
Productivity, Competence and Middle Income Trap: The Malaysian Scenario

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Abstract: This paper provides an overview of the Malaysian productivity and competence related issues in Malaysia. Being an emerging economy, low productivity and low competence easily sends Malaysia spiralling down into the Middle-Income Trap (MIT). The first part of this paper discusses issues related to labour productivity, labour competence, and Middle-Income Trap. The second part looks at possible strategies aimed at overcoming these.

Keywords: Productivity, Competence, Labour, Wages, Foreign workers, Talent loss, Middle Income Trap

JEL classifications: E23

Introduction

For the past several decades, Malaysia has been recording strong economic growth that has earned it membership in what the World Bank called “high-performing Asian economies” (HPAEs) (Birdsall et al, 1993). However, its long-term aspiration of attaining a high-income nation status is yet to be realized. Since its progress up into the upper-middle income economy in 2003, Malaysia’s productivity improvements are not strong enough to catapult it into the higher income brackets. For decades now the nations GNI has been lower than US\$11,000 (World Bank, 2020), confirming that it has been caught in the wicked Middle - Income Trap (MIT).

The recent pandemic, COVID-19 have pushed this dream back even further than would it have been originally. In the brink of economic recession following the COVID 19, Malaysia needs to pay close attention to several issues that had been hampering its growth. The Herculean task for Malaysia is to pick itself up and continue sprinting towards the desired finishing line. But where would it start from?

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This paper addresses issues with productivity deficiencies and talent losses that would be able to catapult Malaysia out of its present situation.

Malaysian Productivity

Productivity is known as the cornerstone of the economic growth of a nation. It is a measure of the efficiency with which a country combines capital and labour to produce more with the same level of factor inputs. Higher productivity is always desired as it improves living standards, life quality, wages and government's income through higher tax while lower productivity bring additional cost to the society.

For these reasons' productivity has been a popular research topic of many scholars in Malaysia. Both the factors and benefits of productivity are explored. Benefits of higher labour productivity among others include expansion of capital investment; enhancement of country's competitiveness, improved foreign investments, improved living standards and development of personal skills and capabilities that leads to higher wages and salaries (MPC's Productivity Report 2018/2019).

Hard technology, human capital, capital equipment, cultural factors such as attitudes and aspirations, quality of management or supervision and competition within markets have all been explored as factors that influence productivity. Razak et al (2014) explored motivation as a factor of labour productivity in Malaysia and it showed a significant positive correlation with labour productivity.

Ahmad and Kialashki (2017), analysed productivity factors in some Asia Pacific countries such as New Zealand, Australia, China, Japan, Korea, India, Indonesia, Malaysia, Thailand, Philippines and Singapore using time series data for the period 1970 – 2012. Their result revealed that an increase in GDP, Foreign direct investment (FDI), Skills Development and infrastructure improvement (communication) increased productivity in Malaysia while an increase in labour force reduced Malaysian productivity.

High productivity is necessary to propel Malaysia to achieve its advanced economy and inclusive nation aspiration and Bank Negara Malaysia is confident that Malaysia would be able to attain a high-income nation status by 2024 (East Asian post-2019). Realizing the importance of having and sustaining a higher productivity, the 12th Malaysian Plan (2021-2025) continues the emphasise on improving productivity and innovation under the theme of Shared Prosperity Vision (SPV). The 12MP also focuses on environment enhancement and social reengineering as shown in figure 1 below. Issues such as protecting the environment, reducing pollution, and aging society are addressed under this new plan.

