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LABOUR PRODUCTIVITY AND INTERNATIONAL COMPETITIVENESS

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1. INTRODUCTION

Considering the openness of the Malaysian economy in which more than 50% of its Gross National Product are derived from exports and the rapid change of international demand pattern, enhancing its export competitiveness has become an important agenda in her industrial development strategy. For the 1990's, as trade in manufactured goods is fast expanding in significance and diversity and Malaysia is increasingly dependent on the export of these products, the critical elements for Malaysia's success in the global market are in maintaining and enhancing its competitive edge.

In meeting the above objectives, it is essential for the State to provide a policy framework that will help our industry to adapt to changes in international competitiveness. There is also a need for the private sector to double its efforts in ensuring productivity growth, Research and Development activities, reduction in unit labour cost and capital investment. Against the above background, this paper will mainly examine the relative position of Malaysian labour productivity and its relationship with competitiveness vis-a-vis the Newly Industrialised Countries (NICs). The paper also attempts to discuss some major issues relating to efforts in enhancing labour productivity and competitiveness.

2. THE MEANING OF COMPETITIVENESS

In its broadest sense, international competitiveness may be defined as the combination of elements which enable one country to secure sale at the expense of world market rivals. These elements can be divided into two broad categories, namely price and non-price factors. The primary concern of this paper, however, is the price factor and its relation to the labour cost and productivity.

Under the assumption that the products produced are of equal quality, the ability of any country to compete on world markets is ultimately determined by the relative price of those products. In Malaysia, much attention has been focused on the issue of unit labour costs in relation to such international competitiveness. Unit labour cost is defined as the total labour earnings (total wages and salaries) divided by output produced. The unit labour cost comparison is preferred over merely labour cost (such as wage rate) because of the fact that it takes into account the productivity factor. In other words, unit labour cost is equivalent to wage rate divided by productivity per worker.

3. PRODUCTIVITY AS A CONCEPT

In essence, productivity is basically a relationship between real output and input used to produce a certain level of output. It is a measure of input efficiency which may be expressed as the following ratio:

$$\text{Productivity} = \frac{\text{real output}}{\text{input}}$$

In practice, depending on the purpose of the study, different measures of productivity are used, namely output per unit of physical input or output per unit of input time, and value added per unit. However, the ideal productivity indicator being value added per unit input time employed. Unfortunately, based on the existing information, Malaysia does not have such data. Consequently, the comparison of productivity data is less meaningful. Due to data limitation and in order to make comparison more meaningful, labour productivity measure, in which work is related to real GDP, may be converted into an index number using a specific year as the base year. Specifically:

$$\text{Productivity index (Year 1)} = \frac{\text{Productivity (Year 1)}}{\text{Productivity (base year)}} \times 100$$

The factors which affect labour productivity are manifold and diverse. They include improvements in the quality of labour, production technologies, managerial organisational techniques, shifts in the structure of the economy, and societal attitudes. The point is that while the index of labour productivity provides information pertaining to changes of labour productivity, it does not explain the cause of these changes. Despite this limitation, the labour productivity provides a reasonable approximation of how efficiency in each sector of the economy has changed through time.

Indeed, the labour productivity can be directly compared with wage rates. More specifically, productivity gains may offset increases in wages and thereby help restrain increases in unit labour costs and ultimately product prices. On the other hand, a slow rate of productivity growth as compared to growth in the wage rate would lead to the increase unit labour costs which in turn would inflate the prices of our products relative to foreign goods and hence deterioration in our export competitiveness. Consequently, we might expect our export to contract and our import to rise, leading to Malaysian international trade deficits.

4. PRODUCTIVITY AND LABOUR COST: A COMPARISON

The above line of reasoning is too simplistic. In reality, the relationship between a nation's productivity growth and its competitiveness in world markets is complex and unclear. In particular, high rate of wage increases. As shown in Table 1.1 (see also Figure 1.1), while the productivity of manufacturing workers grew by 2.5% per annum over the 1981-1985 period, the real wage rose by about 6.2% per annum during the same period.

The combined effect of the above changes in labour productivity and costs is reflected in unit labour cost as shown in Table 1.2. Over the same period, unit labour cost measured by average earnings in manufacturing relative to real GDP per employee in manufacturing, had increased by 4.7% per annum.

