




Living Wage in Malaysia: A Livable Solution or A Living Dream?

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As Malaysians readily embraced a long-awaited political upheaval in the recent general election, all eyes are set on the Pakatan Harapan government's plans to fulfill the pledges in their election manifesto. The euphoria surrounding the unexpected victory of the former opposition in the election was short-lived by growing concerns of mounting national debts and the reality that the government may not be able to deliver all the changes it promised, and one such promise is a 50% increase in minimum wage. In fact, a living wage report published by Bank Negara Malaysia in May this year has fuelled debates on the optimal level of minimum wage which should be set based on the economic conditions of Malaysia. Initially established as an unofficial benchmark for firms to set wage levels, the living wage refers to the minimum wage required for an individual to attain a minimum acceptable standard of living. A 'minimum standard of living' includes social participation, such as being able to afford occasional trips to visit friends and family, and financial security.¹

¹ Chong, Eilyn, and Farina Adam Khong. "The Living Wage: Beyond Making Ends Meet." *Publications | Bank Negara Malaysia | Central Bank of Malaysia*, Bank Negara Malaysia, Mar. 2018, www.bnm.gov.my/index.php?ch=en_publication.

| |  Single adult |  Couple, without child |  Couple, with two children |
|--|--|--|--|
| Estimates of a living wage in Kuala Lumpur (RM/month) | 2,700 | 4,500 | 6,500 |
| Key assumptions on the representative basket of goods and services | <ul style="list-style-type: none"> • Rents a room • Eats out more often, cooks occasionally • Drives less, uses more public transport | <ul style="list-style-type: none"> • Rents a one-bedroom apartment • Eats out half of the time • Owns two vehicles (a motorcycle and a car) | <ul style="list-style-type: none"> • Rents a three-bedroom apartment • Cooks most of the time, eats out during weekends • Owns two vehicles • Pays for private extra classes and childcare |

Note: The estimates above are provisional and subject to further revision as the underlying assumptions and cost estimates are refined. Single-adult households include adults who live alone and those who live together with non-related members of a household.

Source: Bank Negara Malaysia estimates using data from Household Expenditure Surveys 2014 and 2016, Department of Statistics, Malaysia, Ministry of Domestic Trade, Co-operatives and Consumerism, and the National Property Information Centre

Figure 1

Source: 'The Living Wage: Beyond Making Ends Meet' Living Wage Report, Monetary Policy Department, Bank Negara Malaysia, March 2018

Setting the minimum wage according to the living wage concept will ameliorate Malaysians' standard of living, and the stakeholder that gains the most will be the bottom 40% (B40) of households with low income. To put things into perspective, the average income for B40 households grew by an average of 5.8% annually from 2014-2016, which was marginally lower than the 6% annual growth in the B40 household spending². Despite the increase in average income, the income share of B40 household group has decreased from 16.8% to 16.4%³. Hence, a higher minimum wage will certainly help reduce the widening gap between income and expenditure, helping B40 households achieve a higher standard of living. Considering the fact that approximately 50% of Malaysian households earn below

² Salaries and Wages Survey, Malaysia, 2017, Department of Statistics, Malaysia

³ Report of Household Income and Basic Amenities Survey 2016, Department of Statistics, Malaysia

the national median income in 2016⁴, the impact of setting a minimum wage commensurate with the estimated living wage on the current income gap will be significant. Moreover, this will, in theory, rectify the imperfection of the labour market, manifested in the monopsony power of dominant firms in the market that suppresses the increase in wage.

Another strong case for setting a higher minimum wage based on the living wage concept stems from economic theories of the labour market. Increasing the minimum wage means incentivising more people of working age to join the labour force and, as outlined by the efficiency wage theory, increasing the productivity of labour as there will be a greater motivation to work. Given that Malaysia's current labour force participation rate (LFPR)⁵ is 68.2%,⁶ setting the minimum wage higher will, inferring from the law of supply of labour and the ceteris paribus assumption, encourage more people to join the labour force and expand Malaysia's production possibility frontier as idle factors of production will be utilised to increase the level of output of the economy. As wage increases to a level commensurate with household expenditure necessary to attain a minimum acceptable standard of living, the disposable income will rise, resulting in an increase in the consumption and investment components of the aggregate demand which then translates into economic growth. Bearing in mind that the demand of labour is a derived demand, increasing levels of aggregate demand will have a positive impact on the demand of

⁴ Report of Household Income and Basic Amenities Survey 2016, Department of Statistics, Malaysia

⁵ LFPR refers to the percentage of Malaysians of working age who are in the labour force.