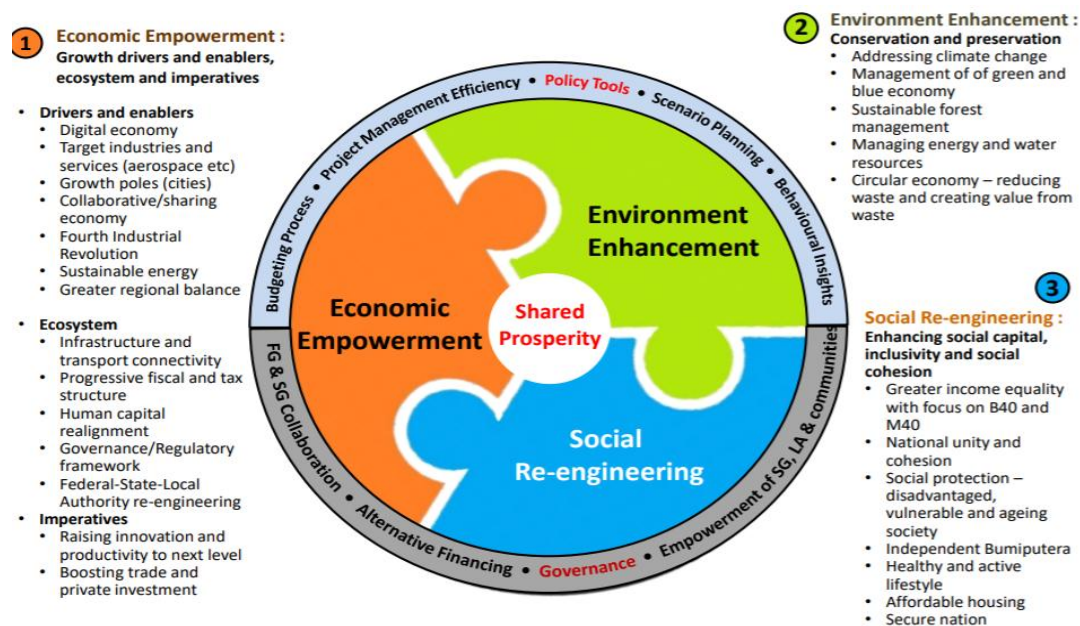


Figure 1: 12MP (2021-2025)

Source: Ministry of Economic Affairs MEA (2019)

Under the earlier 11MP, the Malaysia Productivity Blueprint (MPB) was introduced in May 2017 as a strategy to raise labour productivity. The blueprint provides guided implementation to expedite productivity improvements as envisaged in the 11MP through five strategic thrusts. These thrusts are to ensure holistic and systematic change rather than fragmented efforts. Figure 2 shows that the five strategic thrusts include building the workforce of the future; driving digitalization; Making industry accountable for productivity; Forging a robust ecosystem and Securing a strong implementation mechanism.

THRUSTS	NATIONAL INITIATIVES
1 Building Workforce of the Future	Enforce structural changes to the workforce by formulating a comprehensive labour market policy, including reducing reliance on low-wage and low-skilled workers
	Conduct national strategic workforce planning in anticipation of changing needs across the sectors
2 Driving Digitalisation and Innovation	Strengthen readiness, knowledge and adoption of technology by enterprises across sectors
	Strengthen digitalisation among SMEs through e-commerce and adoption of innovative technology
3 Making Industry Accountable for Productivity	Gradually reduce the reliance on non-critical subsidies, and ensure liberalisation efforts are linked to productivity outcomes
	Realign key grants, incentives, soft loans and other funding mechanisms to productivity metrics and outcomes
4 Forging a Robust Ecosystem	Accelerate efforts to enhance whole-of-government approach towards addressing regulatory constraints
	Establish an accountability mechanism for the implementation of regulatory reviews by the government
5 Securing a Strong Implementation Mechanism	Institutionalise a strong coordination and governance model to secure implementation certainty across government, sector, and enterprise levels
	Launch nationwide productivity movement to inculcate a stronger culture of productivity across all segments of society

Figure 2: Malaysian Productivity Blueprint: Five strategic thrusts

Source: Humanresourcesonline.net

The mid-term review of the 11th Malaysia plan showed that there are challenges in implementing the proposed thrusts as originally intended. The thrusts were faced with issues such as the inclusiveness of the rakyat, disparities between the states, increase in housing prices, increase in cybercrime, dependency on low-skilled foreign workers, fragmented TVET landscape, low job creation in the skilled, governance issues, poor 1st and last mile connectivity, low productivity and inability to compete (Talentcorp 2019)

The Covid-19 crisis is expected to push Malaysian economy into recession this year. The World Bank has projected a negative economic growth for Malaysia by cutting its 2020 gross domestic product (GDP) target for Malaysia to -0.1%, a significant drop from its earlier target of 4.5%. However, the bank is confident of Malaysia's recovery in its fourth quarter (4Q) of the year before transiting into a smoother momentum in 2021.

In the first quarter of 2019, Malaysia GDP growth was recorded at 4.7 %, dipping slightly to 4.5% in the second quarter, accelerating to 4.9% in the third quarter and recording a 4.4 % in the final quarter as shown in figure 3. This was mainly supported by private consumption, government spending and net external demand.

