Muhammad bin Ibrahim: New models and sources of prosperity in an uncertain world

Speech by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 31st Annual G30 International Banking Seminar "New Models and Sources of Prosperity in an Uncertain World", Washington DC (in conjunction with the IMF World Bank Annual Meetings), 9 October 2016.

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Over the last four days, the keywords from our conversations about the global economy have been "moderate", "lacklustre" and "uncertain".

Let me offer a slightly different perspective to this solemn outlook. I want to focus on the evolving role of technology and its importance to the modern economy. Technology has made connections become cheap and endless. Data has become priceless. Very soon, cars will be driverless. In many ways, the economy as we know it, has evolved significantly. With it, the rules of the game have changed. But on the upside, it brings opportunities as never before.

The question is, what can we do to realise the full potential of these new developments? What are the new growth models and sources of prosperity? I will hazard a guess.

The evolving global economy

One perspective of the modern global economy is that emerging economies are associated as producers of goods for consumption by advanced economies. In this model, the comparative advantage and consumer demands of advanced economies and emerging economies are distinct, and the flow of goods, one-directional. Extending such stereotypes; emerging markets save, while advanced economies borrow and consume. Let us term this as the 'old real economy'.

The model of the modern economy as we know has evolved from the "old real economy" model. While the focus still remains largely on the old economy of manufacturing and services, global dynamics have changed. If we continue to view the current economy through the lens of the "old real economy", we will be engrossed with traditional thinking, such as, whether jobs, particularly in the manufacturing sector are being created in advanced or emerging economies. We will be too preoccupied with the idea of off-shoring, on-shoring and movement of jobs.

In reality, shared global prosperity is not a zero-sum game. In my opinion, our current economic model could well serve us, if it is one that is underpinned by opportunity, complementarity and technology.

There are three reasons why I say this.

First, the rapid income and population growth in emerging markets have turned these economies into large and growing consumer markets. Second, the rising demand for technologically-intensive goods and services has re-ignited the growth potential for advanced economies, particularly, in the fields of advanced services and manufacturing. Third, the advent of technology has lowered barriers to entry significantly and narrowed the gap in comparative advantage between emerging and advanced economies.

What is apparent over time is that the conventional schisms between advanced and emerging economies have become blurred. The uni-directional flow of goods from manufacturing-intensive emerging economies to consumption-driven advanced economies, has now turned into a two-way exchange of goods and services.

In this regard, advanced economies are increasingly becoming global service providers, catering to the demands of emerging economies. Several authors have gone on to suggest that the advanced economies have perhaps become "emerging economies" when it comes to producing new economy products and services.

An economy re-defined

We are experiencing a technological revolution that has fundamentally altered the way we live, work and interact with one another. Allow me to share some perspectives on our new models and sources of prosperity. In the "new real economy", value creation will no longer just be generated by traditional growth drivers, such as manufacturing and banking services. Instead, the new economy is likely to be characterised by digital technological gains of unprecedented scale, scope and speed, possibly akin to the industrial revolution the world experienced 200 years ago.

The advancement of current technology such as big data, cloud computing, data analytics, artificial intelligence, advanced niche and customised services will re-define the landscape of our future. This is anticipated to accelerate the rise to high-value industries, ranging from advanced manufacturing to high-tech services, traditionally the forte of advanced economies. An integration of advanced manufacturing and services through the Internet of Things is currently the domain of advanced economies, accounting for all Top 20 companies in this field.

In the advanced supply chain manufacturing production for instance, the design resides mostly in advanced economies although some of the production facilities may be developed all over the world. But unlike in the old economy where the consumption of these high-end products predominantly lies in the advanced economies, the emerging economies are now vast markets for these products. As technological advancement continue to increase the affordability of high-end products, the expansion of consumer markets in emerging economies is further boosted by rising income and dynamism in these economies.

These industries are expected to accelerate innovation, re-ignite productivity growth and create more sophisticated demand due to their ability to support longer and more complicated supply chains as well as a wider consumer market. These are indeed positive prospects for both advanced and emerging market economies.

New rules for a "new real economy"

If economic history is any guide, a "new real economy" calls for a new operating landscape. Just as cyber security rules for floppy disks are no longer relevant, rules and regulations that were aptly designed for the "old economy" is bound to be irrelevant, or at worst, create perverse effects. Hence, policymakers may need to develop new systems of regulations (a Regtech for Fintech) that is flexible enough to adapt, and robust enough to manage the rapid technological advancements. With economic growth increasingly stemming from techno-preneurs and start-ups, productions and markets are becoming less and less homogenous.

In the past, when economic agents and activities - ranging from textile production to banking industry were clearly defined and more homogenous, we could rely on internationally-mandated metrics to assess compliance to a certain set of standards. Unfortunately, those approaches are fast reaching their limits of effectiveness. As such, regulations need to be localised, particularly taking into account an economy's specific needs and stage of readiness. For instance, while we universally share the importance of product safety, welfare of workers and consumer protection, the pace and types of regulation for Uber and AirBnB have been highly varied across countries.