⁶ Key Statistics of Labour Force in Malaysia, May 2018, Department of Statistics, Malaysia

labour, ultimately contributing to more employment and economic growth of the country.

A concomitant fall in welfare spending with a higher minimum wage will be a boon to economic growth, as government could spend more on the public sector and pay off national debts. Indeed, imposing a minimum wage commensurate with the level of living wage could be a pre-emptive measure to prevent the over-dependence of the aging population on the government's welfare spending - an issue that has been fuelling budget deficits and soaring national debts in developed countries like the U.K. and the U.S.; a subsequent increase in employee's investment in the Employee Provident Fund due to higher wages will reduce current workers' future reliance on government aids to sustain their livelihood upon retirement. With a greater budget for public spending, the government could adopt the expansionary fiscal policy to spur economic growth and create more job opportunities to combat unemployment. These allow the government to invest more in capital and technology for targeted industries with great potential, such as the palm oil industry to increase productivity and achieve a sustainable economic growth.

However, the limitations of economic theories in providing one-off solutions to real world problems are aptly highlighted in the words of prominent economist Thomas Sowell, 'There are no solutions, only trade-offs'. The salient point here is that imposing a legally minimum living wage will entail trade-offs, as a higher standard of living as a result of higher minimum wage may attract a greater influx of foreign workers to Malaysia, further complicating the migrant worker conundrum.

Besides that, the LFPR may not rise as expected because most Malaysians who are not in the labour force are women who choose not to work due to reasons other than a low wage rate; out of the 7.1 million Malaysians of working age who were not in the labour force, 42.7% and 41.2 % of them cited 'schooling' and 'housework and family responsibilities' as the main reasons to not join the workforce respectively⁷. The *ceteris paribus* assumption must be dismissed in assessing the possible impact of a higher minimum wage as an incentive to utilise the idle workforce in Malaysia to achieve economic growth, and it is clear in this case that a hike in the LFPR is quite unlikely given the irrelevance of the incentive of a higher wage rate.

⁷ Labour Force Survey Report, Malaysia, 2017, Department of Statistics Malaysia.

