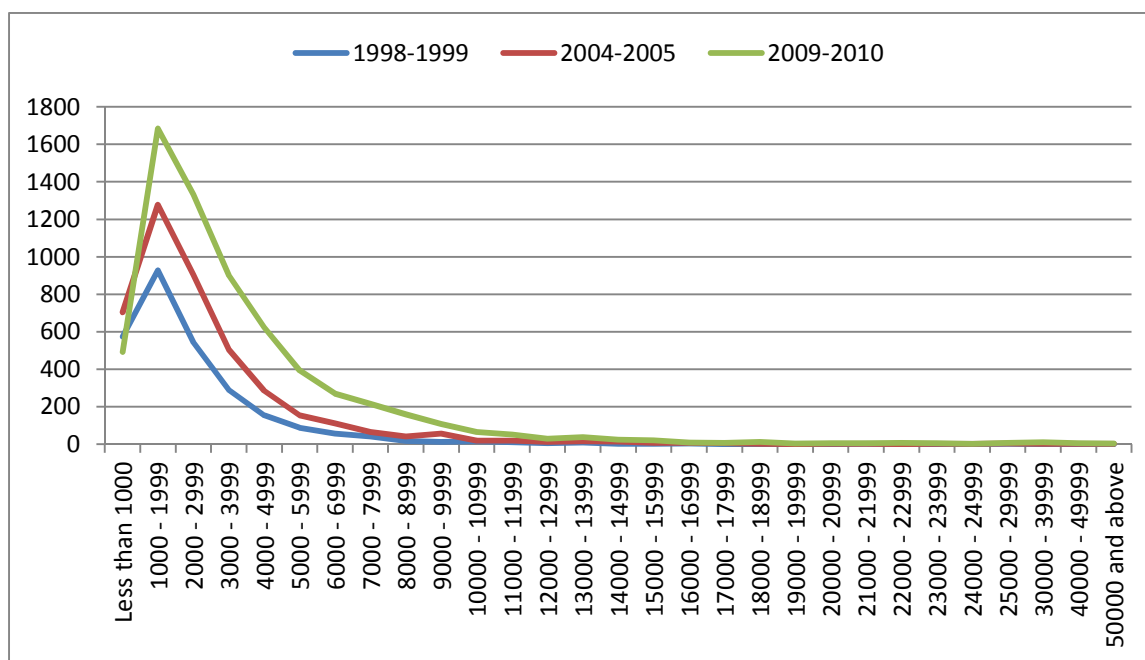
	RURAL		URBAN	
	Number of Household	Percentage	Number of Household	Percentage
HES 1998/1999	322	27.5	401	27.3
HES 2004/2005	373	26.9	743	26.2
HES 2009/2010	786	26.0	894	25.8

Table 4. The Size of the Middle Class by Ethnic Group - 1998/1999, 2004/2005 and 2009/2010

	MALAY		CHINESE		INDIAN	
	Number of Household	Percentage	Number of Household	Percentage	Number of Household	Percentage
HES 1998/1999	453	28.1	204	26.3	62	31.5
HES 2004/2005	777	26.2	256	26.2	71	29.6
HES 2009/2010	1106	26.5	385	25.2	103	26.8

What appears to be surprising and interesting in our findings is that the middle class in Malaysia is small than what it is generally assumed. In fact, our findings also show that the income range which defines the middle class is also quite narrow than it is commonly believed. It turns out that this peculiar finding could be explained by looking at the distribution of household income in the HES data.





Note: The horizontal axis displays the income range while the vertical axis displays the frequency of households belonging to the corresponding income range.

Figure 5: Distribution of household income 1998/99, 2004/2005 and 2009/2010

As shown in Figure 5, the distribution of household income is highly skewed to the lower income bracket, and this gives rise to the low median income and narrow income range of the middle class. Inasmuch as our findings might not really reflect the true picture of the size of the middle class in Malaysia, this study casts doubt on the appropriateness of the existing method employed and calls for the development of a new method of defining and measuring the middle class in Malaysia.

## 5. Conclusion

The expansion of the middle-class is one of the characteristics expected in the growth and development process of a country. The importance of the middle class lies with the fact that they are perceived to have strong values on family and country as well as portraying a relatively high degree of diligence. They are also perceived to have relatively high savings, and have the attributes of investing in education and health. Besides, the middle class is also argued to have the entrepreneurial spirits, and demand quality public goods and services that spur government reform. Furthermore, the middle-class also contributes towards the socio-political stability in the society. Hence, the middle-class is not only the outcome of development, but it is also viewed as a factor or an input of development. Thus, examining the size of the middle-class is important not only as indicator of the development success, but also as a factor that shapes future development.

With regards to Malaysia, the outstanding growth of the Malaysian economy in the past prompted the expectation that it must be associated with the creation and expansion of the middle class society. It is therefore quite reasonable to expect that the magnitude of the middle class in Malaysia would be larger than the normally referred 40% of the population. However, quite surprisingly, we discover that the middle-class society in Malaysia, measured as the group of households whose income is within the range of below and above 25% of the median income, is not only relatively small, but it is also marginally declining. A similar finding is observed for each of the rural and urban households, as well as for each of the major ethnic groups in Malaysia. Therefore, the findings of this study suggest that there seems to be no association between the rapid growth of the economy in the past with the creation and expansion of the middle-class society in Malaysia. In addition, our finding reveals that there are generally no differences in the magnitude of the middle class across ethnic groups. This finding therefore does not lend support to the common perception that there is an identification of ethnicity with the middle class in Malaysia.

With the benefit of hindsight, it should be noted that our results hinge on the specific definition of middle class which, in turn, depends on the shape of income distribution. That is, our definition of middle class is appropriate for a normally distributed income. Since our data on income distribution is highly skewed to the lower income group, the definition might not be appropriate to measure the size of the middle class since it is inherently small. Thus, future studies should explore a new method of defining the middle class for a skewed income distribution. One possible way is by redefining the reference income for the middle class group. Instead of using the median income, the lower bound income could be used as the reference income. The lower bound

income is the income level that segregates between the lower class and the middle class based on the distribution of income. Once this lower bound income has been identified, any households whose income are equal to that lower bound income or higher but are sufficiently close to it could be considered as the middle class. Perhaps this alternative method could capture a more proper measure of the middle class in a society characterised by a skewed income distribution.

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