

What Malaysia Has to Change to Keep Up With Its Neighbors

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By Pooi Koon Chong and Shamim Adam

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- Nation faces steep challenges as cheaper-cost rivals emerge
- Competitiveness impeded by low productivity, education system

In Malaysia, Khairy Jamaluddin is canvassing ideas to "future-proof" a country he warns has trailed its counterparts for decades.

"If we're not ready for the next 30 years, then the stakes are high," the Youth and Sports Minister told business leaders in June. "We've spent the last 20 to 30 years [chasing](#) and trying to catch up with other advanced countries. If we don't future-proof Malaysia and plan it from now, then we're going to spend the next 30 years catching up as well."

For businessman Lim Wee Chai, that means Malaysia must speed up a move to more value-added production. While the country has shifted focus -- from tin and rubber industries that were the bedrock of the colonial economy to the electronics factories and palm oil plantations of today -- the transformation needs to go further, he said.

"Build more [chocolate factories](#) rather than more cocoa plantations," Lim, who is president of the Federation of Malaysian Manufacturers, said in an interview in Kuala Lumpur. Turning to about 120 research and development employees at Top Glove Corp., his company that supplies a quarter of the world's rubber glove market, he added: "no research, no future."

Perched on the lower end of peninsular Southeast Asia, Malaysia straddles some of the world's busiest waterways and is a conduit for trade between Europe and Asian economic powers like Japan and China. Bigger in area than all but four U.S. states, Malaysia is a net oil and gas exporter and the world's [second-largest producer](#) of palm oil.

The country is regaining favor as investors shrug off probes into the finances of a state investment company.

Credit-default swaps protecting Malaysia's sovereign notes are near the lowest in almost three years, while the benchmark stock index has more than doubled from 2008 lows and is now the world's longest-running bull market.

Approved foreign investments rose 63 percent in 2016 to 59 billion ringgit (\$13.8 billion), led by sectors such as electronics manufacturing.

Still, there are steep challenges for Malaysia as it turns 60 later this month. Smaller and cheaper-cost [rivals](#) in the region, like Vietnam, are reducing the competitive advantage of Malaysian manufacturers and becoming bigger contenders for [foreign investment](#).

[Read more: Malaysia's muddle](#)

With an election due in the next 12 months, Prime Minister Najib Razak needs to convince voters he can keep growth humming and wages rising. But right now, Malaysia risks becoming stuck as a middle-income country, said Francis E. Hutchinson, a senior fellow at the ISEAS-Yusof Ishak Institute in Singapore.

"Unless the country starts looking at issues like producing more scientists and engineers, more university graduates that are labor-ready and of better quality, spending more on R&D, and improving its legal and regulatory framework, it is possible that Malaysia will not be able to attain high-income status," Hutchinson said. "It's not a static benchmark."

Malaysia dropped [five places](#) this year to 24 in a ranking of the 63 most competitive economies by the Lausanne-based Institute for Management Development. When measuring the extent to which basic, technological, scientific and human resources meet the needs of business, it came in at 32.

"Attempts to shift Malaysia's economy towards one that is being driven by productivity will face limited success," said Chia Shuhui, an Asia analyst at BMI Research in Singapore. It "will be hindered by Malaysia's [inadequate education](#) system and exacerbated by the nation's ongoing brain drain."

Enter Khairy, who's spearheading an initiative to outline a social and economic vision for Malaysia in 2050 and the policies to achieve it. He said companies are still too labor intensive, productivity is low, and mechanization rates trail Thailand and Singapore.

Access to cheap foreign labor lowers the incentive for businesses to automate and innovate, keeping wages depressed, Khairy said. Youth unemployment is creeping up, reaching 10.7 percent in 2015 compared with the national rate of 3.1 percent that year.

[National Transformation 2050](#) -- or TN50 as it is known -- follows previous master plans to restructure the economy. The New Economic Policy from the 1970s gave social and economic benefits to the indigenous majority under a program designed to rebalance wealth and eradicate poverty. It still exists, though business leaders argue the affirmative-action programs [impede competitiveness](#) and are shackling Malaysia.

Vision 2020 was a strategy introduced by then-Prime Minister Mahathir Mohamad in 1991 to transform the country into an industrial powerhouse from an agricultural nation. The target was to be a developed economy by the end of this decade.

While those blueprints helped lifted millions out of poverty and allowed Malaysia to [narrow the gap](#) toward achieving high-income status, the country isn't moving fast enough to keep up with other industrialized nations.

Malaysia's selling point can't be cheap labor anymore, said Roberto Benetello, chief executive officer of the EU-Malaysia Chamber of Commerce and Industry. European companies need workers who can operate in a high-tech environment and they bring it up as a critical issue for Malaysia, he said.

"It really is important to move the skills of people, of talent, at the same speed and along the same line as the sophistication of your manufacturing capabilities and your productivity," Benetello said.

Malaysia doesn't grow much cocoa, but it has become the continent's No. 2 processor by grinding beans imported from Indonesia. Malaysia has 51 chocolate manufacturers and confectioneries and 194 local chocolate producers, selling about 1.1 billion ringgit a year. In comparison, the cocoa it cultivated last year was valued at \$5 million when calculated using average futures prices for 2016.

"We need to learn from advanced countries, why they are so advanced," said Lim of the manufacturing federation. "Invest in the right things. Then only you can compete."

— With assistance by Anisah Shukry, and Anuradha Raghu

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