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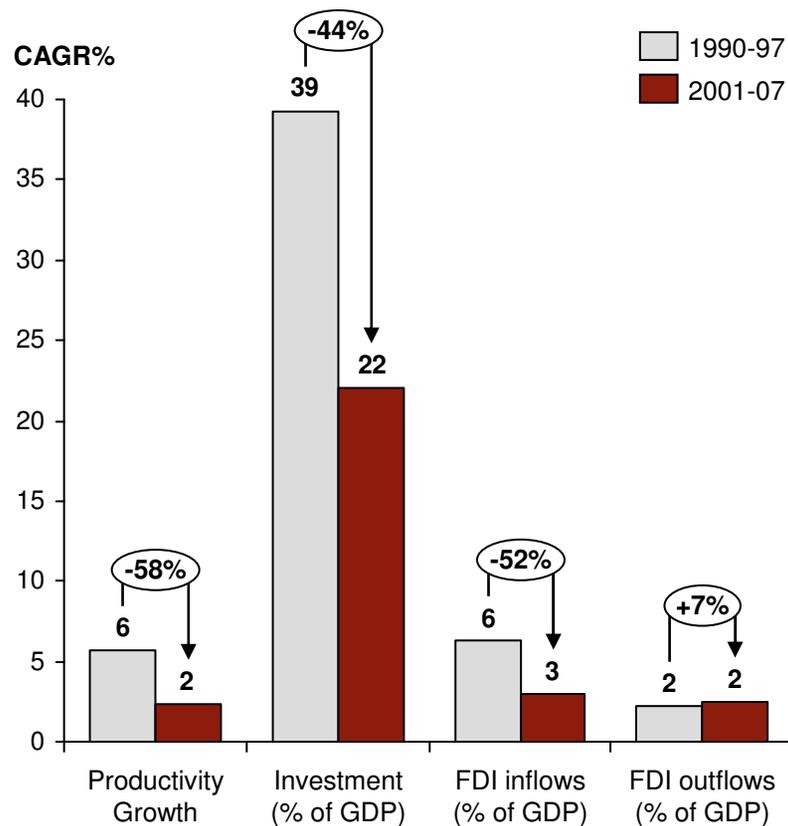
HARVARD | BUSINESS | SCHOOL

IXP Course: Malaysia - Unstuck from the Middle

Prepared by: Harvard Business School

Recent trends in productivity and investment highlight growth challenges

Protracted slowdown observed in the economy between 2001-07 vs. 1990-97



Immediate Causes

- Changes that lead to slowdown in the 2000s
 - External factors: Increasing competition from China, Vietnam, Indonesia as manufacturing powerhouses
 - Lower availability of low hanging fruit projects domestically than in 1990s (e.g., ports, etc.)

Underlying Drivers

- Companies and the economy are not moving up the value chain - amplifying competition from China and limiting the creation of new growth opportunities



What can Malaysia do?

HBS aimed to identify Malaysia's growth constraints and policy suggestions



Objectives

- 1 To frame the challenges facing Malaysia as the country which aims to become "high income"
- 2 To diagnose the main constraints preventing Malaysia from achieving its potential
- 3 To identify key policies to address main constraints



Deliverables

1. A framework to help:
 - Evaluate key factors of production in today's economy
 - Identify key growth constraints
1. A prioritized list of key constraints
 - Determined through quantitative and qualitative analysis
 - Evaluated based on their impact on key factors of production
- A suite of policies targeted at resolving key growth constraints

Malaysia's growth prospects were evaluated utilizing a capital and labour framework



	Accumulation	Cost	Efficiency
Capital	<ul style="list-style-type: none"> Is there sufficient capital in your industry to pursue growth? Is that capital easily accessible? How sticky is that capital (i.e. FDI or DDI)? 	<ul style="list-style-type: none"> How expensive is capital? 	<ul style="list-style-type: none"> Is capital deployed against the highest return (both economic and social) projects?
Labour	<ul style="list-style-type: none"> Is there a sufficient amount of the required skills needed for growth? Is that skill set local or international? 	<ul style="list-style-type: none"> How expensive is labour relative to Malaysia's competitors (i.e. Thailand, Indonesia, Singapore)? 	<ul style="list-style-type: none"> Is the labour force as productive as it can be relative to Malaysia's competitors? <ul style="list-style-type: none"> Is the industry employing the most effective technology? Is the labour force allocated most efficiently?