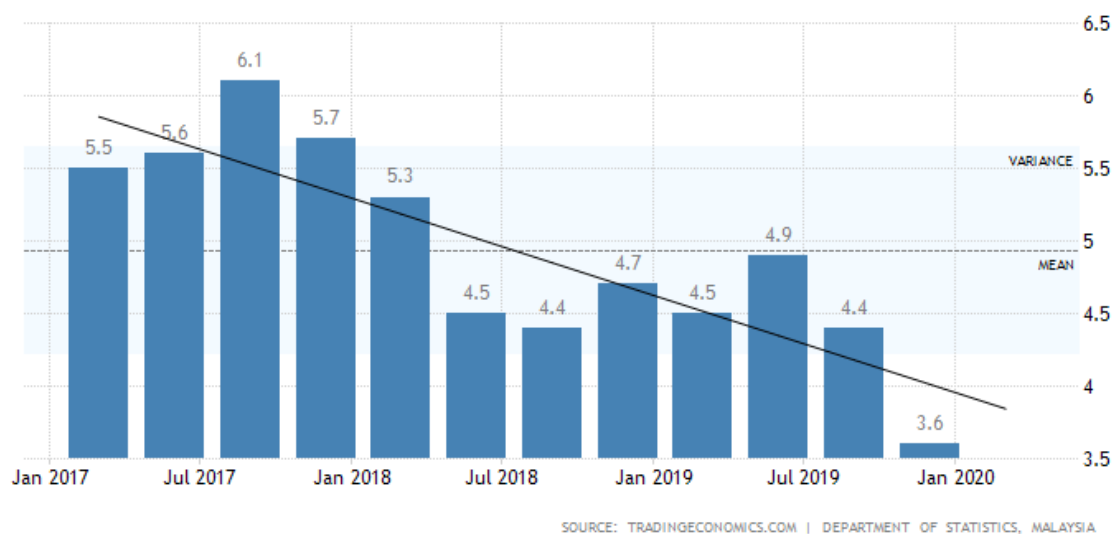


Figure 3: Malaysia GDP Annual Growth Rate 2000-2019 Data

Source: TradingEconomics.com

Figure 4 shows Malaysia productivity for the past three years, from July 2017 to March 2020. The highest productivity was recorded in October 2017 (4.8%) before it skidded continuously to October 2018 (1.8%) before improving in January 2019 (2.3%). However, from July 2019 (2.6%), labour productivity continued plunging and recorded the lowest in January 2020 (-0.804).

