# Effects of the middle income trap economics essay

Malaysia's caught in the " middle-income trap" right now give awareness to our policymakers that the export-led growth strategy, according to some, is no longer an optimal development strategy for developing countries especially Malaysia. Continued emphasis on export-led growth will, among other things, increase the reliance of developing countries on the developed world and dampen domestic market growth. Many export-dependent developing countries started tweaking their growth strategies especially after external demand for their exports dried up on account of the current global financial and economic crisis. Though Malaysia's growth strategy had started emphasizing domestic demand since about a decade back, it still remains largely dependent on external demand for its economic growth (Quah, 2009). Ex-World Bank chief economist and Brookings Institution's Wolfensohn Centre for Development, Global Economy and Development's senior fellow, Homi J. Kharas, said there was an impetus for change and rethinking on policies and strategies in Malaysia every 10 years based on economic developments. " Malaysia has been very successful as an exporting nation but has also been very export dependent. About 90% (of products) are being exported to the United States, Europe and Japan," he said, adding that Malaysia needed to diversify its exports (Malaysia needs to be high-income economy, 2009). However, the main challenge is domestic market of Malaysia is too limited due to only 28 million of populations. That's why we are facing the dilemma of the exploration of external and domestic market. However, 2010 GDP performance sets strong momentum for a robust 2011. Given the marked improvement in economic growth in the first half of the year, domestic demand was clearly the chief momentum driver for the recovery. Moving forward, the country is anticipated to register a robust GDP growth of 5. 6% in 2011, with domestic demand once again acting as the back-bone for momentum (RAM Rating Services, 2011).

Besides, middle-income trap also lead to declining private investments. The old growth model provided three decades of outstanding performance, permitting Malaysia to provide for the health and education of its people, largely eradicate poverty, build a world-class infrastructure and become a major exporter globally. But the progress we have made over the past half-century has slowed and economic growth prospects have weakened considerably. We are caught in a middle income trap. Malaysia has been susceptible to external shocks, as seen during the past crises. Increases in international commodity prices, like fuel or food, have direct impact on domestic prices. Similarly, unless production costs and productivity in Malaysia can keep pace with those abroad, exports are likely to lose ground with negative effects on national employment and income.

Malaysia’s economic engine is slowing. Since the Asian financial crisis of 1997-1998, Malaysia’s position as an economic leader in the region has steadily eroded. Growth has been lower than other crisis affected countries, while investment has not recovered. Private investors have taken a back seat. Since the Asian crisis, aggregate investment as a share of GDP in Malaysia has continued to decline, with private investment remaining stagnant due to several factors. In some industries, heavy government and government linked company (GLC) presence has discouraged private investment. Cumbersome and lengthy bureaucratic procedures have affected both the cost of investing, and the potential returns on investment. Malaysia’s place within the Global Competitiveness Index dropped to 24th in the 2010 report from 21st previously, indicating that the country is losing its attractiveness as an investment destination (New Economic Model For Malaysia, 2010)

A plunge in exports wounded this trade-sensitive economy in 2009. The impact of weak exports spread to private investment, which fell sharply, and to private consumption, which was nearly flat. Fiscal stimulation packages provided some buffer for aggregate demand. Economic growth will rebound during the forecast period, underpinned by a recovery in exports and rising incomes. Annual inflation is set to pick up from low levels. The government plans renewed efforts to encourage private investment. Fixed investment fell sharply by 5. 5%, with many firms canceling or deferring investment decisions. Investment acted as the major drag on GDP in 2009. The ringgit, having depreciated by 5. 0% against the dollar during the first 3 months of 2009, when increased risk aversion and deleveraging activities by international investors increased the demand for dollars has since appreciated. Economic growth, while impressive, has slowed and private investment, averaging about 30% of GDP just before the Asian financial crisis, has fallen to around 9. 5% of GDP. These indicators point to the need to address deficiencies in the investment climate and to reappraise the role of public sector companies that compete with the private sector. (Rajapakse, 2010)

Other than that, the effect of middle-income trap include lack of appropriately skilled human capital caused by brain drainA graduate teacher starts at RM2, 500 per month in Malaysia, compared to RM6, 196 in Singapore and RM15, 661 in Hong Kong. Malaysian wages have fallen behind partly due to the gross divergence between the suppressed Malaysian CPI and that of the world (FONG, 2010). Globalization, outsourcing, offshoring and business process outsourcing gave rise to mobility of resources, investment, companies and skilled workers. Skilled workers flow to locations where they are paid higher and companies move to locations that are more competitive. Many skilled Malaysian workers have been leaving the country, lured by higher pay (Altfa, 2011). Many Malaysians could be found working overseas as they were often adaptable, multi-lingual and inexpensive. In terms of composition of the economy for most developed countries, more than 60% of annual gross domestic product (GDP) came from the services sector, with Malaysia somewhere just over 50%. Deputy director in the Public Private Partnership Centre and Secretariat to the Economic Council of the Economic Planning Unit Dr Soh Chee Seng said: “ Our productivity levels are not really low, it is just that they are falling behind other rapidly developing countries like China, India, Indonesia and Thailand:’ According to HSBC Bank Bhd executive director Jon Addis the country’s infrastructure was still “ patchy” such as in terms of public transit, which had some idiosyncrasies. (Min)