Financial intermediation is a good example of how disruptive technologies are increasingly re-defining the financial landscape. A decade ago, a suggestion of peer-to-peer lending would be met with skepticism. Currently, Fintech companies are prominent competitors to our banks and have triggered the re-evaluation of our financial system. "Selfie pay" or Identity Check Mobile is going live in several European countries. In a sense, Fintech develops in response to changing consumer behaviour and needs, namely the preference for speed, convenience, safety, and even unanimity. Financial consumers demand and expect a different engagement model with financial institutions.

If the "old real economy" financial institutions could not provide that, technological firms with a singular focus on solving customer needs will and have created new models to meet the market demand. Given the imminent expansion of Fintech innovation, central banks all over the world have embarked on developing regulatory mechanism that balances the risks and opportunities posed by Fintech phenomenon. In fact, Bank Negara Malaysia is one of several central banks to introduce a regulatory sandbox to allow experimentation of genuinely innovative ideas while preserving consumer protection. It is clear that the rules have changed, and regulatory authorities are striving to cope with this new environment.

Strategies to unlock potential in "New Economy"

But there is an enigma, if our new economy is delivering so much and promising vast potential, why then is global growth still anaemic? Why is it in a world that allows consumption at the swipe of a finger, we face the unseemly prospects of global growth of 3%? The Brookings Institution argues that efficiency and productivity gains accorded by technology are insufficiently reflected in our existing measure of economic activity. There is also the view that the acute decline in demand and rising inequality means that positive effects from the new economy have not been sufficiently diffused to realise its vast potential.

Let me again hazard a guess. The reason is a combination of all of the above. We are still in transition, and the potential of the new economy has not been fully realised. We are just beginning to understand it.

The immediate challenge for policymakers is to create an enabling environment to expedite the rise of this "new real economy". From the emerging markets perspective, a critical aspect here is infrastructure readiness – but with a bias towards the new economy. Under the new scenario, virtual connectivity is no longer an aspiration, but an imperative.

Previously, coding belongs in the exclusive domain of a handful of computer programmers. Now, it is part of the basic education curricula for most economies. From Coursera to LinkedIn, virtual connectivity has opened doors to greater life-long learning and upskilling, network expansion and knowledge transfers.

However, while things are advancing rapidly in the virtual world, physical infrastructure needs to keep pace. Physical infrastructure remains the bedrock in transforming and delivering ideas into tangible goods and services for consumers, especially in emerging economies. Its development needs to be sustainable, anchored by shared governance between authorities and local communities.

ASEAN, with a population of more than six hundred million people, is estimated to require infrastructure investment amounting to over USD1 trillion by 2025. At a time when fiscal space is constrained, we are developing ways to attract greater private sector participation or public-private partnership in advancing our infrastructure development.

Governments play important roles as facilitator, motivator and protector. Any innovation is bound to remain merely an idea when confronted with restrictive and archaic rules. Therefore, policymakers need to ensure that regulations are flexible yet proportionate to the risks of technological advancement. The tradeoffs between rules that promote change and adoption of new technologies versus the need to maintain order and resilience have never been so stark.

Policies must not stifle growth but at the same time not at the expense of a resilient economy. The new real economy promises ease of greater access to both consumers and producers. Therefore, monopolistic policies, rent seeking activities or activity or rules that prevent competitions need to be removed. Proportionality is thus, the key adjective in the management of the new economy. Economies need tailor-made rules to suit their own unique characteristics. One-size-fits-all approaches to regulations require re-thinking and might no longer be relevant in our dynamic world. The challenge to policies in the context of the new economy is daunting, but the dividends are immense.

Finally, let us not forget the inherent need to help the incumbents that are negatively affected by the progress and advent of the new economy. Lest we forget or become passive in managing it, the backlash to globalisation will intensify. Global trade will be the victim. Protectionism will take root. Therefore, re-skilling, mobility of labour and targeted social protection are key. To some extent, what is being mentioned is not new. Throughout history, countries from Australia to China to the US, have experienced shifting comparative and competitive advantages all the time. Perhaps what is different is the intensity, frequency and scale of the upcoming shocks.

In Malaysia, taxi drivers affected by ride sharing apps have been offered a small grant to start anew. But the real challenge lies in the ability of affected incumbents to change their mindset and rise to the challenge of finding a new operating model. In some respects, effective adjustments are mostly about adaptable skill sets. Thus, the re-integration of displaced incumbents needs to place emphasis on life-long learning and expansion of skill sets with the hope that these will raise their agility and adaptability to future shocks.

Conclusion

Looking ahead, new sources of prosperity lie in the ingenuity of people to mine existing resources to uncover opportunities from the ‘new real economy’. While acknowledging that times remain challenging, we should still remind ourselves that modern medicine, current manufacturing philosophy and even the internet were discovered under equally uncertain conditions.

Hopefully, when we meet again sometime in the future, our “moderate”, “lacklustre” and “uncertain” global economy would be replaced by “stronger”, “brighter” and one day, maybe “solid”.