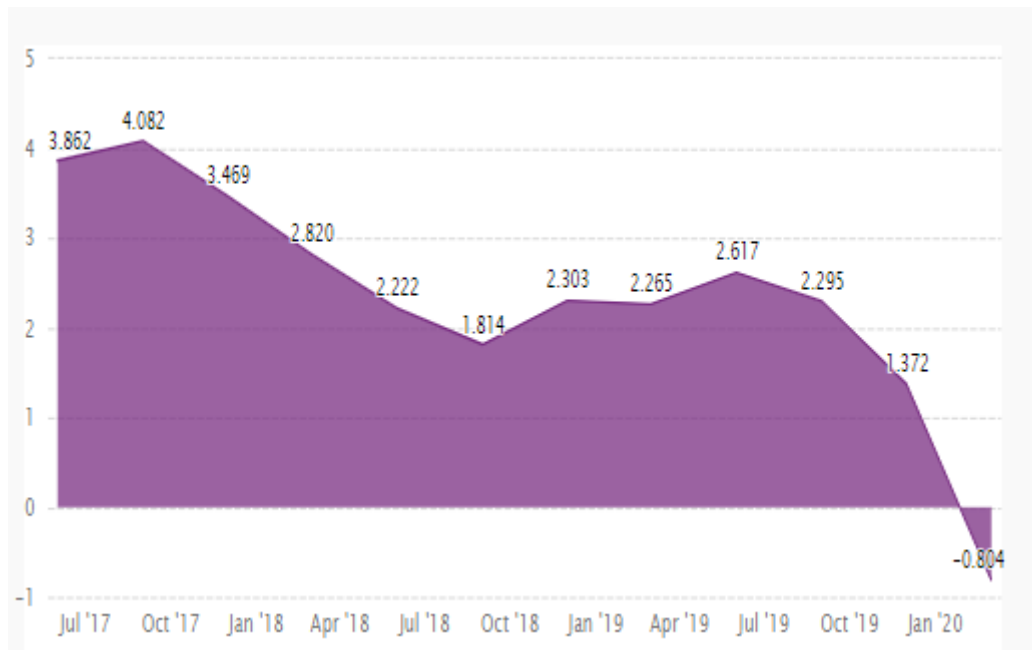


Figure 4: Malaysia's Labour Productivity Growth from Jul 2017 to Mar 2020

Source :Ceicdata 2020

<https://www.ceicdata.com/en/indicator/malaysia/labour-productivity-growth>

In comparison with other ASEAN countries between 2013 to 2017 as shown in figure 5, Malaysia stands closer to countries with lower productivity level rather than of those higher such as Brunei or Singapore. This shows for Malaysia the longer working hours are not translating into higher productivity.

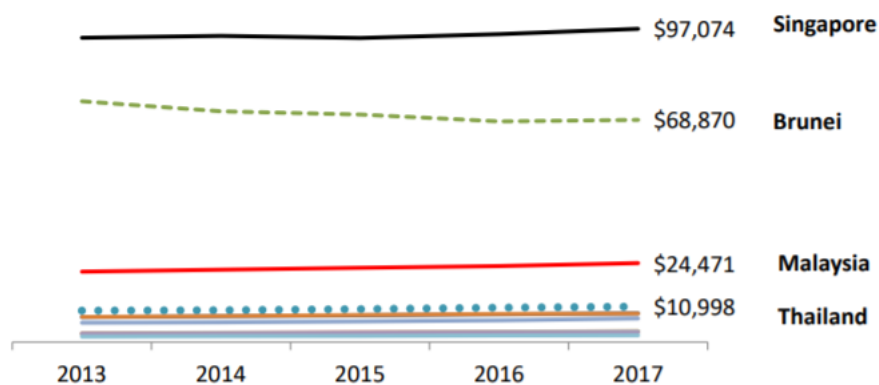


Figure 5: Labour productivity comparison among ASEAN countries

Source: Ministry of Economic Affairs (MEA)

Labour productivity growth is affected by a composite of factors, namely multi-factor productivity (MFP) growth and capital intensity. MFP brings about technological dynamism while capital intensity refers to the utilisation of capital within the workforce. Investments on

capital alone will not reflect higher productivity but must rather be complemented with efficient managerial practices and work procedures, advanced machineries & technology and skilled labour (productivity report 2018/2019). In many Asian economies production methods often utilizes the abundant low-skilled and cheap labour with little capital that often leads to high capital productivity but low labour productivity (Jordaan, Jacob 2017).

Structural issues such as shortcomings in higher education, lack of skilled local employees, lack of R&D, inadequate institutional progress and lack of diversification of the economy towards the service sector must be addressed before any transformation of Malaysian economy could be seen sector (Hill et al., 2012; Flaaen, Ghani, & Mishra, 2013; World Bank, 2009; Rasiah, 2009).

Labour Competence

Skills and competencies are the fuel in raising productivity and performance in businesses and nations (Kunjiapu, 2021). Due to its significance the development of these skills or human capital has always been featured in many development plans and industry-masterplans. MEA (2018) pointed out that Malaysia is still reliant heavily on low and semi-skilled local and foreign workers in its industries are the main cause of the lower GDP growth. Highly skilled and competent workers are needed to encourage creativity, innovation as well as technology adoption. Without these Malaysia will not be able to retain its competitive ability nor attain the high-income nation status.

Labour competence often refers to individual knowledge, skills, attitudes, talents to meet the needs of organizations (Bhatnagar, 2007 & Lewis and Heckman, 2006) and has become one of the critical resources for organizations to attain competitive advantage (Zhang, S. et al,2012). A good performance and productivity in organizations require both hard skills and soft skills as the former is the muscle and the latter human touch (Kunjiapu & Yasin;2015). Skill shortage affects the labour productivity and overall competitiveness of Malaysia in the world market. In 2016 Malaysian Critical occupation list showed that 46 occupations faced labour shortage (COL 2015 and COL 2016) while in the year 2017, the number increased to 56 occupations indicating that Malaysian skill shortage is worsening.

