

THE DRIVERS OF COMPETITIVENESS IN MALAYSIA

By Mohamed Ariff

The term “competitiveness” has many meanings. To the OECD, the competitiveness of the nations is a measure of meeting the test of international markets. The International Institute for Management Development (IMD) describes it primarily as the ability of a nation to create and maintain an environment for wealth creation. The World Economic Forum (WEF) views it essentially as a means to ensure sustained growth in income per capita. To consumers all this means more value for money.

In Malaysia, competitiveness is taken very seriously. To guarantee rising living standards and economic prosperity, the nation has no choice but remain competitive in this era of globalisation and trade liberalisation. To be sure, it is not nations but companies that compete in the global arena. Nonetheless, the fact remains that the enterprises that compete internationally are conditioned by their home environment in which they operate. The Malaysian Government, accordingly, is bent on providing a policy environment that will enable its enterprises to compete effectively in the international market place. These include measures to streamline the country’s civil service with greater transparency and better delivery systems.

Needless to say, Malaysia is not an average developing country by any measure. Malaysia is the fourth most open economy in the world with exports and imports accounting for over 200 per cent of its total gross domestic product (GDP). Trade is the lifeblood of the Malaysian economy. Foreign direct investment (FDI) has long been its backbone. Economic openness has brought much prosperity to this multi-racial country, as evidenced by the rapid pace of economic growth and development since Independence in 1957. It is noteworthy that the country’s per capita income now exceeds US\$4,000 mark, placing Malaysia in the league of the advanced developing economies. It is pertinent to mention in passing that Malaysia is Australia’s 10th largest trading partner and that Australia is Malaysia’s 14th largest trading partner.

Malaysia has done fairly well in terms of competitiveness. It is worth noting that the IMD, in its World Competitiveness Yearbook 2004, has given Malaysia a reasonably high rating. Malaysia's overall ranking jumped to 16 in 2004 from 21 in 2003. Among the economies with population exceeding 20 million, Malaysia is ranked fifth in 2004 compared with its seventh position in the preceding year. Within the Asia-Pacific region, Malaysia is the fifth most competitive economy after Singapore, Australia, Hong Kong and Taiwan.

While all this sounds reassuring, if not flattering, there is absolutely no space for complacency of any sort. International competition is getting stiffer as globalisation and trade liberalisation gathers momentum. The Malaysian industries are facing increasingly tough competition not only abroad but also at home, as domestic trade barriers gets dismantled through regional and bilateral free trade agreements (FTAs), not to mention the ongoing multilateral negotiations under the auspices of the World Trade Organization (WTO). Import substitution is not an option any more, now that it is already difficult to protect domestic production against international competition in the era of globalisation and regional economic integration. Export orientation is not going to be easy either, with more and more countries joining the bandwagon in the pursuit of export-led economic growth.

Malaysia's comparative advantage in unskilled labour intensive manufacturing has been eroded by the entry of low-wage countries, especially China, into the foray. Given China's seemingly unlimited supply of cheap labour, it is quite conceivable that China will enjoy competitive advantage in a wide range of products for a long time and become the factory for the whole world. However, it will take a while for China to realise its full potential. Although labour costs are low in China, many other costs, especially transaction costs, remain high, giving countries like Malaysia some breathing space for now.

The time has come for Malaysia to move away from low value-added labour-intensive manufactures to high value-added skill-intensive and technology-intensive

manufacturing. This calls for increased science and technology (S&T) related investment in human capital and research and development (R&D) activities. In the interim, viable alternatives to labour-intensive assembly activities include biotechnology, photonics and nanotechnology, especially in the areas of micro-electro-mechanical system (MEMS), advanced electronic displays, high density data storage and conductive polymers. In the electronics sector, there is considerable room for Malaysia to move up the value chain.

The time has also come for the Malaysian automotive industry to take a spin, allowing the global manufacturers of motor vehicles to share the centrestage with the national carmakers. Under the ASEAN Free Trade Area (AFTA), the national carmakers will face tough competition especially from Thailand, which is emerging, by default, as the Detroit of Southeast Asia. Arguably, Malaysia is better equipped in terms of industrial infrastructure to play this role. Additionally, Malaysia has the largest passenger car market in ASEAN. Malaysia will be able to gain a lot, if it can encourage some major global manufacturers of automobiles to use Malaysia as their regional base. This will also be a boon for the Malaysian small and medium enterprises (SMEs) in the components and parts industry.

The Proton's domestic market share has fallen from over 65 per cent in 1999 to 44 per cent in 2004. All indications are that this downtrend will continue, as the Malaysian car market becomes increasingly open. It is time for the auto industry to think out of the box. It is time for lateral, not linear, thinking. For there is considerable scope for regional specialisation in the automotive sector, with Malaysia concentrating on passenger cars and Thailand on commercial vehicles. Within the passenger cars segment, further division of labour for Malaysia and Indonesia is not unthinkable, with Malaysia focussing on bigger models and Indonesia on smaller makes.