In fact, from 1980-1985, it can be observed that real wage in the manufacturing sector in Malaysia had increased faster than in other New Industrialised Countries such as Korea and Taiwan, though in Singapore real wage increases approximately matched that of Malaysia. On the other hand, productivity growth in manufacturing had increased more rapidly in Korea, Taiwan and even in Singapore than in Malaysia. Over the 1981-1985 period, as noted above, output of Malaysian manufacturing workers increased at about 2.5% per annum as compared to approximately 4.8% per annum for Korea, 3.4% per annum for Taiwan, 2.8% per annum for Singapore. These partly explained their (except Singapore) slower growth in unit labour cost prior to 1986. The generalisation that a slow rate of productivity growth generates trade deficit is only

partially true. Increases in real wage rates must also be considered, since unit labour costs are based upon both wages and productivity.

Since 1988, as shown in Table 1.2, Malaysia has been enjoying unit labour costs advantage over Singapore, Taiwan and even Korea. This has improved our cost competitiveness vis-a-vis those of the NICs. However, with high growth and virtually tight labour market condition, this position will be harder to sustain in the near future. The advantage in unit labour costs, nevertheless, can be maintained perhaps through wage flexibility policy which link wage and productivity growth.

However, it is worth noting that labour costs are by no means the only element contributing to price formation. In other words, an exclusive focus on labour cost alone is misplaced. At least two other major contributing factors had helped to limit the competitiveness of Malaysia's exports during the 1980's, namely the appreciation of the exchange rate and the rapid rise in interest rate and hence capital costs. Thus, the Malaysian competitive edge can be maintained not only through lower unit labour cost but also through manipulation in capital costs (interest rates or tax incentives) and the exchange rate.

Table 1.1
Trend in Manufacturing Productivity
and Real Wage (Indices 1980 = 100)

Year	Malaysia	Korea	Singapore	Taiwan
Productivity:				
1980	100.0	100.0	100.0	100.0
1981	99.4	111.1	101.2	105.8
1982	101.4	109.1	98.3	107.1
1983	106.2	113.7	104.7	112.0
1984	114.2	127.4	113.3	115.4
1985	112.9	126.4	115.0	118.3
1986	120.5	135.9	126.4	129.1
1987	127.8	137.0	134.8	135.4
Real Wage:				
1980	100.0	100.0	100.0	100.0
1981	106.4	99.0	108.4	102.0
1982	111.5	105.9	114.0	108.7
1983	118.8	115.0	124.2	114.0
1984	125.3	121.5	133.5	131.6
1985	134.9	130.4	138.4	129.4
1986	133.1	139.2	130.6	141.4
1987	137.6	150.8	137.2	154.3

Sources: Malaysia, Industrial Survey and Economic Report.
IMF, International Financial Statistics.
ILO, Yearbook of Labour Statistics.
UN, Yearbook of National Accounts Statistics.

Table 1.2

**Trend in Manufacturing Unit Labour Cost
(Indices, 1980 = 100)**

Year	Malaysia	Korea	Singapore	Taiwan
1980	100.0	100.0	100.0	100.0
1981	110.1	90.6	108.4	114.1
1982	117.4	90.0	122.3	114.5
1983	116.2	83.7	125.6	105.6
1984	119.3	78.9	131.0	119.1
1985	125.8	75.1	144.7	116.0
1986	110.5	68.7	114.8	118.8
1987	109.1	72.7	110.7	139.7
1988	102.5	86.5	117.5	163.2
1989	95.3	109.7	124.8	182.5

Source: Ijaz Nabi, *Lessons From Experience With Wage Flexibility in Asia*, paper presented at Seminar in Kuala Lumpur, (June, 1991), Table 5.

5. ISSUES AND STRATEGIES RELATING TO PRODUCTIVITY AND COMPETITIVENESS

There are numerous issues which relate and affect the level of productivity growth and hence economic competitiveness. However, this paper will only discuss two broad issues namely quality of manpower and management of technological change.

