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Malaysia's Biggest Economic Challenge

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Introduction

Aspiring to become a high income nation by the year 2020, Malaysia is soon to show its results to the world. With per capita income of US$9,850 in 2016 (Kok, 2017), Malaysia is moving towards the high income threshold of US$12,236 as set by the World Bank. Despite the rapid economic expansion during the turn of the century, Malaysia currently face certain challenges that might hinder its growth in the near future.

Greatest Economic Threat that Malaysia Faces

In my opinion, the greatest economic threat that Malaysia is facing right now is the middle-income trap. The trap is described as the phenomenon whereby rapidly growing countries experience stagnant income levels, unable to advance to high-income from its current middle-income (Aiyar et. al., 2013). Countries in the middle-income trap often find it hard to break-away. An article by The Economist (2012) reported that only 13 countries in history has escaped the middle-income trap, and Malaysia is absent from the list. Despite local economists arguing that Malaysia has broke free of the middle-income trap (FMT, 2017), its effects are still felt till today and there is always a chance of falling back into the trap.

Contributing Factors of Countries Falling in the Middle-Income Trap

One of the factors causing the middle-income trap is the loss of comparative advantage in manufacturing costs paired with the inability to keep up with more developed markets. Malaysia is currently facing a situation where it is incapable of competing with the low prices of neighboring countries such as Myanmar, Cambodia, and Laos and at the same time, Malaysia does not have the technology to compete in the high-quality goods market. It is a lose-lose situation.

Besides, rising prices further entrench Malaysia’s position in the middle-income trap. The implementation of the GST has reduced the spending power of citizens due to higher commodity prices. Moreover, the housing sector plays a part in this too. Real estate prices have skyrocketed and word on the streets is that the market is in a bubble, though this has been denied by several industry experts (New Straits Times, 2017). The exorbitant prices denies ordinary citizens of the opportunity to own a property as the monthly installments take up a huge portion of their monthly income. With rents increasing and shelter being a basic necessity, this expense is inevitable and will definitely decrease disposal income and subsequently consumption levels.

Moreover, the plummet of the Ringgit, caused by a combination of factors such as the 1MDB scandal and the oil glut has worsen the whole situation. With the weak Ringgit, all imported raw materials and consumer goods experienced cost push inflation, increasing the burden of both consumers and manufacturers. As investors lose their confidence, the domestic economy is experiencing an outflow of capital which might further deteriorate the floating exchange rate. Hence, the local firms who are doing import trading are heavily impacted as their costs are increasing drastically.

Impact Towards The Economy

The middle-income trap has negatively impacted Malaysian households and the economy as a whole. Viewing it from the consumption perspective, low private consumption is expected to occur in the short-term. Although consumer spending remains at a healthy level, it has not reach its full potential due to cautious consumer spending. Due to the rising cost of living and weakening consumer sentiment, households have decreased their spending in order to maintain the same saving level. In term of housing ownership, due to the rising property price, households have begun to save more for a larger property downpayment, especially since the mortgage approval rate has declined in recent years. As a result, a leakage from the market's circular flow is expected, which will be a further headwind for Malaysia to achieve its high income nation goal.

Furthermore, investment levels will be affected as well. Lower disposable income potentially leads to lower consumption from the public, which subsequently diminishes the intention of investors to invest in the country. Businesses, for example, will either establish themselves in other countries with better growth prospects or close down due to their inability to make profits. There are signs of lower investment happening already as shown by the Global Competitive Index. The index shows the competitive levels of the countries based on their productivity drivers. Malaysia was ranked 18th in year 2015/2016 but has slid to 25th in the following year (WEC, 2017). Domestic investments are reported to be down by 5% as well (Tan, 2017) and the introduction of the GST has made matters worse. Potential business owners are hesitant to borrow money for investing into a business as the costs needed to sustain a business have increased. Hefty administrative and compliance costs are also expected for a newly-formed business due to GST. With uncertainty in the demand of goods and services and a more cautious spending pattern, it is little surprise that investors opt to hold back and invest in more promising markets. The lack of investments will negatively impact the country's economic prospects and will definitely deter hopes of breaking through the middle-income trap.

In the social context, it is highly likely that the middle-income trap will lead to an outflow of skilled human capital. The brain drain issue has worsened over the past decade and there are no signs of decline (Nadaraj, 2016). Apart from political and social issues contributing to this phenomena, stagnant real growth in wages played a big part as well. Statistics show that median wages have increased steadily in recent years. However, it is cancelled off, and in some years, overtaken by the inflation rate. Hence, the net effect is that there has been no changes in real wages and disposal income for an individual. Younger professionals might seek better employment options overseas and eventually migrate to that country as they perceive that said country can provide a better social and economical environment for themselves and their future family. This is evident in the Malaysian context whereby young Malaysians are hoping to enrol into the best universities outside Malaysia and build their career in the said country.

Possible Solutions to Tackle and Breakthrough the Trap

To overcome the middle-income trap, several measure should be taken in order to boost business activity in Malaysia. Data shows that 65% of total employment in Malaysia are provided by small and medium enterprises (SME) (World Bank, 2016). These SME contributed nearly 36% of Malaysian GDP. It can be said that SMEs are the backbone of the local economy. However, SMEs nowadays are facing financial constraints in the form of tightening loan approvals from banks and fluctuating commodity prices. For those SMEs who import raw materials from other countries, they further face the disadvantage of a weak exchange rate. Therefore, grants and credit should be provided for SMEs to encourage R&D in order to improve productivity or to reduce the cost of production, which will ultimately help the SME's sustainability in the long-run. The Ministry of International Trade and Industry should also play a role in helping SMEs promote their products in the global marketplace in order to boost their revenues and expand their businesses.

As mentioned above, investments have shifted to neighbouring countries due to their lower cost of production. Governments should work to keep these investments within the country and attract more investments into the country by providing more beneficial conditions to all investor, such as better infrastructure, a more productive workforce, and tax reductions or exemption for the first few years. The initiative in making Malaysia a favourable place for businesses and investment is crucial for the future growth of the country and the improvement in households' income.

In order to tackle the rising cost of living, the government plays a pivotal role in monitoring the price setting of products in the country. Regardless of cost-push inflation, the government should implement a certain level of protection to cushion the impact of rising cost towards households. Initiative like setting ceiling price on necessities, increasing the minimum wage, and giving out subsidies to vulnerable groups can be implemented to counter the inflation in the short-term period. However, continuous subsidies from government will not be a viable option in the long-run as this will worsen the country's budget deficit might potentially set Malaysia into another financial crisis. Therefore, households should also reduce their dependance on the government and seek for alternatives in tackling this issue. Besides ordinary income, households can seek side income by investing a portion of their savings into investment vehicles. Despite the volatility of the financial market, households can choose to invest in some lower risk investment vehicle such as bonds compared to the risky stock market. Good financial planning will not only help households survive during the lows, but also thrive during the boom.

Conclusion

In conclusion, despite the positive projection of Malaysia's GDP growth, the economy as a whole has not fully benefitted from it as the growth is offset by the impact of inflation and a weak Ringgit. To escape from the middle-income trap, the focus should remain on empowering national growth but at the same time focus on solutions to mitigate contributing factors of the middle-income trap. Governments should not be the sole authority that works toward this goal, but collaborations should occur with the private sector as well due to the ability to contribute a fair share towards achieving the high-income status. These collaborations ensure different perspectives are being considered and the best possible solution that benefit all sectors can be made to march towards the common goal, a nation that prospers with high-income earning citizens by the year 2020.

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