Bank Negara Malaysia (2018) revealed that there is high dependence on foreign workers in Malaysia. This was further supported by Lee Hwok- Aun and Khor Yu Leng (2018) estimation of a total of 3.85 to 5.5 million migrant workers in Malaysia in 2018, including the undocumented workers in their study. Tharani Loganathan et al (2019) showed that the foreign workers are mainly supplied to Malaysia from Indonesia (39%), Nepal (24%), Bangladesh (13%) and Myanmar (7%). Largest number of foreign labours are found in Agriculture 37.3%, construction 22.4%, Manufacturing 20.2%, Services 9.3% and mining 4.9% (Lee Hwok- Aun and Khor Yu Leng 2018).

Brain Drain is a common term used to describe loss of talent to other countries and other sectors contributing to a limited pool of skilled and experienced talent and inadequate talent pipeline which has adverse impact on its economy (IBM, 2014; Ehambaranathan, 2015; Jamshed, 2015). A survey from the Economist Intelligence Unit (EIU, 2011) reported that Malaysia was ranked 36 out of 60 countries in the Global Talent Index 2011-2015. According

to the World Bank Report 2011, an approximately 300,000 high skilled Malaysian moved overseas such as Singapore, Australia, US and UK (Mustafa, 2015). Fong (2010) reported that between 1990 and 2000, the emigration of Malaysians to Canada had increased by 43.5 per cent (8480–12,170), to Australia by 14.1 per cent (34,716–39,601) and to the United States by a large 100.5 per cent (12,315–24,695) while Azman (2016) showed that Malaysia has lost almost 46% of its population to Singapore. More talent is expected to be lost in near future as a recent study shows that 26% of the citizen, who has US\$30 million of investable assets have decided to leave the country within next 10 years (Rasiah, 2015).

In analysing the reasons for brain drain, low salary package, lack of promotional opportunities, increasing crime rate, ethnic and religious conflict and also lack of career prospects for fresh graduates topped the leading causes (Fong and Hassan ,2017; Lim Kim-Hwa 2014; Ishak, Norakmarwati & Abdul-Aziz, A.-R., 2012; Kaur , 2012; Zeher ,2011;Johnson 2009). According to Kaur (2012) the wage structure of Malaysia is quite ineffective as compared to other countries like Singapore, USA, UK and Australia therefore encouraging Malaysians to leave their homeland. Zeher (2011) & Johnson (2009) stated that racial and religious discrimination causes negative impact in work environment that cause citizens to leave in search of harmony and justice. Finding jobs overseas is also much easier and more attractive to Malaysian talent pools as they are highly demanded due to their cultural versatility, willingness to relocate, and ability to speak at least 2-3 languages fluently, with one of them being English (IBM, 2014).

Retaining competent employees continues to be a key concern for employers in Malaysia as more employees indicate their intention to leave their organization within two years (Willis Tower Watson, 2015). A new perspective on employee value proposition and greater flexibility to attract diverse talents are much needed in Retaining and attracting the needed talent pool (Cheese, 2010). Whelan and Carcary (2011) explained that hygiene factors like benefit, compensation, location which has a direct effect on career success contribute to talent retention, while career success and intrinsic rewards indirectly reduce talent loss. This was supported by Willis Tower Watson (2015) who showed that Job security, and learning and development for attraction and relationship with supervisor per manager are important components for talent retention

Various initiatives such as the Government Transformation Programme (GTP), the Economic Transformation Programme (ETP) and the Malaysia Plan have been developed to turn Malaysia into a high-income nation are much dependent on critical talent management. The effort on bringing back the migrated talents has only yielded a small success. Talent Corp programme managed to return only 2,500 talents from overseas over a period of 4 years (Izwan, 2014). Norzaini Azman, Morshidi Sirat and Vincent Pang (2016) argued that Malaysia has to be more aggressive in retaining local talent and engaging talented Malaysians from abroad as many are dissatisfied with Malaysia's policies on interethnic relations, future political scenario and bureaucracy.

Middle Income Trap

Middle-income trap is a development stage where countries are caught between low-income, low wage economies and high skilled innovation economies. At low levels of income, cheap labour and low skilled manufacturing exports assisted these countries to move up into the middle-income category rapidly however once at the middle-income stage, both the income and the cost escalates, forcing these countries to innovate and deploy labour and capital effectively to produce technologically advanced exports. Moreover, Gill and Kharas (2007) pointed out that three elements were necessary for middle-income countries to grow: (1) specialization in production and employment; (2) focus on innovation; and (3) preparing employees to create new products and processes.

