

“Has openness to international trade and investment benefited or harmed the Malaysian economy? How can Malaysia ensure that it reaps more benefits than harms from international trade and investment in the future?”

In line with the goal of becoming a high-income nation by 2020, Malaysia is relatively open to international trade, as shown by the World Trade Organization’s 2014 Trade Policy Reviewⁱ. Measures like unilateral tariff cuts show an increasing liberalisation of the Malaysian economy. However, protectionist measures, such as high excise duties on imported automobiles, still shelter certain sectors from global competition.

We believe that although there are drawbacks, Malaysia still gains net benefit from globalization. Our arguments are followed by policy suggestions to minimize disadvantages, thus maximizing the benefits of international trade and investment.

Benefits:

(i) Knowledge Spillover

Opening up to international investment increases productivity through knowledge spillover – the transfer or exchange of knowledge from foreign firms to the institutions in the host country.

Theoretically, when Multinational Corporations (MNCs) set up Research and Development (R&D) alliances with domestic institutions, useful technical information can be transferred into Malaysia. Cooperation can also lead to the development of new, innovative ideas. Domestic firms can apply this ‘spilled-over’ knowledge to their production processes, improving quantity and quality; local universities involved can enhance their research practices, passing it on to students.

In the Malaysian context, more MNCs have been operating in science-based industries such as healthcare and chemicals, where R&D is prevalent. There is also a 12 to 23 percent increaseⁱⁱ in cooperation links between foreign firms and local academic and public research institutions. This increased investment in the research capabilities of local universities can improve technical progress, human capital and local productivity.

However, whether Malaysians benefit depends on our level of absorptive capacity, thus emphasizing the need for skilled labour. Currently, foreign-educated Malaysian students make up the largest percentage of skilled emigration, draining our human capital.ⁱⁱⁱ Opening branch campuses of foreign universities mitigates this issue by providing quality tertiary education locally. Students who study in Malaysia are usually employed here, thus making them less likely to migrate. They will provide enough manpower to optimize the increasing knowledge content in the economy.

(ii) Creation of Employment Opportunities

With an increase of 8.6% in export value and a total contribution of RM249.8 billion, the electronics and electrical (E&E) industry is Malaysia's main export^{iv}. The expansion of the E&E sub-sector, as a result of increasing external demand, creates a large number of jobs.

Table 1: Direct Employment Multiplier Effect of the E&E Industry

No	Business Opportunities (BOs)	Impact	
		GNI (RM billion)	Employment Opportunities
1	Industries supporting fabrication plants, bump and sort companies and substrate companies	1.0	24,664
2	LED applications for medical devices, automotive industry, signal and display signboards and, aerospace and defense industry	0.7	5,040
3	Radio frequency identification application projects	0.05	229
4	Solar upstream development business opportunities	2.5	11,500

The creation of new jobs will reduce the rate of unemployment, enabling more people to have stable incomes. This, in turn, increases effective demand, because consumers can afford to spend more. Consequentially, an induced employment multiplier effect is generated. As new businesses spring up to meet growing demand they will hire new employees as well, thus benefitting from the flow of cash spent by the workers in the E&E industry.

Local economic activity is stimulated, especially in areas which have a high population density due to the presence of an industrial plant nearby. This aids in the distribution of wealth, as the money spent by consumers with higher income levels will circulate in the economy and be remitted to employees of small local businesses in the form of revenue and wages.

(iii) Increase in Quality of Life

Table 2: Malaysia's HDI trends based on consistent time series data and new goalposts

	Life expectancy at birth	Expected years of schooling	Mean years of schooling	GNI per capita (2011 PPP\$)	HDI value
1980	68.1	9.0	4.4	7,569	0.577
1985	69.5	9.8	5.6	9,069	0.619
1990	70.7	9.7	6.5	9,767	0.641
1995	71.8	10.2	7.6	13,432	0.681
2000	72.8	11.9	8.2	14,493	0.717
2005	73.7	12.7	8.9	17,149	0.747
2010	74.5	12.7	9.5	19,716	0.766
2011	74.7	12.7	9.5	20,555	0.768
2012	74.8	12.7	9.5	21,048	0.770
2013	75.0	12.7	9.5	21,824	0.773