2017 Wages by Sector in Malaysia

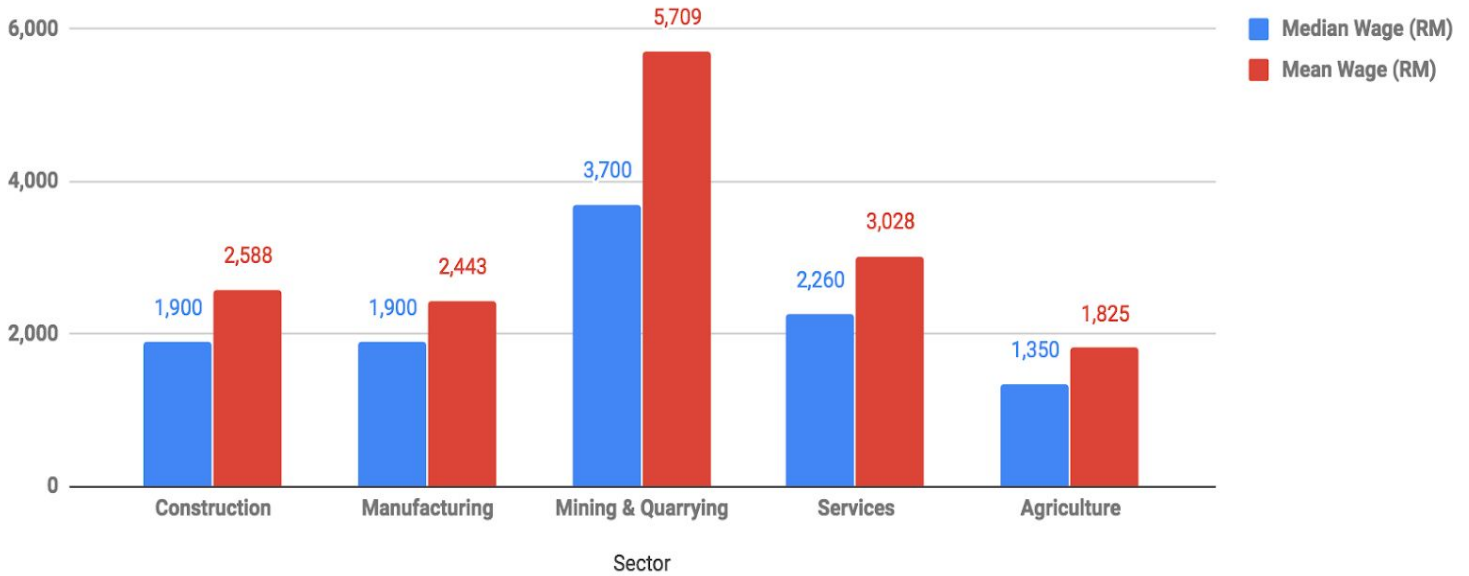


Figure 2

Source: Salaries and Wages Survey, Malaysia, 2017, Department of Statistics, Malaysia