5.1 Lack of Quality and Quantity of Manpower

Skilled and more productive manpower is a critical determinant of competitiveness and productivity. In the past, the growth in output of the manufacturing sector has largely been attributed to competitive labour cost apart from the expansion of capital investment and the buoyant international market (Malaysia, 1991, p. 143). However, this competitive edge is now being eroded with the increasing wage pressures and emergence of competition from the low-wage developing countries (op. cit). It must be noted that this problem has been exaggerated by the shortage of labour. According to the Sixth Malaysia Plan, labour shortage has been caused by rapid expansion of the manufacturing sector especially in the West Coast of Peninsular Malaysia. Labour shortages were more apparent among labour-intensive industries especially textiles, wood-based and electronics. Specifically, we had experienced shortage of experienced technicians and production workers. In order to sustain the competitive edge of the industrial sectors, it is imperative that both aspects of labour problems must be solved. Efforts should be made to enlarge the pool of trained and skilled manpower. This would require not only the replacement of the present skill delivery system with one which is more market-driven but also a greater role of the private sector. (EPU, 1991, p. 53).

With regards to training, the recent Annual FMM Manufacturing Survey showed that a high percentage of respondents (43%) do not incur any training expenditure. To encourage greater private sector participation in training, a Human Resource Development Fund (HRDF) will be introduced. HRDF whose legislation is now being studied by the Attorney General's Office, is aimed at improving the training system by providing incentive grants to enterprises undertaking training of workforce in basic, enterprises-based and new emerging skills as well as retraining of higher skills. Under this scheme it is compulsory for enterprises to contribute to Human Resource Development Fund and at the same time workers has the right to undergo training. In addition to HRDF, it is also proposed to establish specific training institutions such as the Penang Skill Development Centre (PSDC) in selected industrial zones.

5.2 The Management of Technological Change

Beside industrial skills, technological capability is also critical in sustaining productivity growth especially in the context of increasing international competitiveness. It is generally accepted that market forces alone will not be sufficient to generate technological and skill advancement (Annuar, 1990). Thus, in the context where market forces failed to activate technological change the role of the Government is very crucial. In the case of Malaysia, as shown in Table 1.3, it is observed that public sector's contribution in R&D expenditure is relatively large as compared to developed countries and the NICs.

Compared to other countries such as South Korea, Japan and the United Kingdom, the ratio of research scientists to total population in Malaysia is low. In fact, by international standards, the number of Malaysian R&D personnel is not only small and concentrated in the public sector but its utilization for user-oriented research is also limited (Malaysia, 1991, p. 197).

The role of private sector in this respect is still essential. The FMM Annual Manufacturing Survey showed that more than 50% of the respondents do not incur R&D expenditure. This may hamper the country's industrialisation process as R&D and the ability to innovate are the key factors to competitiveness. Under the Second Outline Perspective Plan (OPP2), the government's aim is to increase the nation's R&D expenditure by at least two-fold as a percentage of GNP by the year 2000 from the current level of 1% p.a. The private sector contribution is expected to be at least 40% of the total expenditure.

Table 1.3.

R&D Expenditure in Selected Countries

Country	Year	R&D Expd: Public/Private
Australia	1987	60 : 40
Canada	1990	43 : 57
Japan	1988	20 : 80
South Korea	1988	18 : 82
Malaysia	1987	80 : 20
New Zealand	1987	60 : 40
Singapore	1988	40 : 60

Source: PECC (1990) cited by Annuar Ali (1990).

In this context it is clear that Malaysia has appropriately addressed the issue of industrial R&D by enlarging as well as managing the Science and Technology (S&T) base of the country. In order to strengthen our competitiveness the following strategies may be considered (Paul, 1991, p. 123);

- i) creating competitive culture amongst Malaysian enterprises.
- ii) develop Human Resource and S&T base
- iii) improve infrastructure facilities
- iv) ensure accessibility of finance to the manufacturing sector at a reasonable cost.
- v) reduce cost of doing business and encourage SMIs to modernise and grow.

