

The structural regression of Malaysian manufacturing

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- Malaysia's manufacturing sector is reversing to a state reminiscent of its post-colonial stage of development. Regrettably this situation was avoidable.
- When the Federation of Malaya gained independence from Britain in 1957, economic conditions were ripe for rapid and sustained growth.
- Its primary export sector was showing immense potential for expansion. **Primary commodities — particularly tin ore and natural rubber** — accounted for a third of Malaysia's GDP and over 75 per cent of exports by 1970, a legacy of its colonial past.

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- But manufactured exports accounted for less than 10 per cent, raising concerns that heavy reliance on a few commodities left Malaysia vulnerable to terms-of-trade shocks from swings in commodity prices.
- There was **little economic diversification up to the 1980s**, with already undersized manufacturing focused on little more than processing agricultural and mining output.
- A new National Development Policy was introduced in 1990, easing the affirmative action strictures of the pro-ethnic Malay [New Economic Policy \(NEP\)](#) and placing wealth creation ahead of wealth redistribution.
- The Promotion of Investment Act of 1986 extended **generous incentives** for private investors and **relaxed regulations on foreign direct investment (FDI)**, allowing for full foreign ownership of export-oriented companies. Massive FDI inflows ensued.

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- These reforms opened Malaysia's gates to the global production network and **it succeeded in developing a vibrant and competitive electronics sector.**
- Manufacturing grew sharply from about 12 per cent of GDP in 1970 to over 30 per cent by the mid-1990s.
- The share of **electronics in manufactured exports soared from below 50 per cent in 1980 to peak at more than 70 per cent in 2000.**
- But its share has fallen to **below 50 per cent again in 2015.**

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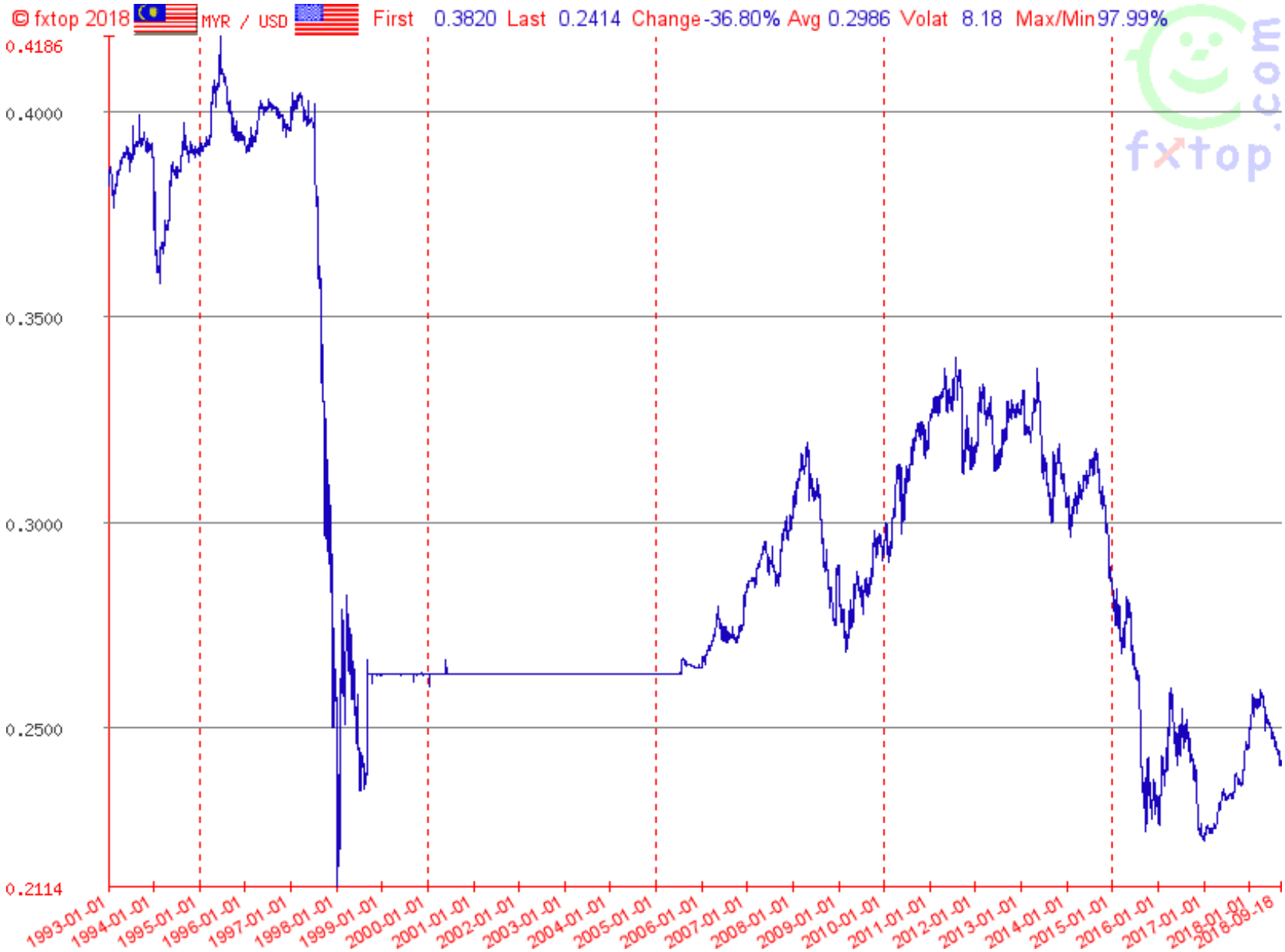
- Like its early post-colonial phase, **Malaysia is moving back to processing its agricultural and mineral resources**. The only difference now is that the commodities themselves have changed.
- **Rubber and tin have shifted to palm oil and petroleum**. Petroleum refining and palm oil processing accounted for almost 19 and 12 per cent of manufacturing output in 2012, respectively — with both of **these industries now bigger than electronics**.
- While developing countries are often encouraged to process agricultural or mineral outputs before exporting to increase their value, **Malaysia appears a rare example of an upper-middle-income country — aspiring to high-income status — that is stunting or even reversing its previous successes in manufacturing**.

