Chapter 1

Introduction

1.1 An Overview of the Malaysian Manufacturing Sector Growth

In the four decades since Malaya achieved independence in 1957, the Malaysian economy has undergone significant transformation and rapid growth. Prior to independence, the Malaysian economy was based predominantly on the primary sector. The primary sector, consisting of agriculture and mining was a major contributor to Gross Domestic Product (GDP) as well as employment. It generates 45.7 per cent and 1.3 per cent of the GDP and total employment, respectively. In contrast, the manufacturing sectors in Malaysia offered negligible GDP shares and employment opportunities. Its contribution to GDP and employment was only 11.1 per cent and 9.6 per cent respectively, about one quarter of the agriculture output and one sixth of its employment size.[1]

At that time, Malaysian industrial activities were mainly primary commodity processing such as rubber milling and packing, and tin smelting. Other industries were handicrafts (includes attap making, rattan ware, tailoring and dressmaking), rural industry (food, drink, and tobacco processing), engineering (railway workshops) and others (includes bricks, tiles, rubber goods, furniture and etc).

[1] Samuel *et al.* (1999). *The Changing Phases of Malaysian Economy*, Pelanduk Publications, Selangor. p.25

During the pre-independent period, most establishments in the Malayan manufacturing sectors were small-scale family enterprises employing less than twenty persons. Not many of the establishments had large-scale and highly capitalized production processes or were funded by large amounts of capital.

After independence in 1957, the Malayan government adopted a strong industrialization strategy. The reasons for this were rapid population growth and the need for diversification of the economy. With a population growth rate of more than 3.3 per cent per annum at that time, it was unlikely that the agriculture sector would be able to absorb the expected increase in the labour force. Furthermore, fluctuations in price of rubber and tin made the government aware that the economy needed to be diversified to eliminate its heavy dependence on primary commodities.[2]

In the early 1960s, the major development strategy of the government was the import substitution strategy. The first measure taken to accelerate industrial development was through tax incentives offered to pioneer industries, along with the introduction of tariff protection and other qualitative restrictions on imports to encourage the establishment of import-substituting industries.[3] As a result, during the 1960s, net output in Malaysian manufacturing grew rapidly from 9 per cent of GDP in 1960 to 13 per cent in 1970 (Table 1.1).

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[2] Fong (1989). *The Malaysian Economic Challenge in the 1990s: Transformation for Growth*. Longman Singapore Publishers, Singapore. p. 192-194.
[3] Fong, *op.cit.*, p. 194.

In spite of rapid expansion of the manufacturing sector, export earnings are stagnant due to the fall in rubber price and the failure of iron ore to increase its export volume. The impetus of output growth was mainly caused by an increase in domestic demand. Domestic output grew at 9.2 per cent while export grew at 2.8 per cent from 1960-65.

With the implementation of export-oriented industrialization in 1970s, the manufacturing sector experienced tremendous growth and underwent structural changes. Various new measurements – notably the establishments of Free Trade Zone Act (FTZ) in 1971 were introduced. Under this Act, companies established themselves in FTZs to export goods without customs formalities, and import all its needed parts and components duty free. Thus, export of manufactures from Malaysia grew rapidly especially in the second half of the 1970s. By 1980, exports of manufactures accounted for more than a fifth of all exports from Malaysia (Table 1.2). Most of the growth was in electronics and electrical machinery and to a limited extent, in textiles and clothing.

At the beginning of the 1980s, a new phase of industrialization was launched under the leadership of a public sector agency – the Heavy Industries Corporation of Malaysia (HICOM). Most of the investments in heavy industrialization projects such as iron and steel, cement, and the national car were financed by external borrowings. As a result, Malaysia's effective exchange rate rose in real terms and as it did so; the export-oriented manufacturing sector became less and less competitive.[4]

[4] Chris Edwards(1991). Tariff and Trade-related Policies for Malaysian Industrialization in Vijayakumari Kanapathy (eds), *Managing Industrial Transition in Malaysia*. Institute of Strategic and International Studies (ISIS) Malaysia. p.19.

The years 1985 and 1986 saw Malaysia's deepest recession of that decade. In 1986, real GDP was at about the same level as it had been in 1984. There was particularly severe recession in manufacturing in 1985, with real output in that year falling by over three per cent. The government took drastic measures to pull the economy out of the recession and to correct the imbalances. The recovery began in 1987; the economy grew at 6-7 per cent in 1988 and growth was led by the manufacturing sector. This period also saw the results of structural changes introduced over the years – the manufacturing sector overtook agriculture as the main contributor to GDP.

The growth momentum, which dominated three decades, continued for most of the 1990s. Between 1991 and 1997, real GDP grew by 8.9 per cent per annum. The rapid expansion of real output was due to the investment in physical infrastructure, research and development (R&D), education and skill training, and large inflow of Foreign Direct Investment (FDI). Together these factors led to the dramatic shift of industrial focus from an investment–driven economy, which dominated the 1970s and 1980s to a productivity-driven economy of the 1990s. The total factor productivity (TFP) increased from 1.2 per cent or 17.9 per cent of GDP during 1971-90 periods to 2.5 per cent or 28.7 per cent of GDP growth between 1991 and 1995.[5]

For international comparison, Malaysia's productivity growth (5.5%) exceeded that of Hong Kong (2.6%), Taiwan (4,7%) and the Republic of Korea (5.2%) but was not on par with that of growth in Singapore (7.1%) for the period 1993-95. On the manufacturing sector, Malaysia's productivity growth from 1993-94 was 6.3% which

[5] Mid-Term Review of the Seventh Malaysian Plan 1996-2000.

was higher than Taiwan (5.7%). In 1997 the manufacturing sector experienced a growth in productivity of 5.7% exceeding that of Singapore (2.3%), Indonesia (2.1%), and Japan (1.0%). (Table 3)

Table 1.1

Malaysia: Gross Domestic Product by Sector (%), 1955-1990.