Efficiency and labour highlight key areas of concern for Malaysia

	Accumulation	Cost	Efficiency
Capital	<p>High capital availability</p> <ul style="list-style-type: none"> - Significant domestic savings (~160% of investment in 2011) - Debt continues to be a significant source of capital (bond issues only 0.8% of GDP in 2011) <p style="text-align: right;"></p>	<p>Competitive cost of capital</p> <ul style="list-style-type: none"> - Cost of capital is ~3.2% in 2011 - Market has confidence in Malaysia - as indicated by 'A' grade debt rating <p style="text-align: right;"></p>	<p>Low capital efficiency</p> <ul style="list-style-type: none"> - Capital has flowed to less productive sectors (e.g., agriculture and construction) <p style="text-align: right;"></p>
Labour	<p>Lack of sufficient labour in required skill categories</p> <ul style="list-style-type: none"> - Increasing foreign proportion of Malaysia's workforce (3% CAGR for overseas workers vs. 1.9% for local workers) - Slowly declining local labour participation rates (-0.4% 10yr CAGR) <p style="text-align: right;"></p>	<p>Middle-income status reflected in its unit labour costs (ULC)</p> <ul style="list-style-type: none"> - Manufacturing ULC on par with regional peers - However, including other sectors, overall ULC are stuck between higher-end value added players and lower-cost manufacturing focused economies <p style="text-align: right;"></p>	<p>Stagnating labour productivity</p> <ul style="list-style-type: none"> - Manufacturing and Total Factor Productivity growth has slowed: <ul style="list-style-type: none"> - Since the 90s - Versus its regional peers in recent years (e.g., Indonesia recently overtaking Malaysia in manufacturing labour productivity) <p style="text-align: right;"></p>

Four key constraints hold Malaysia back, with technology and know-how as the most critical



Four constraints restrain growth...

	Acc	Cost	Eff
1 Low technology adoption and knowledge acquisition			
Labour			

2 Lack of meritocratic allocation of resources by government			
Labour			

3 Insufficient qualified labour for future growth			
Labour			

4 Risk aversion by firms, government and individuals			
Labour			

...and manifest across several metrics

- Malaysia is in the lowest quartile amongst its SEA peers in the adoption and dissemination of new technologies
- When compared to its peers, Malaysia's government spending results in significantly lower GDP impact
- Malaysia's tertiary education enrollment is 37% while Korea is at 100%
- Malaysian children are attending fewer years of school in contrast to the reverse trend seen in regional peers
- Individual: Fear of failure prevents 45% of the 18-64 year olds from entrepreneurship
- Firm: 71% dividend payout & (20)% net debt
- Government: circular investment flows and distorted incentives

In order to address constraints, following policies are suggested to Malaysia (1/2)



Policies		1	2	3	4	
		Tech. & knowledge	Qualified labour	Meritocratic allocation	Risk aversion	
Business	1	Create institutions (e.g. Fraunhofer) that accumulate knowledge and help domestic companies upgrade technologies (incl. processes) by leveraging foreign and domestic institutions	✓	✓	✓	
	2	Continue investing in infrastructure (incl. registration, regulation, cheap financing) to prepare environment for key industries	✓	✓		✓
	3	Continue providing fiscal incentives to domestic and foreign companies investing in higher value-add industries (e.g. shrimp processing)	✓			✓
	4	Reform bankruptcy legislation to reduce institutional and legal punishment for failure	✓			✓
	5	Increase transparency and access to licenses / certifications	✓		✓	
	6	Establish clearer and positive image of Malaysia to attract talent, investment and tourists	✓	✓		

In order to address constraints, following policies are suggested to Malaysia (2/2)



Policies		1	2	3	4	
		Tech. & knowledge	Qualified labour	Meritocratic allocation	Risk aversion	
Education	7	Shift the content of education to better match the current and future market needs (e.g. critical thinking, specialization and English) and enhance teacher capabilities	✓	✓		✓
	8	Encourage greater flexibility in education resource allocation (e.g. foreign teachers, business professional as instructors, partnership with corporation)	✓	✓	✓	
Social	9	Rebalance affirmative action policies to account for socio-economic status and increase transparency of the policy		✓	✓	✓
Investment	10	Reevaluate regulatory framework for financial market structure (e.g. Allow more flexible EPF)	✓		✓	
	11	Reduce the mandated contribution to EPF to facilitate consumption and investment by contributors	✓		✓	