In the long term, it is advisable for Malaysia to avoid a collision course with China, not only because an all-out direct competition with China will be suicidal, but also because the costs in terms of forgone opportunities will be enormous. It will be wiser for Malaysia to make its own economy complementary to that of China so that it can ride on the

latter's coat tails. Seen in these terms, China is a land of opportunity, not a source of threat. To be sure, China is not the only country that is changing the global manufacturing landscape. There are other players to watch out for, including India, Thailand, Vietnam and the Philippines.

The manufacturing sector may not remain the number one engine of growth for the Malaysian economy for long. The services sector is poised to play a lead role in the foreseeable future. Already, the share of services in GDP has risen from 50.7 per cent in 1995 to 57.6 per cent in 2003. Tourism has emerged as the second largest foreign exchange earner after manufactures with tourist inflows of 14 million a year. The growing regional demand for manufacturing-related services and education, healthcare, and financial services augurs well for Malaysia's services sector. However, the services sector is likely to play a relatively lesser role in Malaysia than it does in smaller economies like Singapore, as the former has options not available to the latter. In other words, manufacturing will remain a major growth engine for the Malaysian economy for quite some time, although it will have to re-invent itself by shifting to the upper end of the value chain, producing skill- and technology-intensive goods for niche markets.

Like manufactures, services too will face an increasingly competitive environment both at home and abroad. India is likely to emerge as the largest provider of services. Here too there is a need for Malaysia to avoid a collision course, with Malaysia forging strategic alliances with top-notch players in India. There are turf in which India cannot be challenged, especially in the information technology (IT) software, but Malaysia can initiate joint ventures, rather than compete head-on, with Indian companies such as Wipro and Satyam in the realm of business process outsourcing (BPO). It is encouraging to note that A.T. Kearney's Offshore Location Attractiveness Index 2004 has ranked Malaysia third after India and China as investment destinations for outsourcing.

Malaysia's heavy investments in the development of the Multimedia Super Corridor (MSC) in 1996 is beginning to produce results. The number of companies in the MSC has grown from 94 in 1997 to 1,067 in 2004. The number of multinationals (MNCs)

operating in the MSC has increased from 13 in 1997 to 65 in 2004. It is noteworthy that Motorola, Ericsson, IBM, Shell, DHL, HSBC and BMW have located their regional offshore service centres in the MSC. The flagship IT applications by MSC companies cover (a) electronic government, (b) smart card, (c) smart schools, (d) telemedicine (e) R&D cluster, (f) e-business and (g) technopreneur development.

The Abdullah Badawi administration attaches much importance to the development of small and medium enterprises (SMEs). According to the Companies Commission of Malaysia (CCM), there are 40,655 SMEs in the country, accounting for 29.1 per cent of the country's manufacturing output, 26.1 per cent of manufacturing value added and 32.5 per cent of manufacturing employment in 2003. It is of interest to note that, in 2003, SMEs directly exported 26.5 per cent of their output. In terms of capital intensity, however, the SMEs lag behind the manufacturing sector average, with fixed assets per worker standing at RM35,792, which falls short of the manufacturing sector's average of RM49,117 in 2003. It is encouraging to note that the Malaysian SMEs have been registering double-digit growth in value-added terms in a variety of industries in recent years. The Malaysian Government has put in place a number of programmes to bolster SMEs and these include Industrial Linkage Programme, Global Supplier Programme and Skills Upgrading Programme. More recently the Government has set up the National SME Development Council to chart out new directions and strategies for SMEs. What is more, there are plans to establish SME Development Bank to cater specifically to the financial needs of SMEs.

The Malaysian Government, under the present administration, has laid considerable emphasis also on modernising the agricultural sector through S&T applications that would raise productivity and profitability in the sector. It is hard to imagine a dynamic agricultural sector in the country in the absence of foreign investment in the sector, which however would raise such thorny issues as land reforms and property rights. It is also hard to imagine a competitive agricultural food sector in Malaysia now that land and labour, key factors of production in agriculture, are more costly in Malaysia than in the neighbouring countries, unless this disadvantage can be more than offset by quantum leap

at the technological front. Under AFTA, it will be profitable for Malaysia to concentrate on food manufacturing, importing raw materials from regional sources at lower costs instead of producing them all at home. There is a lot to gain by focussing on high value-added downstream food processing and manufacturing rather than on primary production. Needless to say, there is much more to agriculture than just food crops. Malaysia is also targeting at fishery, herbal medicine, palm-oil based fuel, etc. What is in Prime Minister Abdullah Badawi's vision for agriculture is not traditional agriculture but technology-driven "value adding" to agricultural produces.