MALAYSIA CURRENT ACCOUNT TO GDP

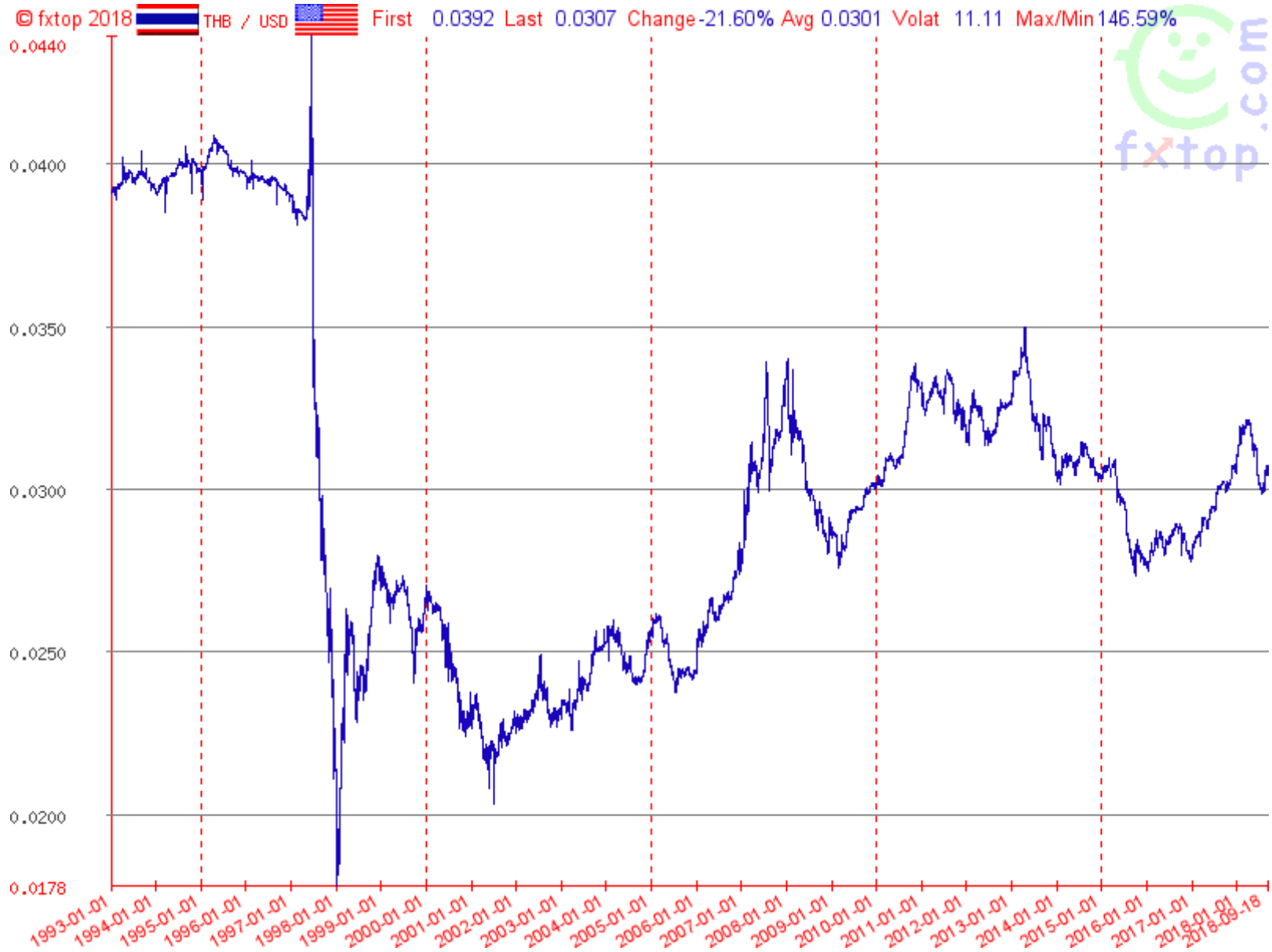


SOURCE: TRADINGECONOMICS.COM | DEPARTMENT OF STATISTICS, MALAYSIA

Exchange Rate: MYR / USD

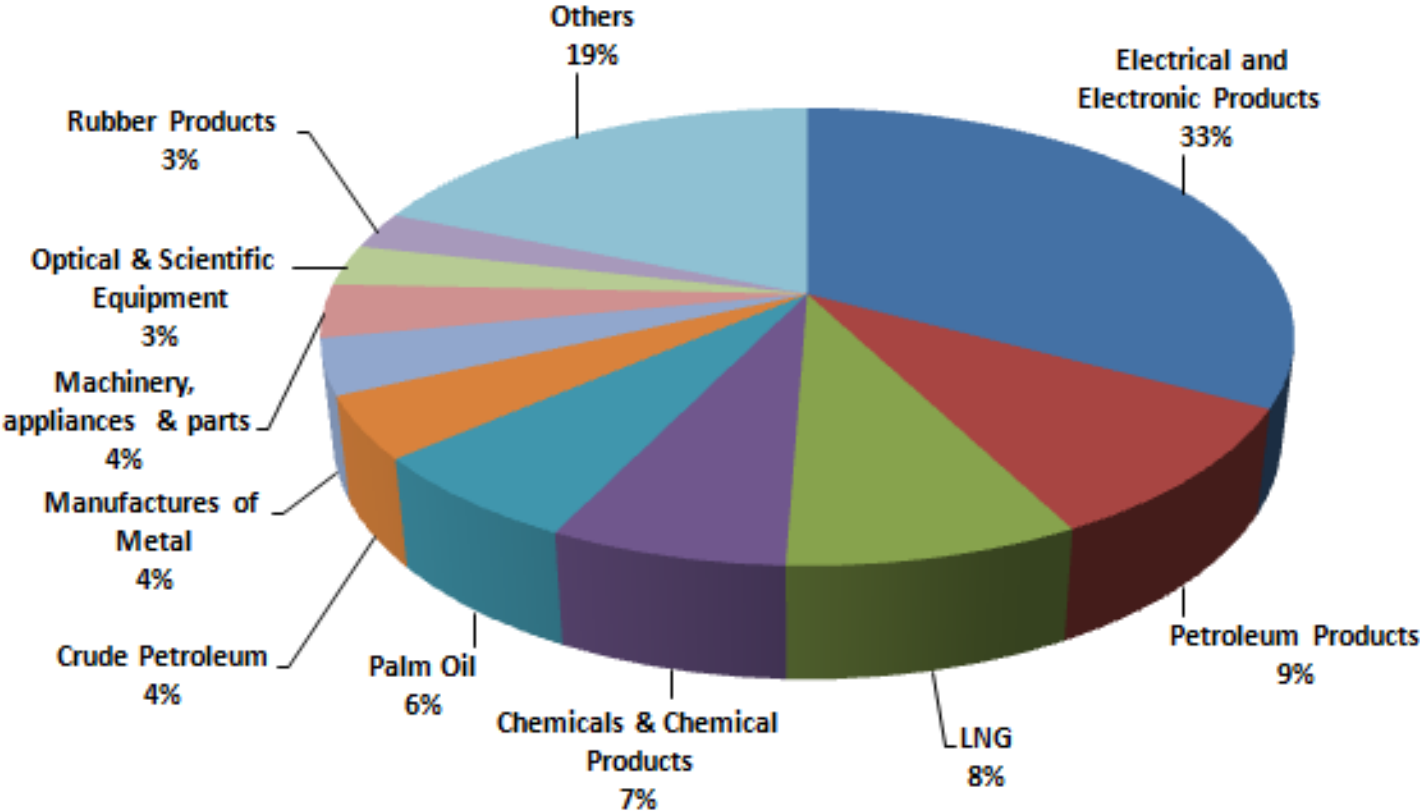


Exchange Rate: THB / USD



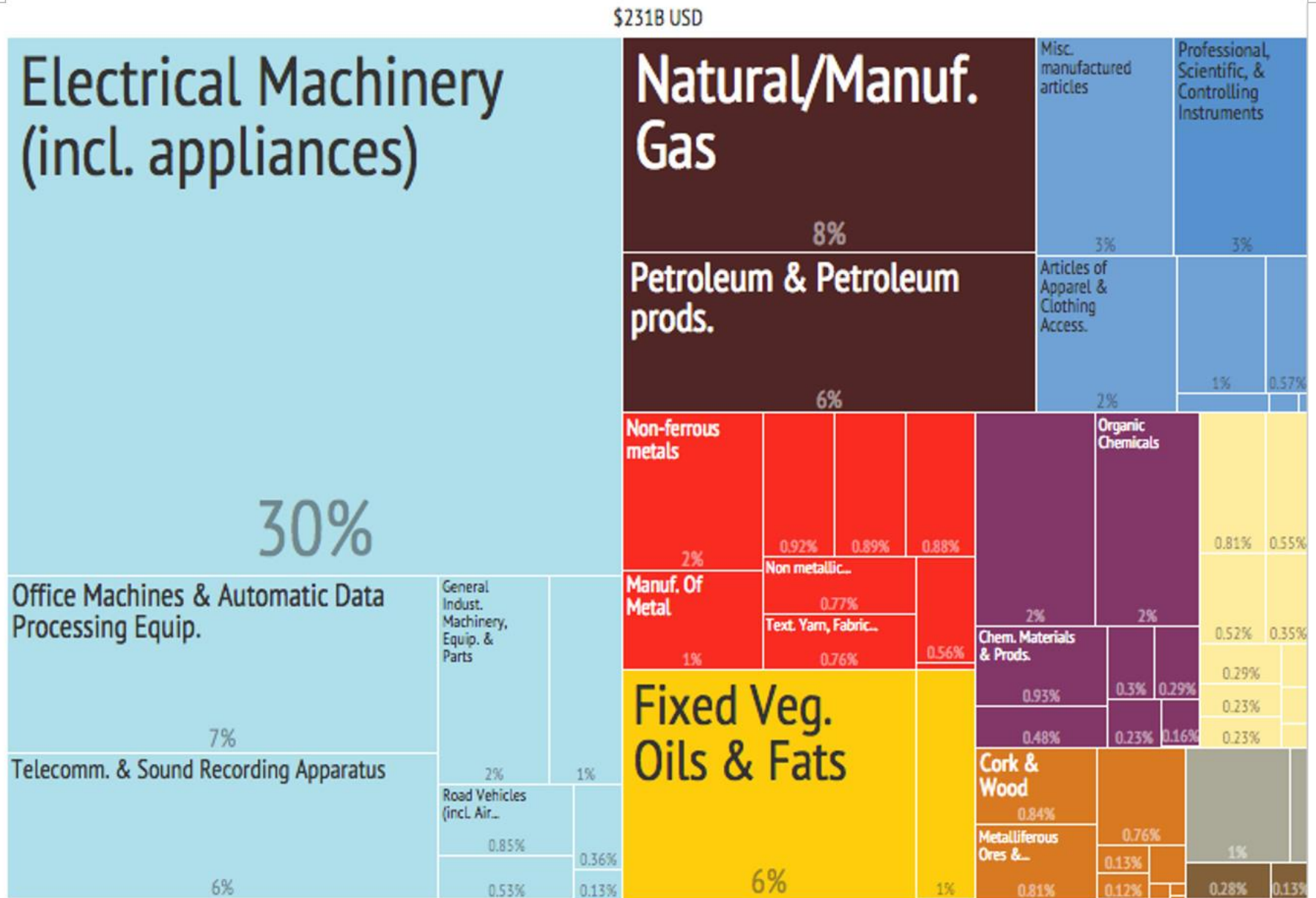
Malaysia's Exports by Major Products

TOTAL EXPORTS 2013: USD 228.27 BILLION

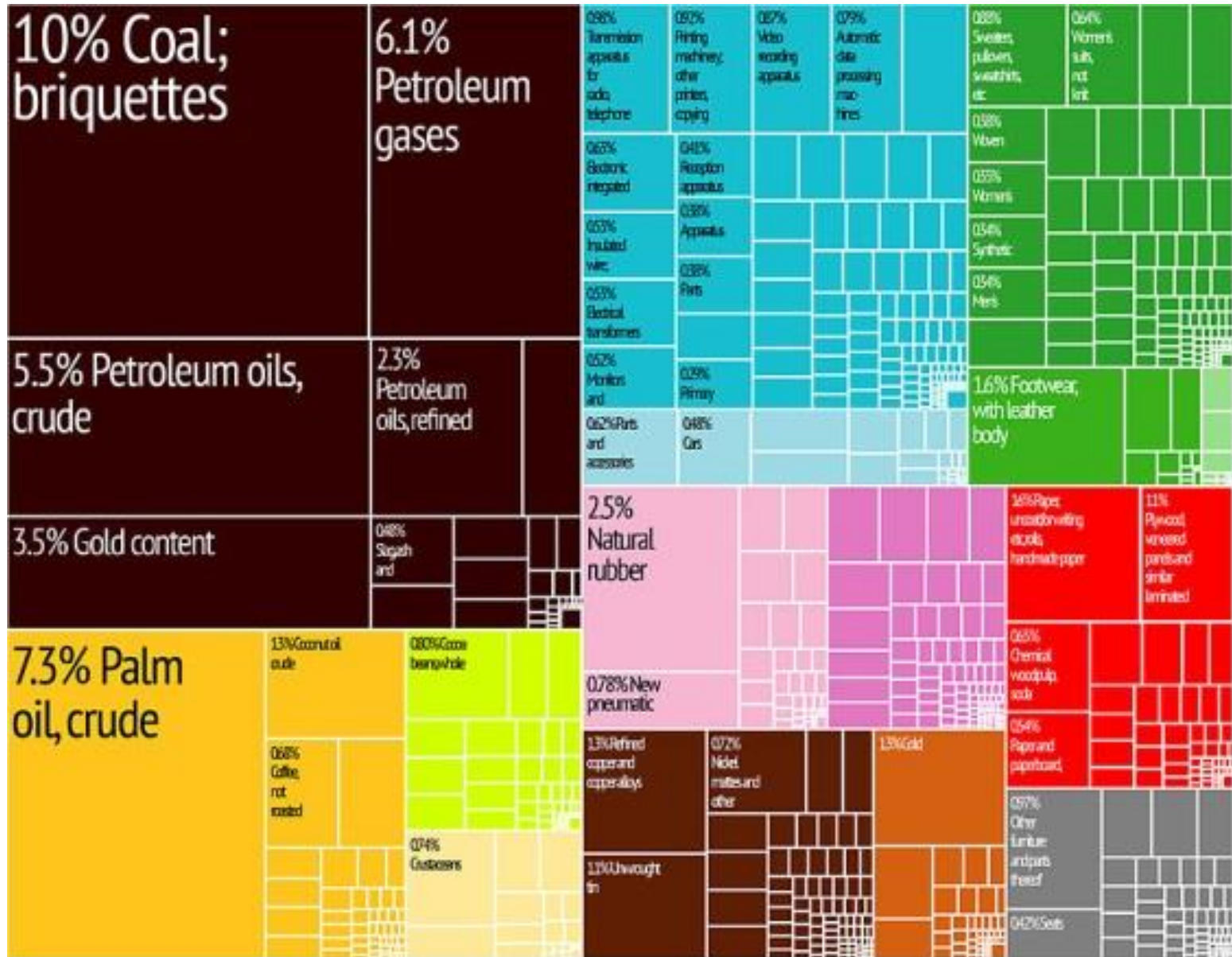


Source: Department of Statistics, Malaysia
Compiled By: MATRADE

Structure of Export: Malaysia (2016)



Structure of Export: Indonesia



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- This manufacturing retrenchment has been demonstrated by the overall contraction of this sector's share of GDP, which fell gradually to 24 per cent in 2008 to remain roughly at that level ever since.