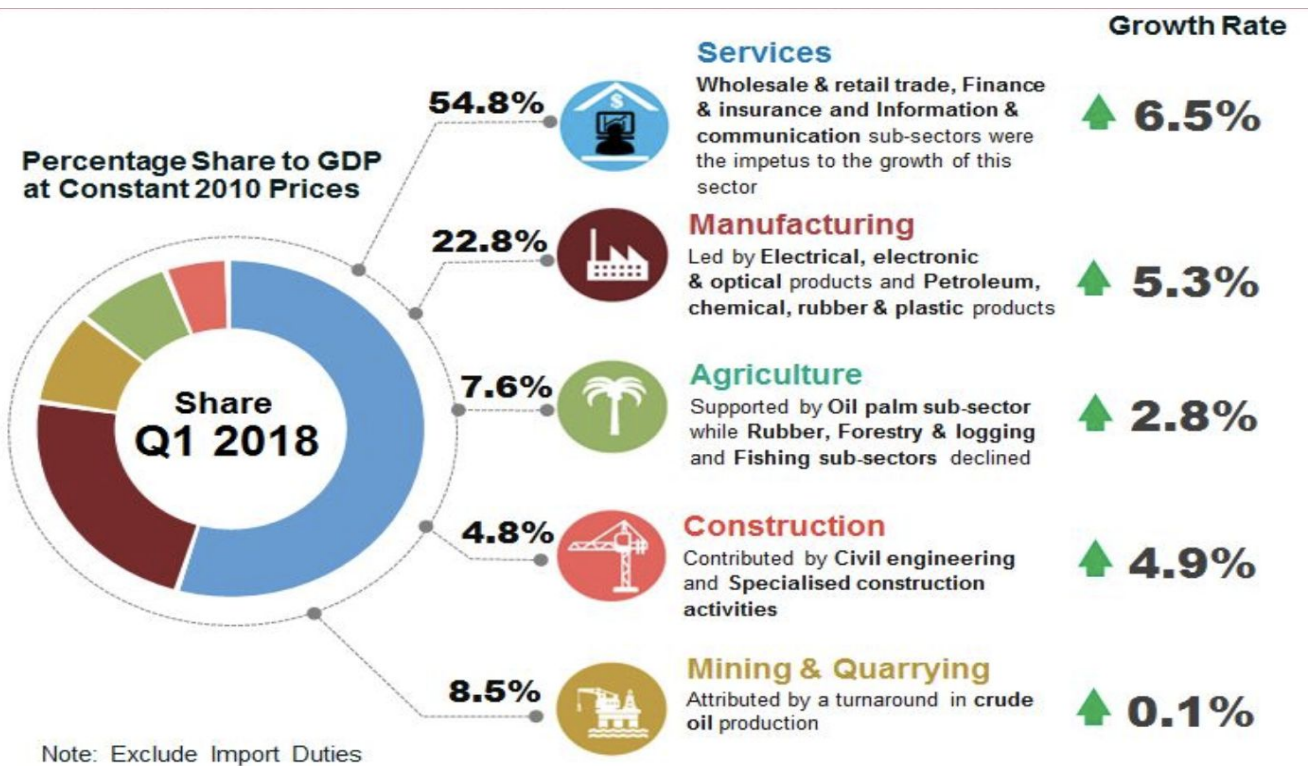


Figure 3

Source: Malaysia Economic Performance First Quarter 2018, Department of Statistics Malaysia, Official Portal

Considering the fact that the services and manufacturing sectors are the largest sectors - each with a percentage share of GDP of 54.8% and 22.8% respectively (Figure 3) - in the Malaysian economy, the effects of setting a higher minimum wage on these sectors will determine the most likely overall impact on the whole economy. Assuming that the average household size of the B40 group is 4 people⁴ that, according to Bank Negara Malaysia's estimate, needs a wage of RM 6,500 to attain a minimum acceptable standard of living (taking the cost of living in Kuala Lumpur as a benchmark), both the mean and median wages across all 5 sectors, apart from the mining sector, are well below the living wage, as shown in figure 2. Even if there is an average of 1.8 income recipients in the majority of Malaysian households⁸, only Malaysians working in the mining and quarrying sector earn the living wage on average, despite the sector's mere 8.5% share of the overall economy. This means that setting a minimum wage parallel to the living wage concept is equivalent to increasing the cost of labour by at least 50% on average across the construction, manufacturing, services and agriculture sectors that aggregate up to a whopping 90% of Malaysia's GDP. The scale of the impact of setting a higher minimum wage is too significant to be ignored: prices of majority of the goods circulating the economy will increase due to higher cost of labour, offsetting the increase in real disposable income of Malaysian households. This countervailing effect of increasing the minimum wage will be aggravated when multinational companies shift their production plants to other countries with cheaper labour, costing Malaysia job and foreign investments.

⁸ Report of Household Income and Basic Amenities Survey 2016, Department of Statistics, Malaysia

Whilst the prospect of a 'one-wage-feeds-all' policy may be very appealing to the new government which is prone to political myopia, it is critically important to assess the economic conditions of the nation, not just domestically but internationally, before making any predictions of how such a policy might help solve or exacerbate the issues faced by Malaysians in the long run. The Malaysian economy which is heavily dependent on exports has been confronted with unprecedented challenges in times of economic turbulence. As two of the largest economies in the world set to engage in a trade war whose impacts on international trade are not definitely known by even the brightest economists in the world, Malaysian exports could take the brunt of this unprecedented economic turbulence between U.S. and China. As shown in Figure 4, Malaysian exports to China constitutes 13.1% of total exports, and a breakdown of the exports sold on the Chinese market, illustrated in Figure 5, shows that majority of the exports are intermediate goods, such as integrated circuits and semiconductor devices used to manufacture electronic goods which are one of the main exports of China. Given that the U.S. is the largest importer of Chinese goods, a fall in China's exports as a result of the high import tariffs imposed by the Trump administration will affect Malaysia's exports to China. Hence, there is a justified concern that the economic challenges in the external market may affect economic growth, and a hike in minimum wage may increase the cost of production and the price of exports, forcing multinational companies to move their production lines to countries with cheaper cost of labour such as Vietnam and China.

