Stronger productivity growth would put Malaysia on a path to become a high-income economy

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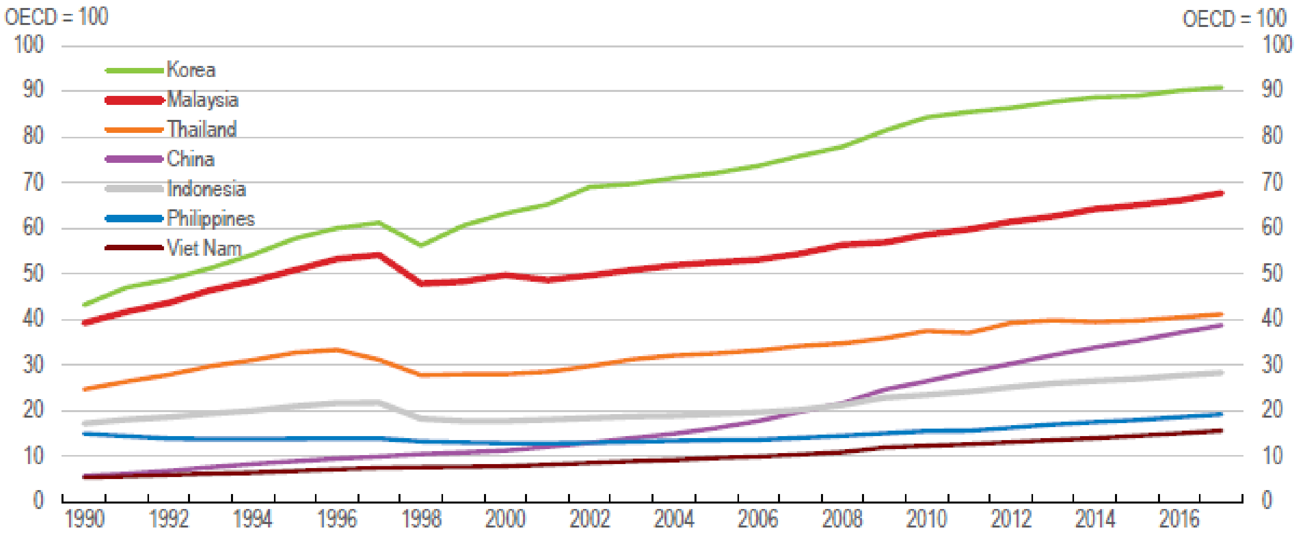
Malaysia is enjoying remarkable economic growth. Real GDP grew at an average rate of 6.1% per year over 1970 to 2018 period, and short-term prospects are for growth to reach almost 5% in 2019-20, despite a difficult international environment. Thanks to pragmatic policies, Malaysia has transformed from an agricultural-based to an industrial- and services-based powerhouse deeply integrated in global supply chains. Living standards are now close to two-thirds of the average in OECD countries (Figure 1) and per capita GDP exceeds levels in Mexico, Turkey and Chile.

The Mid-Term Review of the Eleventh Plan, announced in October 2018, postponed the target year of achieving a high-income nation status from 2020 to 2024 due to recent macroeconomic developments. To achieve the planned target would require implementing an ambitious agenda of reforms focused on productivity gains and skills development (OECD, 2019).

Figure 1. With further reforms, Malaysia could soon become a high-income economy

Per capita GDP, relative to the OECD average, computed at 2011 USD PPP

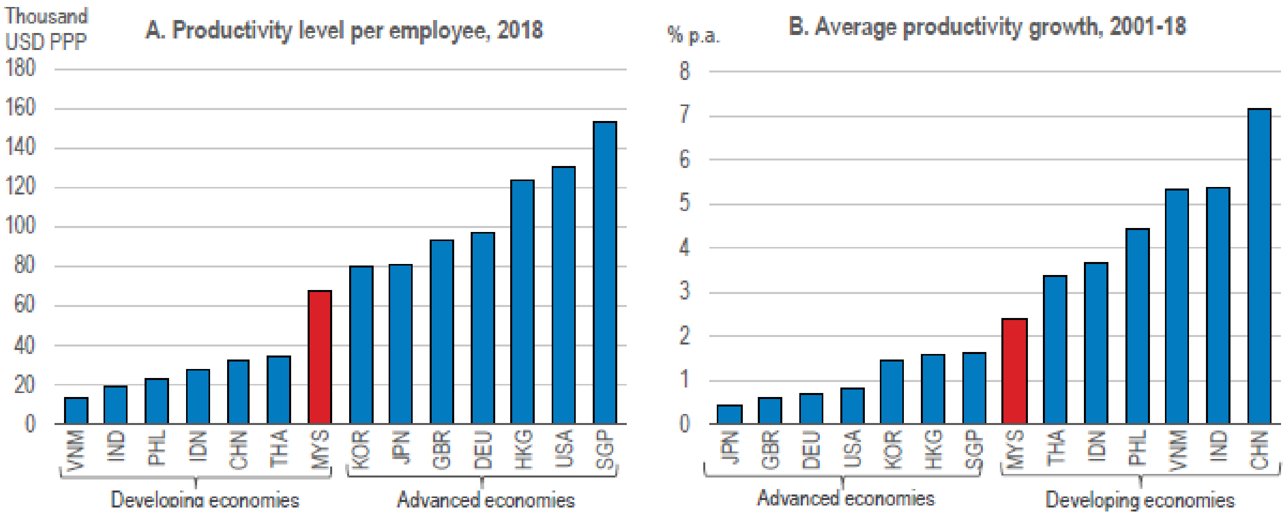


Source: World Bank, *World Development Indicators database*.

Since the mid-1990s, Malaysia has embarked on a programme to promote innovation and transform the economy from an input-driven to a knowledge-based one (EPU, 2015a). However, Malaysia’s productivity levels remain weak and the economy is still highly dependent on, and driven by factor inputs, especially non-ICT capital accumulation.

As a result, Malaysia’s productivity level continues to lag behind most advanced countries. For instance, based on purchasing power parity terms, Malaysia’s productivity level in 2019 was about half that of the United States and Singapore (Figure 2). On the other hand, Malaysia’s productivity level is ahead of its regional peers like Thailand, China, Indonesia, India and Viet Nam. However, these countries experience higher productvity growth than Malaysia, implying a rapid catching up of these countries.

Figure 2. Labour productivity level still lags behind advanced countries



Source: The Conference Board (2019), *Total Economy Database*, April.

Human capital development is a key priority to boost Malaysia's labour productivity. The importance of improving human capital has been highlighted in most development plans and industry-specific masterplans. Currently, Malaysia's industries are excessively dependent on semi- and low-skilled workers and foreign low-skilled labour (MEA, 2018), as shown by the ratio of skilled workers to total employment, which is still low at 27.2% as compared to the target of 35% by 2020 set by the government (EPU, 2015b). As a result, the contribution of labour quality to economic growth remains low. On average, labour quality contributed only about 8% to real GDP growth over 2001-18, much lower than the OECD average. Skilled workers are crucial to facilitate innovation and technology adoption as well as to promote upgrading of activities to unlock potential economic growth. Therefore, efforts need to be intensified in producing high-quality talent pool to support the Malaysian government's aspiration of becoming an advanced and inclusive country.

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