The production of "halal" food, in particular, has exciting prospects in Muslim societies. Malaysia has the credentials and capabilities to be a major halal food production base for the entire Muslim world. Here again, it will not pay Malaysia to go it alone. Malaysia can source inputs from the region more cheaply than producing them domestically. Malaysia has not been very successful in its attempts to establish economically viable livestock farms in the country. Malaysia can team up with Australia and New Zealand in producing meat-based halal products. Export potentials for halal food are huge by any measure. Thus, halal food production can add a powerful new cylinder to the growth engine of the Malaysian economy.

Post-1997/98 crisis figures do show a slower growth rate for all sectors except agriculture compared to the pre-crisis benchmarks. During 1999-2004, manufacturing grew at an average rate of 7.6 per cent, down from 12.3 per cent growth in 1991-97. The pace of expansion was the slowest in the construction sector in 1999-2004 at 0.5 per cent, which pales in comparison with 14.2 per cent in 1991-97. The corresponding figures for business and non-government services were 7.3 per cent and 11.8 per cent, respectively. The only exception, as mentioned, was agriculture with an average post-crisis growth of 2.8 per cent, up from the pre-crisis low of 0.6 per cent, but still considerably lower than that of manufacturing, mining and services.

Experience has shown that input-driven growth is not sustainable, as there are limits to the additions of capital and labour. Hence the importance of productivity-driven growth.

Total factor productivity (TFP), which represents the residual after accounting for the contributions of incremental capital and labour inputs, is a useful measure of competitiveness. The 1997/98 crisis is partly explained by the loss of competitiveness of East Asian exports. There is a close correlation between export competitiveness and TFP growth. In Malaysia, TFP growth was shrinking from 1994, with negative growth in 1998 and 2001. Since then Malaysia's TFP growth has been clearly trending up.

The National Productivity Corporation (NPC) has stepped up efforts to improve productivity and quality across industries, both manufacturing and services. Recent data do show encouraging trends in productivity on a wide range of activities. While such relentless efforts must continue as a major driver of competitiveness, Malaysian companies need to forge strategic alliances with others in the region and elsewhere. After all, it is companies, not countries, which compete internationally. The Government will have to focus increasingly on creating a business environment for enterprises to bring out the best in them. ASEAN economic integration and bilateral free trade agreements provide valuable opportunities for Malaysian companies to spread their wings far and wide.

The time has come for Malaysia to move up the value chain. Although there is evidence of this happening already, Malaysia has a long way to go. The level of R&D expenditure is still disappointingly low in Malaysia. In 2002, R&D expenditure amounted to only 0.7 per cent of Malaysia's GDP, which pales in comparison with Japan's 3.1 per cent, USA's 2.7 per cent, Korea's 2.5 per cent, Taiwan's 2.3 per cent and Australia's 1.5 per cent. In 2002, the number of researchers per 10,000 labour force stood at 18 in Malaysia, which compares poorly with 120 in Denmark, 113 in Japan, 99 in Australia, and 90 in the United States. Enhancing the country's R&D capabilities is high on the Malaysian Government's agenda.

Competitiveness based on undervalued exchange rate is unsustainable. Malaysia's fixed exchange rate regime has apparently worked in favour of Malaysian exports, as the US dollar, to which the Malaysian ringgit is tied, has been depreciating significantly since

2002. In Malaysia, the cheap ringgit is generally seen as a “plus point” contributing to the country’s export competitiveness. Little is realized how dangerous it is to rely on cheap currency for competitiveness. For undervalued currency also means increased cost of imports and higher domestic prices. The rising cost of imports and domestic inflation will eventually negate the competitive advantage attributed to the undervalued exchange rate, given the high import content of manufactured exports. The futility of this strategy is thus readily obvious. However, there are fears in Malaysia that a sudden currency appreciation will hurt Malaysian exports. Yes, it certainly will, but the loss of export competitiveness will be temporary. As the currency appreciates, imports will become cheaper and inflation will subside, reversing the initial adverse impact. For competitiveness, one must turn to innovations, cost reductions, productivity improvements, new processes, and new products.

In the final analysis, it is the quality of the workforce that will make the real difference. The human factor plays a pivotal role. First-world infrastructure with third-world mentality will not produce the desired results, as Prime Minister Abdullah Badawi has warned. Investments in education, training and skill development will determine the capacity of a nation to change with changing times. As mentioned, it is companies, not countries that compete in the market place. By the same token, it is human capital, not physical capital that is crucial to the competitiveness of these enterprises. It is heartening that Malaysia is investing increasingly in human resource development instead of being preoccupied with infrastructure development.