Gill and Kharas (2007) defined Middle-Income Trap (MIT) as an unfortunate situation where a country fails to transit to a high-income economy due to rising costs and declining competitiveness. There have been many explanations provided to this by many scholars and researchers. Gomez et al (2019) argued that too much focus on state-business ties, technological constraints and human capital deficiency as major causes of the trap. This seems to be in line with the argument of Doner and Schneider (2016) that the trap is more about politics than economics.

While there is no standard length of the trap, some academics regard nations as mired in middle income status if they spend five decades or more with average incomes of 10% to 50% of U.S. levels. The World Bank defines low income economies as those with a GNI per capita of \$995 or less, lower middle-income economies with a GNI per capita between \$996 and \$3,895, while upper middle-income economies range from \$3,896 to \$12,055. Only a handful of Asian economies have risen to high income status in recent times. These include South Korea and Taiwan (manufacturing bases), Hong Kong and Singapore (small trading hubs) and Brunei (oil rich).

Countries that were caught in this middle-income trap often had experienced average GDP growth of 3.5% for several years before receding by at least 2% between seven years (Felipe et al. 2012; Eichengreen et al. 2013; and Veerayooth, 2015). The Malaysian economy has flourished with an average of 5.8% growth per year ever since the 1990's Asian financial crisis. However, it has remained at about the same level for the last 20 years indicating the inability to leap higher into the high-income group. Malaysia has attained upper middle-income status in 2003 with a GNI of US\$4,160 but remained in this bracket ever since. Malaysian GNI continued improving over the years but was always confined to the bracket, in 2013 Malaysian GNI was US\$10,840 and in 2018 it was US\$10,590 (World Bank, 2020). This suspicion was confirmed by (Suehiro, 2018) who showed through his study that among the Southeast Asian countries, Malaysia is one of the five that may have fallen into the upper-middle-income trap, while Indonesia is in danger of remaining in the lower-middle-income trap.

Eichengreen, Park and Shin (2013) & Agenor and Canuto (2012: 2014), explained that countries get stuck in the trap due to lack of productivity. In their work they found that what increased the probability of growth slowdowns were: i) a high rate of investment before reaching the critical level of development (threshold), ii) undervalued domestic currency, and

iii) a relatively low proportion of high-tech (high-value-added) products and services in exports. An inefficient labor market especially that with skills gap or mismatched skills may discourage hiring, which increases the likelihood of falling into the MIT. There is a question on Malaysia's talent whether they would be able to bring the country to the technology frontier due to the poor academic performance as evident from International exam scores such as Programme for International Student Assessment (PISA) and Trends in International Mathematics and Science Study (TIMSS) apart from talent retention issues (Perkins 2019). Menon & Ng (2015) concluded that factors that pushed Malaysia into the Middle-income trap is its politics, politicization of education and deindustrialization policies. Perkins; Rasiah and Woo (2018) propose that it is possible when (i) domestic innovation capacity is based in Malaysian companies and carried out by Malaysian workers and entrepreneurs; (ii) reformation in education sector especially entrance requirement and faculty appointment is done on merit and not race base and (iii) revision of policies that side-line non-*bumiputeras*.

Conclusion and recommendations

The Middle-income trap is not inevitable and not impossible to be escaped from; as all it takes is a change in policies is the way to escape from the trap (ADB, 2017). Key to avoiding the trap is for each country to find the right mix of demand and supply-side policies to sustain a further lift in their per capita incomes and to achieve balanced growth sourced from domestic and overseas markets (Riley, 2014).

Malaysia needs to improve its productivity by addressing the issues related to its human capital development which in turn would help with competitiveness, innovation and entrepreneurship. There is a great need to overhaul the Malaysian education system and human capital strategies for long term improvement according to Cheong & Lee (2016). The gap between the academia offerings and the industry's need must be narrowed. Kunjiapu & Yasin (2015) in their research showed that employees gain competencies mainly through informal, incidental and formal learnings at workplaces.

A quality education system can stimulate creativity, innovation and in turn fuel higher economic performance through highly skilled employees. International comparisons show that Malaysian students' competencies are far from satisfactory. Malaysia's position in the World Bank's Knowledge Economy Index is generally the same as two decades ago (48th out of 145 countries). The index records the capacity to produce, embrace and diffuse knowledge and to make effective use of knowledge shows that Malaysia lags in the areas of innovation and education.