Malaysia stuck in middle income trap will lead to bring to affect of low value added industries. According to Wikepedia, value added can be refers to “ extra” features of an item of interest for example product, service, person and etc that go beyond the standard expectations and provide something “ more” while adding little or nothing to its cost. Value-added features give competitive edges to companies with otherwise more expensive products. (Wikipedia) In Malaysia, Small and Medium Enterprises (SMEs) have evolved to become a key suppliers and service providers to large corporations, inclusive of Multinational Corporation and Transnational Corporation (MNCs & TNCs). SMEs contributed to expanding output, providing the value added activities in the manufacturing sector, creating employment opportunities, contributing to broadening Malaysia export based. Our Prime Minister Datuk Seri Najib Tun Razak has urged SMEs to adopt technology as a core part of their business strategy to gain a sustainable competitive edge. He said that the SME community in Malaysia was not adopting technology as rapidly as it should. (Adopt new technology, Najib urges SMEs, 2011) For this point, SMI Association of Malaysia president Chua Tiam Wee urged the government should concern about the problem faced by SMEs, such as securing adequate financing at competitive rates for new start-ups, the issue of frequent policy changes in employing foreign workers to overcome shortage, and also the problems in dealing with government agencies to acquire halal certification and other licences. (Mustaza, 2011) Besides that, there are many factors have contributed to the country's slower growth over the past year among them to caused less invest from FDIs to Malaysia, we are loss of comparative advantage with other emerging economics such as India, Vietnam and China which being supplanted as a low-cost export and services based. (The Middle Income Trap, 2010)

Another effect of the middle income trap is that Malaysia providing a low skilled jobs and low wages to attract foreign worker migrant into our countries. To become one of the high income countries, mean that the income of an individual is high. The main goals of the New Economics Model(NEM) are that Malaysia will toward become a high income country with target of US$15, 000 until 20, 000 per capital by 2020. But now Malaysia stuck in the middle income trap because there are not enough high wages job created in Malaysia. Normally, high wages are often related to the high skilled worker. In fact the share of skilled labour has declined across industries. The figure as shown as below shown that the use of high skilled labour for differences industries for 2002 and 2007. The E&E as one of the largest industries contribute in GDP of Malaysia. From the diagram, the use of high skilled labour in E&E was declined from 54% to 46%.

The regional competition did lead to some minor transformation over the years. Although the manufacturing sector in Malaysia was grew rapidly, but that is resulting shortage of Malaysian workers with higher wages. Therefore, the foreign labours are welcome to Malaysia to fill the gap. So the companies could enjoy low wages and production costs to comfortable profit. The skilled labour force is also linked to education. The labour force with tertiary education for advanced countries is usually high, so many skilled Malaysian worker will leaving the country to pursue a higher pay.

The central themes of the 10th Malaysia Plan (10MP) is encapsulated in 10 Big Ideas, says the Economic Planning Unit (EPU) of the Prime Minister's Department. These 10 Big Ideas, if vigorously and consistently implemented would see Malaysia through the challenging times and enable the nation to be a high-income and developed nation by 2020, said the Unit under the Prime Minister's Department. (10MP Encapsulates In 10 Big Ideas, Says EPU, 2010) One of the ideas of the Tenth Big Ideas is to unleashing productivity-led growth and innovation. Malaysia stuck in the middle income trap will cause lacking in talent and innovation to do so. Malaysian graduates tend to more interested to work in abroad because they offered a high income from the other countries. As they leaving from Malaysia, it will lose the skilled talent needed to make innovation to develop the country. Therefore, Malaysia lack of holistic approach and systematic assessment of innovation. Besides that, the growth model eventually runs out of steam. As the incomes increase, so the costs also have to be concern. The low-tech manufacturing industry was undermining the competitiveness. Therefore, Malaysia tend to move " up the value chain," into exports of more technologically advanced products, like electronics. The economy has to innovate and use labor and capital more productively. To get to become a high income country, the economy needs to do more than just make stuff by throwing people and money into factories. That requires an entirely different way of doing business. Companies must invest more heavily in R&D on their own and employ highly educated and skilled workers to turn those investments into new products and profits. (DAN, 2010)

Based on the effects of middle-income trap stated above, we strongly suggest that government has to consider thoroughly before Goods and Services Tax (GST) is imposed. . Such a plan has pros and cons and serious implications and has to be thoroughly studied and extensive consultation made before a final decision is made. Public consultation on this policy that would have great impact on the Malaysian economy and investment is seen as vigorous enough that would have an impact on poorer Malaysians and the government coffers (Altfa, Minimum wage policy can hurt manufacturers' competitiveness, 2011). GST wills worsening the poverty condition in Malaysia as well as deteriorates the private consumption in economy. The ripple impacts of GST will deepen the situation of middle-income trap in our country.