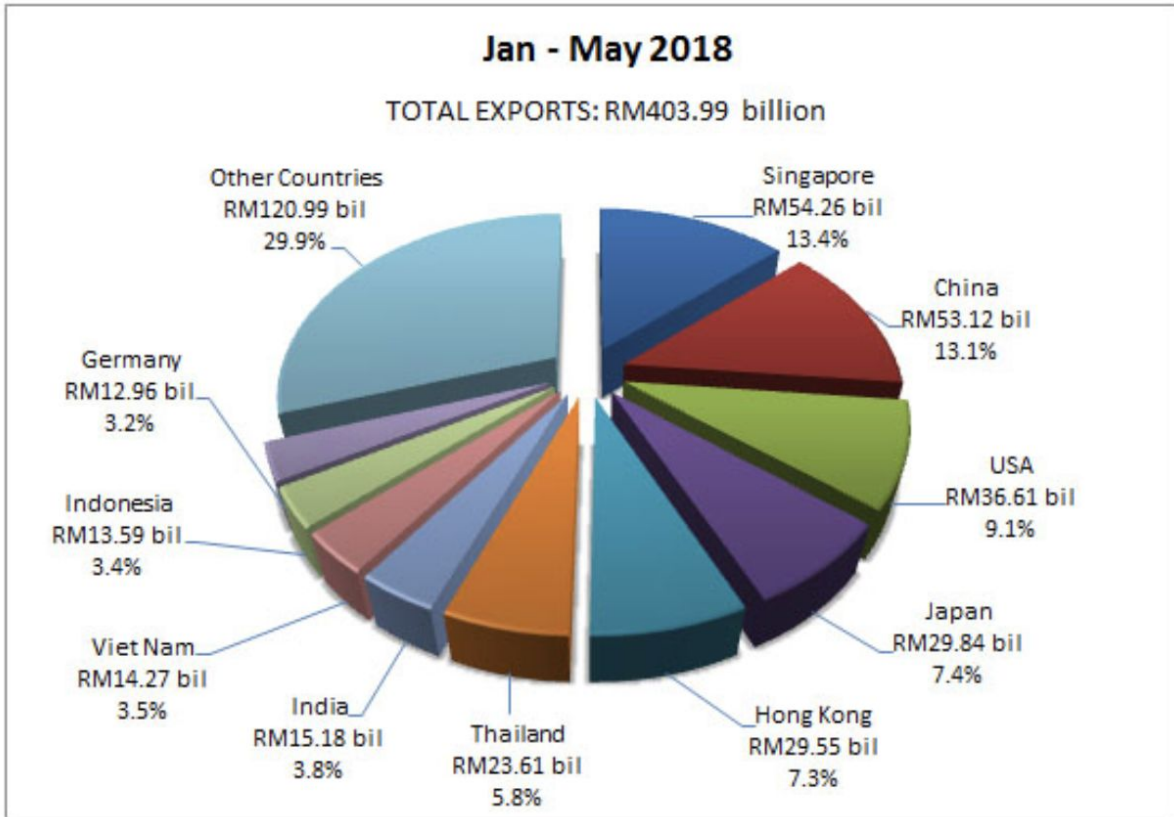


Figure 4

Source: Top 10 Major Export Countries, 2018, Malaysia External Trade Development Corporation