Table 3: International Trade Statistics of Malaysia, 1980-2013

Year	Total Exports (RM billion)	Total Imports (RM billion)	Trade Balance (RM billion)	Total Trade (RM billion)
1980	28.17	23.45	4.72	51.62
1985	38.02	30.44	7.58	68.45
1990	79.65	79.12	0.53	158.76
1995	184.99	194.34	-9.36	379.33
2000	373.27	311.46	61.81	684.73
2005	536.23	432.87	103.36	969.10
2010	638.82	528.83	109.99	1,167.65
2011	697.86	573.63	124.24	1,271.49
2012	702.64	606.68	95.96	1,309.32
2013	719.99	648.69	71.30	1,368.69

The comparison of the tables above shows an increase in Malaysia's HDI^v (Human Development Index) ranking, in tandem with an increase in international trade^{vi}. The hypothetical relationship between the two can be explained by income stability.

As discussed above, the expansion of the manufacturing sector (due to an increase in exports) gave many people a source of stable income, leading to increased education levels as they could afford to educate their children. The ability to provide a stable home environment and good nutrition also contributed to the academic success of students. With education, students would be able to get high-skilled jobs further up the value chain, improving the lives of their families by moving into a higher income bracket, and, in turn, provide adequately for the next generation.

Besides that, the variety of choices available to consumers is increased by imported goods, allowing them to maximize the value of their money by enjoying products of better quality at lower prices. Moreover, the competitive pressure placed on local firms will spur them towards achieving productive efficiency, which also benefits consumers in the long run, as firms will aim to provide goods which are the best value for money.

Imports also prevent a monopoly by offering more alternatives, so that firms cannot raise prices indiscriminately, without losing customers. This protects consumers from excessive profiteering, especially for basic necessities, such as flour and rice.

Harms:

(i) Overdependence

With opportunities, there are always risks. Globalisation increases a country's vulnerability to external shocks - the volatility of a major export's price affects the welfare of workers in the industry, the trade balance and the country's rate of economic growth. The root of this problem is usually a country's overdependence on a few exports, imports or trading partners.

This risk is best illustrated by Malaysia's current economic situation. Due to the economic slowdown of China, a major trading partner, world prices of natural rubber fell to below costs from the reduced demand, threatening the welfare of Malaysian rubber farmers, a major producer of natural rubber. Following an ineffective minimum price of US\$1.50 per kg^{vii}, Malaysia has to resort to spending on the construction of rubberised roads in underdeveloped areas of Sabah and Sarawak to save the weak prices.

Another external shock is the plummeting global oil prices from 2014. With the oil and gas sector supplying around 32 percent of government revenue in 2013^{viii} and accounting for 17 percent of Gross Domestic Product (GDP)^{ix}, Malaysia's gains from trade will be adversely affected, with other sectors like Tourism and Financial Services making up only 5 to 7 percent of GDP.

In February 2015, Malaysia hit a four-month low in trade surplus at MYR 4.52 billion^x as sales of exports to all trading partners decreased, especially with China with a fall of MYR 1.6 billion. Although the trade surplus grew in March 2015 to MYR 7.82 billion, sales for refined petroleum, palm-based products and natural rubber were still declining – this signals a need to reduce Malaysia's dependence on these commodities.

(ii) Structural Unemployment

In 1970, producing at 73,795 tonnes and employing 49,453 workers, Malaysia's tin mining industry was at its prime. In those golden days, Malaysia –the world's leading producer of tin – could not foresee that just 20 years later, the industry's employment would plummet down by 96 percent, leaving only 2,006 workers in 1994^{xi}.

Table 4: Changes in Malaysia's Tin Mining Industry

Year	Production (Tonnes)	Import (Tonnes)	Export Tonnes)	Average Price (RM/kg.)	No.of Mines	Employment
1970	73,795	13,726	92,631	10.99	1,083	49,453
1975	64,364	18,476	77,940	15.94	910	39,736
1980	61,404	8,422	69,498	35.72	852	39,009
1989	32,034	23,857	49,480	23.09	255	12,695
1990	28,468	21,732	52,703	16.45	141	8,508
1991	20,710	30,536	42,425	15.05	92	6,594
1992	14,339	33,264	45,149	15.25	63	4,672
1993	10,384	27,277	35,545	13.09	43	2,296
1994	6,458	35,574	35,327	14.14	39	2,006

The spike in unemployment in the 1980s is a result of international competition and external price shocks. By 1984, low-cost Brazil mines adversely affected Malaysia's output; in 1985, global prices plunged by 50 percent. The low prices, combined with depleting resources and rising fixed costs, ended the industry's heyday as output and employment fell.