- **Why should we care about Malaysia's manufacturing contraction?**
- The main concern about petroleum refining and palm oil processing is that they are capital-intensive and **generate few jobs**.

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- Despite their importance in overall output, just 14,400 workers are employed in petroleum refining, compared to the nearly 200,000 workers employed in electronics.
- Furthermore, agro- and petrol-processing industries generate relatively low-productive, low-skilled jobs and so wages are also low.
- The largest share of manufacturing workers are plant and machine operators who have an average annual salary of around US\$4000 when per capita incomes average US\$11,000.

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- Malaysia may be experiencing **'premature deindustrialisation'**, having transitioned to a service led economy before it has fully reaped the benefits of industrialisation.
- But unlike many other countries with similar experience, Malaysia's case appears to be **driven more by policy than technological disruption, trade or globalisation**.
- There is growing recognition that many of the country's problems — including the **slump in private investment** — are rooted in **the distortions resulting from the design and implementation of the NEP** and its subsequent incarnations.
- The **government-linked corporations spawned to serve racial economic redistribution** now **crowd-out private investment** in most sectors of the economy, including **manufacturing**.

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- If Malaysia is to realise its aspirations and enjoy living standards associated with high-income countries, it must **arrest this structural regression and revive private investment in manufacturing.**
- But regenerating manufacturing is unlikely **without an overhaul of current policies.**
- And while Malaysia may still reach the technical threshold of high-income status in a few years — assuming an economic crisis can be averted till then — this will still mean little to the welfare of workers in manufacturing if it continues its journey backwards.