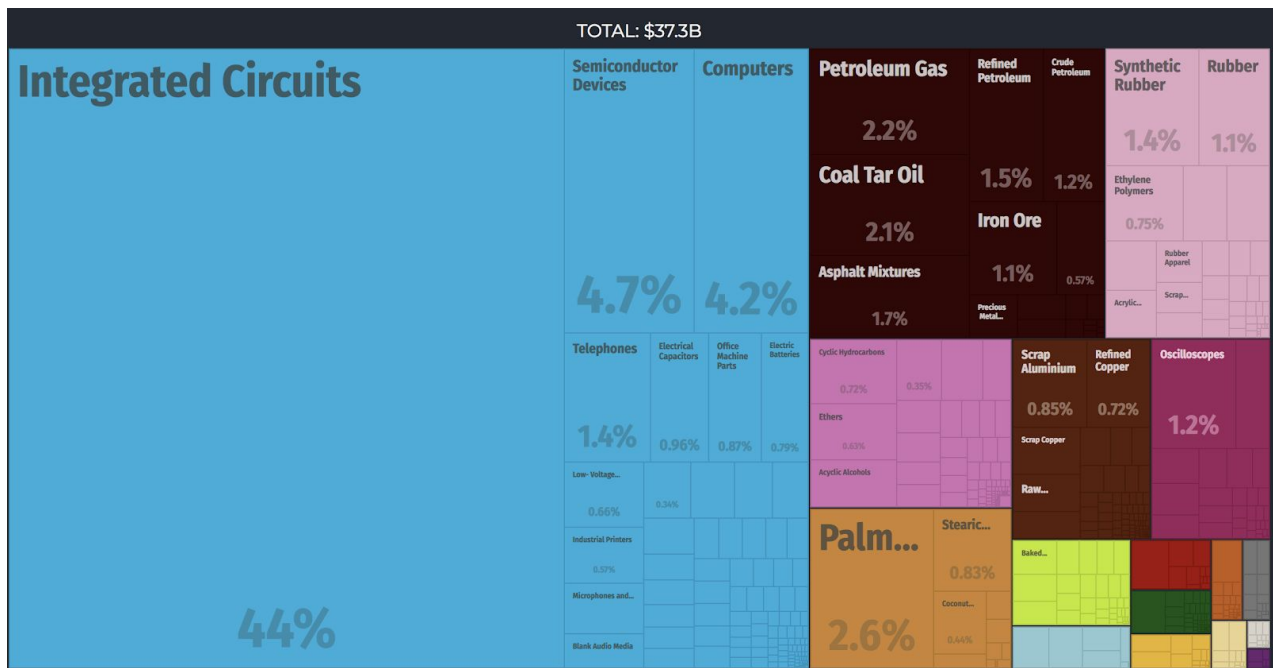


Figure 5

Source: Malaysia's Export to China 2016, The Observatory of Economic Complexity

Despite the government's attempt in registering all foreign workers in Malaysia, there is still an estimated number of 4.24 million⁹ undocumented foreign workers in the country, in contrast to the 1.76 million who registered. 55% of those who registered are working in the manufacturing and construction sectors, which in total constitute about 29.6% of Malaysia's GDP (figure 3). The relevance of these statistics lies in the fact that setting the minimum wage higher may end up benefiting foreign workers more than the locals, as 62% of registered foreign workers work in Selangor, Kuala Lumpur and Johor which are highly populated areas with higher costs of living, and hence a higher living wage. Setting a statutory living wage for all will not only help the targeted B40 group, but inadvertently encourage more outward remittances from Malaysia.

A sustainable economic growth is key to realising the high-income nation dream for Malaysia. An increase in wage must be accompanied by an increase in labour productivity, which is determined by the quality of labour as well as capital investment. Yet, as the International Monetary Fund points out in a report on Malaysia's labour force, the sustainability of the growth in labour productivity in comparison with labour's real earning is a real concern; the average labour productivity growth during 2010 -2016 lagged the rise in real labour earnings, and sectors that experienced the highest negative gap between the former and the latter accounted for about a third of total unemployment¹⁰. Setting the minimum wage

⁹ Lee, Esther. "The State of the Nation: The Labour Conundrum." *The Edge Markets*, The Edge, 9 July 2018, www.theedgemarkets.com/article/state-nation-labour-conundrum.

¹⁰ International Monetary Fund. Asia and Pacific Department. *Malaysia: Selected Issues*. International Monetary Fund, 2018, *Malaysia: Selected Issues*, www.imf.org/en/Publications/CR/Issues/2018/03/07/Malaysia-Selected-Issues-45678.

based on the living wage concept will entail risks of a discrepancy between labour productivity growth and the growth rate of wage.

In conclusion, though living wage is the key to higher standard of living and lower income inequality, the Malaysian economy is not ready for a drastic increase in minimum wage that could cost us the stability in economic growth. A minimum wage policy based on the living wage concept will not thrive in the current economic conditions of Malaysia, which are marked by mounting national debts, an over-dependence on foreign workers as well as the looming uncertainties of the external market. Even if the minimum wage were to be increased progressively based on the living wage concept, technical issues such as the costs of living in different regions of Malaysia and the actual impacts on government welfare spending need to be resolved. Nonetheless, the living wage concept should be set as a target which the new government should work towards and, if implemented progressively alongside labour development strategies that aim to ameliorate the quality of labour through education and capital-deepening investments, is an achievable dream.

(1982 words)

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