

Executive Summary

Economic diversification was adopted as a goal of national policy as early as the Second National Development Plan (1962-1966) and stated explicitly as a goal in the Third National Development Plan. **Brunei's failure to diversify – despite much effort and despite good governance.** Despite considerable strengths and advantages, the fact is that Brunei has failed quite substantially in its efforts to diversify its economy. In terms of what drives the economy, it is still very much oil and gas directly or indirectly through government spending. When oil prices fall sharply, the economy weakens severely. This failure is not because of a lack of effort. There have been several efforts to diversify, especially since the late 1990s. Yet, there has been little progress in terms of projects that get off the ground or significant new engines of growth.

Neither is this failure a result of poor governance. Compared with peers, Brunei comes across well ranked in governance indicators. **The key problem is the enabling environment.** Thus, the failure must be due to weaknesses in the enabling environment. We believe that this can be traced to:

- Lack of clarity of purpose - it is unclear what the trade-offs that policy leaders accept – if Brunei is to diversify, there are costs to be paid in terms of foregoing some other cherished social or political or other objectives. This has not been made clear.
- Bureaucratic hindrances - while the elite ranks of the government are well regarded, the implementing layers of the bureaucracy appear to be a major obstacle to getting things done.
- Corporate sector is weak - this is the basic unit of the economy, yet outside Brunei Shell and a very small number of local companies, local companies have not developed well.
- Lack of scale - a small population with a skewed income distribution means that there is a small domestic market which does not allow economies of scale to be exploited.
- Human capital development is weaker than it should be.
- Foreign direct investment outside the energy sector is barely present.
- The cost structure is high.
- Potential growth areas are not exploited.

Policy Recommendations

Creating a Better Enabling Environment

1. Articulate clearly the trade-offs in policy making. A new consensus on social taboos such as alcohol and on intakes of foreign professionals is needed.
2. Reform the bureaucracy – change the mindset, delegate responsibility, undertake a thorough audit of rules and regulations with a view to abolishing at least a third of them.
3. Create a more business friendly regime by considering more radical tax regime changes and the creation of more powerful agencies for specific high priority objectives such as economic diversification.

Government as a Pro-Active Enabler of Development

4. Brunei needs to gain scale through innovative arrangements with friendly countries. Consider a “Two Countries, One System” model where links are established with a larger but friendly country which will then provide Brunei companies and workers with some degree of economic scale.
5. There must be more aggressive efforts to develop human capital models for early intervention at primary and secondary levels to ensure a high percentage of the work force entering tertiary education or professional fields are needed.
6. A stronger local business sector can be developed through tax changes and the establishment of agencies dedicated to supporting and nurturing small and medium size enterprises. Privatisation of government agencies should also be considered.
7. One area where Brunei has global scale is its accumulated savings from oil revenues. The Ministry of Finance has used part of the smaller fiscal savings to seed fund management companies. But Brunei has to use its financial reserves on a much larger and aggressive scale if such efforts are to make a material impact on diversification.