For innovation-based economies like South Korea, Japan, and Taiwan, the values of Gross Domestic Expenditure on Research and Development (GERD) and educational investments as a percentage of Gross Domestic Product (GDP) are 3.4, 3.3 and 2.9 per cent, respectively. South Korea, for example, invests 7.6 per cent of its GDP on education, and Taiwan and Japan invest 5.8 and 4.9 per cent, respectively. In contrast, Malaysia's expenditure on education was 4.5 per cent of its GDP; GERD to GDP was 1.13 per cent and research and development (R&D) expenditure was 1.3 per cent of GDP, with the business sector as a major contributor (RM6.8 billion, 64.45 per cent) of R&D, followed by institutions of higher

learning at RM3 million (28.67 per cent) and government agencies and research institutes at RM730,000 (6.88 per cent). There is a limited collaboration between industry and research institutes which results in R&D output not being linked to industry's demand. Provision of incentives to non-state training providers and monitoring of training curriculum relevance to industry's is a must to remedy this (Cheong & Lee, 2016).

Malaysia's focus on technical and vocational education and training (TVET) to improve the competencies of the workforce and accelerate the supply of skilled labour is to be lauded. Indeed, internationally, TVET is known as a potent means for fast-tracking technological progress, citizens' capacities, economic growth and national development. From Economic Planning Unit records in 2010, only 10 per cent of students enrolled in upper secondary TVET vocational training, compared with an average enrolment rate of 44 per cent in the Organization for Economic Cooperation and Development (OECD) countries, pointing to a crucial need to increase enrolment rate for the supply of skilled workers. The main challenge is removing the stigma associated with enrolling into TVET programmes. The common perception of only non-academically inclined students opt for TVET must be corrected. Other challenges would be the inclusion of all relevant stakeholders in the policy making relevant to TVET, provision of adequate funding in both private and public educational institutions, coordination of the fragmented skills education landscape.

At present, excessive low-skilled foreign workers keep the Malaysian productivity, competitive ability, innovation and technology adoption lower. Bank Negara Malaysia (2018) stated that a high-dependence on foreign workers, will weaken the case for automation, suppress overall wages, and deter adoption of productivity. It further argued that the creation of high-skilled jobs will be hindered and create Malaysia's reputation as a low-skilled, labour-intensive investment destination which trap the country in a low-wage, low productivity bind. Immigration regulations that curb influx of unskilled foreign workers must be strengthened alongside with the creation of high-skilled jobs. Moving up the value chain into knowledge-based economy and technology intensive manufacturing would bring a drastic reduction in the dependence of foreign workers and increase the demand of higher skilled workers in Malaysia (OECD, 2007).

Effective regulation will ensure that employers apply for work permit, meet the minimum wage and safety and social regulations which will likely to result in a drastic reduction in undocumented migration as well as an adequate supply of unskilled workers and their increased participation in the labour force (Dhadush 2014). Malaysia must also sustain FDI in the country long enough by providing suitable investment facilities; offer a more competitive wage structure and working environment ;introduce more attractive scheme for their spouse and children; introduce law that is more flexible to ease the entrance to the country; provide enough skilled local labours through training to complement foreign skills and new technologies brought by FDI and also provide better infrastructures like health and education for foreign labours' families (Rahmah Ismail & Ferayuliani Yuliyusman, 2014).

The increasing migration rate is weakening Malaysian economic condition as high skilled and talented pool are leaving for what is deemed as a greener pasture. This has not only reduced

the government's earning through the diminishing tax returns but also hinders growth and development pushing Malaysia lower in the global competitiveness ranking. To plug the migration of talents. Malaysian government should look into revising racially discriminating policies and practices that has caused crippling polarization and brain drain. A new policy that includes all races, ethnic and religious group should be put in its place to promote harmony, encourage growth and retain talents. Improved efforts are needed to bring Malaysians working abroad. At present efforts and Initiatives by national agencies to lure the talents back to Malaysia has not been completely successful. Issues such as tapping the skills of the foreign spouses, lack of assistance to returning Malaysians, poor remuneration packages, lengthy administrative processes, lack of quality educational opportunities and weak job market must be addressed (NewMalaysiaHerald,2019).

Multi-pronged strategy that include improving productivity, enhancing innovation and competitiveness, retaining and attracting high skilled talents while regulating low skilled foreign labour could be the way for Malaysia to join the high-income nation league.

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