This illustrates structural unemployment. Globalisation inevitably exposes an economy to market changes. Industries can decline or emerge and grow – in this case, the tin mining industry had lost its competitive and comparative advantage. The retrenchment caused a surplus of structurally-unemployed workers who are occupationally immobile – their obsolete skills inhibit them from working in other industries. If mobility is not improved through provision of training, prolonged structural unemployment could seriously affect the economy.

Overall, international trade and investment has benefitted Malaysia. As proof, our export-oriented economy has allowed us to post an annual growth rate of more than 7 percent for over 25 years.^{xiii} However, policies to optimize liberalisation are necessary for Malaysia to sustain growth and minimize the harms of globalisation.

Policies:

(i) Economic Diversification

In 1980, primary commodities, vulnerable to climate variability and price volatility, made up 33 percent of GDP and 77 percent of exports.

Economic diversification strategies were then implemented, aiming to: reduce the dependence on upstream commodities like tin ore and rubber, and to switch production to higher value-added products in resource-based industries – resources were reallocated towards manufactured products. The latter aim was achieved by promoting the production of nitrile-based gloves for the healthcare industry. Combined with sustained, increased production, this successfully diversified Malaysian exports, leading to export-led growth^{xiii}.

Today, Malaysia's service industry, accounting for 56.2 percent of GDP in 2014, dominates the economy.

Table 5: GDP by Economic Sector (MYR/millions in 2000 Prices)

Sector	1971-75	1976-80	1981-85	1986-90	1991-95	1996-00	2001-05	2006-07
Agriculture, forestry and fishing	15,502	19,364	22,817	27,148	29,015	29,451	33,240	37,939
Average annual growth rate (%)	4.9	4.3	3.2	3.6	-0.2	1.8	3.2	3.2
Average share of GDP (%)	25.8	22.4	18.9	17.8	12.4	9.0	8.3	7.7
Mining and quarrying	11,367	11,949	15,559	20,345	25,253	27,658	35,908	40,330
Average annual growth rate (%)	0.5	9.2	6.2	1.3	6.8	2.5	2.5	0.5
Average share of GDP (%)	20.2	17.9	16.7	16.7	11.7	11.0	10.1	8.7
Manufacturing	8,104	13,945	19,976	31,950	60,081	93,940	120,739	149,206
Average annual growth rate (%)	11.7	11.8	5.3	14.7	11.7	9.0	4.8	4.7
Average share of GDP (%)	13.4	16.0	16.4	20.6	25.2	28.6	30.0	30.4
Construction	2,929	4,347	7,380	6,331	11,227	15,754	14,762	15,173
Average annual growth rate (%)	7.0	13.1	6.1	1.0	14.7	-0.2	1.0	3.5
Average share of GDP (%)	4.9	5.0	6.1	4.1	4.7	4.8	3.7	3.1
Services	21,768	32,779	49,466	63,858	108,426	160,017	204,492	259,753
Average annual growth rate (%)	8.7	9.1	6.9	7.3	11.5	5.9	5.6	8.8
Average share of GDP (%)	36.2	37.6	40.7	41.6	45.5	48.8	50.9	52.9
GDP at 2000 constant prices	60,066	86,997	121,348	153,406	237,584	327,810	402,195	490,934
Average annual growth rate (%)	9.2	8.6	5.4	6.6	9.5	4.9	4.8	6.2

The table above^{xiv} shows the shift of economic structure from natural-resource-based sectors to Manufacturing and Services sectors.

Diversification over the past decades has reduced Malaysia's vulnerability to external shocks, minimising harms. The effects of the fluctuations in ringgit today could have been worse if Malaysia still depended heavily on primary sectors^{xv}. A diversified economy with strong economic fundamentals prepares for unanticipated currency movements, just like how structural reforms were crucial in Malaysia's recovery from the 1997 Financial Crisis.

To strengthen the economy, Malaysia should diversify further. Fiscal incentives can be given to attract export-oriented foreign firms and domestic firms to conduct R&D on new manufactured products, like the switch in developing higher-value petrochemicals and

biodiesel^{xvi} from palm oil. With our dominant tertiary sector, investment in high value-added services such as information and communication technologies (ICT) is also vital.