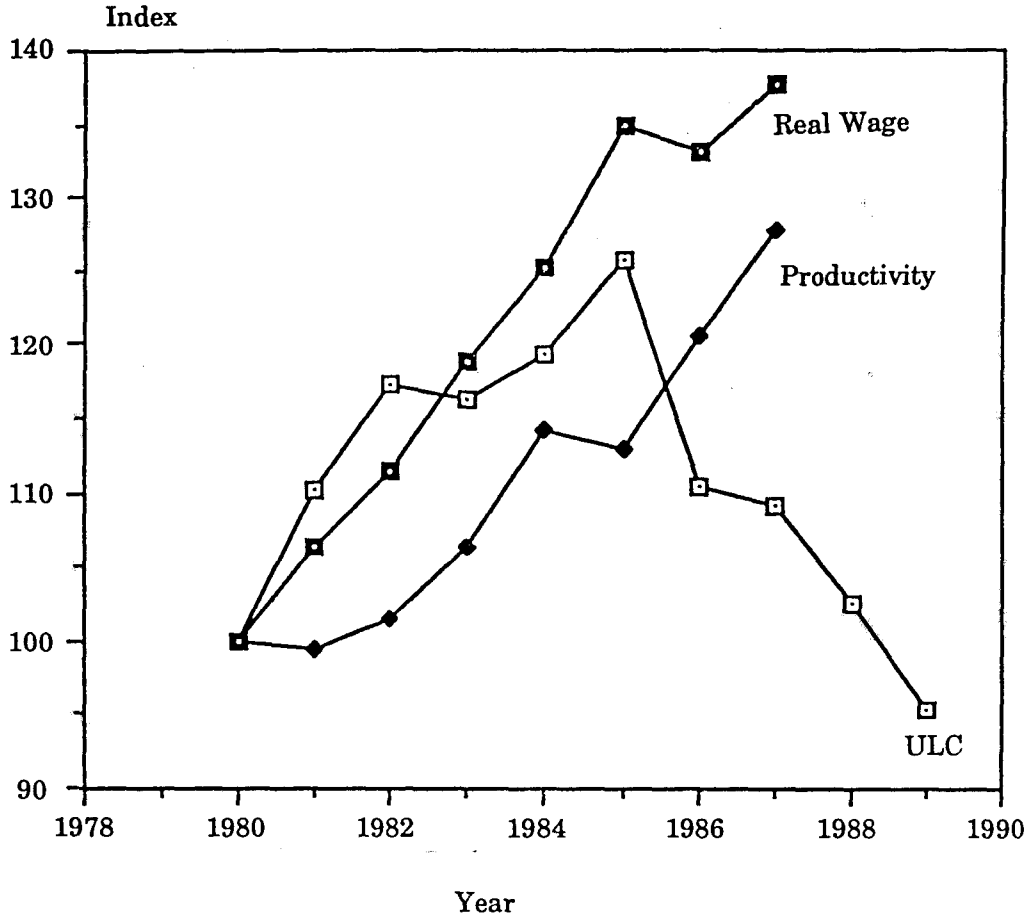
6. CONCLUDING REMARKS

Compared to the NICs, Malaysia has recently enjoyed unit labour cost advantage. Besides this, exchange rate and favourable prices has aided our competitive position. However, this position may not last long unless necessary actions are forthcoming. Issues relating to skill and technological enhancement must be solved comprehensively.

APPENDIX

FIGURE 1.1

MALAYSIA: INDICES OF WAGES, PRODUCTIVITY AND UNIT
LABOUR COSTS IN MANUFACTURING SECTOR 1980-1989
(1980 = 100)



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QUESTIONS AND ANSWERS

Question: My question might not be directly related to your paper. It is on the wisdom of importing labour to overcome the shortage of labour in certain sectors like construction, plantation and so on. As we know, if we depend on foreign labour, we cannot provide our own labour with training, career development and so on. So, what is your opinion on our government's intention of importing more labour into our construction and plantation sector particularly HRD.

Answer: The problem is we want to have rapid economic growth. In the context of OPP2 we must have 7% per annum. We also projected to have substantial employment during OPP2. Where does the labour come from? The shortage of labour was faced since many years ago. The problem is more critical for HRD. If we want to train them permanently or temporarily, the cost goes up. Thus, we prefer to employ imported labour mostly from Indonesia because of the cheap labour and the impact on society is that it slows down the development process in the ulu areas. So from the society's point of view it is not good but from the managing point it is good. But how to lead it to HRD is a difficult question.

From my point of view, we have to give the foreign workers a time in the short term. In the long term, it is up to the locals to pick up HRD in relation to market needs. For industrial development we have to use more capital intensive technique as we want to compete.