	1955*	1960*	1970	1980	1990
Agriculture	40	40	31	23	19
Mining	6	6	6	10	10
Manufacturing	8	9	13	20	27
Others	46	45	50	47	44
Total	100	100	100	100	100

Note: * denotes Peninsular Malaysia only.
Source: *Ministry of Finance*, 1990/91 p.xiii, as cited by Chris Edward (1991).

Table 1.2: Exports of Manufacturing from Malaysia, 1970-1989

	Exports of Manufactures (RM billion)				Total exports (RM billion)	M'fes as % of total exports
Year	Textiles, clothing & footwear	Electrical goods	Others	Total		
1970	-	-	-	0.6	5.2	12
1975	0.2	0.3	1.5	2.0	9.1	22
1980	0.8	2.8	2.5	6.1	28.0	22
1985	1.3	6.0	4.8	12.1	38.0	32
1986	1.6	8.0	5.7	15.3	35.3	43
1987	2.0	11.0	7.3	20.3	45.2	45
1988	2.4	15.2	9.5	27.1	55.3	49
1989	3.2	20.7	12.7	36.6	67.8	54

Source: *Ministry of Finance*, 1974/75, p.xviii; 1982 p.xiv ,xxiv & xxv;1990/91 p.xxi & xxix, as cited by Chris Edward (1991).

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Table 1.3: Comparison of Productivity Levels of the Manufacturing Sector with Other Asian Countries, 1994-1997

Country	1994	1995	1996	1997
Malaysia	6.4%	7.3%	5.8%	5.7%
Singapore	14.43%	6.6%	3.5%	2.3%
Republic of Korea	9.44%	9.0%	8.5%	n.a.
Taiwan	5.66%	7.6%	5.6%	n.a.
Philippines	-0.15%	9.2%	2.5%	n.a.
Japan	n.a.	8.1%	-2.5%	1.0%

n.a.: not available
Source: NPC, *Annual Productivity Report*, 1994-1997.

1.2 Rationale of Study

Malaysia's rapid economic growth of more than 8 per cent per annum in the past ten years (1988-97) led to a situation where full employment was achieved well ahead of the target set. The full employment situation since 1992 resulted in a tight labour market that has affected wage trends. Moreover, the gap between supply and demand of skilled workers led to the incidence of high labour turnover and firms resorting to staff pinching and awarding wage increases, to attract workers without relating to productivity or performance.[6]

In line with this situation, a lot of focus has been placed on the importance of the wages and productivity relationship. This idea has been addressed by the government in following plan:

In the Seventh Malaysia Plan (1996-2000), it is stated, " The Government will, continue its effort to encourage the wider adoption of productivity-related wage

[6] National Productivity Corporation (NPC). *A Handbook on Productivity Linked Wage System*, 1999.

mechanisms throughout the economy."(p.20). " The Government, in collaboration with the private sector, will study the various wage schemes that enable firms to link wages to productivity and encourage wider application of such productivity linked wage schemes." (p.131)

The National Economic Recovery Plan (1998) states, "The tight labour market prior to 1998 had resulted in an upward pressure on wages not commensurate with the increase in productivity. To maintain competitiveness, it is critical that labour productivity growth is higher than wage increases." (p.103)

Lastly, the Mid-Term Review of the Seventh Malaysian Plan (1999) mentioned " The strategic thrust of human resource development includes the implementation of wage schemes linked to productivity and work performance."

The rationale of this study is therefore to verify whether industrial wages in Malaysia respond to sectoral performance, that is, the increases in wages are commensurate with higher increases in labour productivity. In view of the increased competition due to the globalization of economies, it is imperative for firms to ensure increases in wages are kept in pace with increases in productivity.

1.3 Objectives of Study

The objectives of this study are as follows:

1. To analyse wage structure and wage trends of the workforce in Malaysia from the early 1975s to 1997.
2. To examine the key factors in the wage determination process for the manufacturing sector.
3. To verify whether changes in industrial wages are relevant in explaining changes in sectoral performance, as measured by labour productivity.

1.4 Organization of Study

The study is organized into seven chapters. The first chapter comprises the rationale and objectives of the study. Chapter Two consists of the literature review. The following chapter discusses the wage trend of the workforce and wage determinants in Malaysian economy. In Chapter Four, a theoretical framework of the wage bargaining model used in Malaysian manufacturing wage formation analysis will be discussed. Chapter Five presents the methodology of this study which is used to investigate long run relationships and short term dynamics in the manufacturing wage formation process. The Sixth Chapter reports on the findings of this study by means of econometric analysis. The final chapter concludes the findings of the past chapters.