(ii) Increase Competitiveness

The ability to compete in global markets maximises an economy's gains from trade.

Tackling Challenges

In the World Economic Forum's Global Competitiveness Report 2014-2015, Malaysia shot up the ranks to the 20th place out of 144 economies^{xvii}, making it the highest-ranking developing Asian economy. The report ranks countries based on the 12 Pillars of Competitiveness from institution to innovation. Malaysia's results were mainly positive with improvement in transport infrastructure, institutions and financial markets. However, our relatively **low technological readiness**, in today's interconnected world, inhibits competitiveness.

The technological readiness pillar^{xviii} measures an economy's extent of applying existing technologies, especially ICT, in production processes to enhance productivity and innovation. This lies in the accessibility to technology and the economy's level of absorptive capacity.

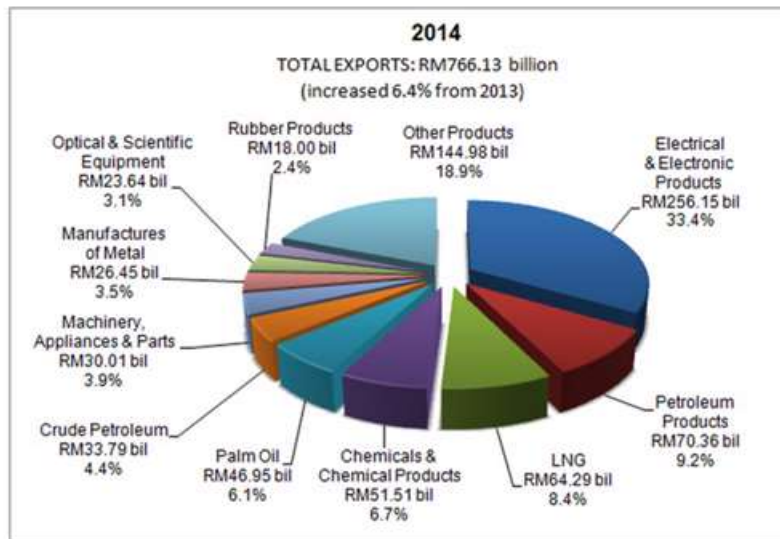
To promote ICT access and usage, supply side policies must be implemented. Increased investment in R&D, domestic or foreign, can advance technological progress, increasing productivity and therefore, competitiveness. With the provision of quality education and training, the Malaysian workforce can catalyse the process of adopting technology into production. This, combined with higher labour productivity, gives Malaysian industries a competitive advantage which attracts FDI, maximising the benefit of knowledge spill-over. Multi-skilled, trained human capital also improves occupational mobility, minimising the effects of structural unemployment.

Free Trade

Exposing an industry to global competitive pressures with minimal protectionism can also increase competitiveness and foster development.

Malaysia's electronics and electrical products sector best illustrates this. With relatively low tariff protection and high levels of capital inflows from FDI, the industry has developed strong competitiveness over the years. Responsible for 2.5 percent of global electronics production in 2001, it was a major assistance to Malaysia's economic recovery from the 1997 Financial Crisis^{xix}. In 2014, electrical products accounted for 33.4 percent of total exports^{xx}.

Figure 1: Top 10 Exports (2014)



Conversely, Proton in the domestic automotive sector has been protected with heavy tariffs on imported cars, sheltering it from competition which is essential for long-run development. Today, 32 years after Proton was established, it is still relatively dependent on the domestic market, with revenue from export sales under 5 percent^{xxi}, indicating low external competitiveness.

Evidently, the liberalised E&E industry has grown into a driving force towards Malaysia's economic growth. Therefore, infant industries in Malaysia should be gradually exposed to competition, without sacrificing employment – competitive pressures could provide the incentive to keep down prices and upgrade quality, eliminating complacency. By tackling the challenge of relatively low technological readiness, accessible modern technology can aid industries to stay competitive and maximise global market share.

In conclusion, the policies above will ensure that Malaysia remains insulated from the volatility of global market conditions. Although external shocks are inevitable, action can be taken to allow the economy to adapt better and avoid the risks of over-specialisation.

The focus on supply-side policies, geared towards improving the productive capacity and competitiveness of the economy, can foster sustainable economic growth and development. Malaysia should continue to take advantage of the increasing movement towards globalisation and advance towards achieving the status of a high-income nation.

2000 words, excluding tables and diagrams.

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