The Malaysian Reserve

Salary increment can help Malaysia achieve high-income economy

THE common assumptions that increasing wages could lead to market distortion and reversely affect economic performance may not be entirely true.

According to the Economic Outlook 2023 Report released by the Finance Ministry in line with the tabling of Budget 2023 last week, the decent level and growth of wages represent the concept of economic justice or fairness for households as almost two-thirds of their income is sourced from the labour market.

Low-Wage Economy Limits Economic Opportunities

“This suggests that wages are uncertain, particularly if someone loses a job, in contrast to property rights, which have greater security in assuring rents and other types of capital incomes perpetuity,” the report said.

The report added that from the nation accounts perspective, the total national income is shared by labour, capital-owners and the government, and the labour income is primarily assessed by compensation of employees (CE) or labour compensation whereas the income for the capital is commonly represented by the operating surplus.

“In Malaysia context, Malaysia’s ratio of CE to GDP remains very low compared to Germany (53.4%), the UK (48.7%), South Korea (47.5%), Australia (47.2%) and Singapore (39.9%) despite it increment to 35.9% in 2019 from 31.7% in 2010,” the report said.

Higher Labour Remuneration Answer for Malaysia’s Structural Issues

The Economic Outlook 2023 report also mentioned that higher labour remuneration might be the solution for some of the structural issues in Malaysia such as low labour force participation (LFPR), income inequality and slow rate of technological innovation and acceptance.

A report by the World Bank stated that Malaysia will miss out on the opportunity to maximise its full economic potential if the level and growth of labour remuneration remains significantly low.

A high labour compensation rate can raise LFPR, reduce income inequality, boost technological innovation and support economic growth.

While higher labour expenses incurred by industries will prompt them to hire fewer workers or lay off some of them and the desire to raise prices are common justifications claimed to limit pay increases, actual evidence suggests that the reasons may not be correct as when productivity rises in tandem with minimum wage increases, there is no incentive for industries to raise product pricing.

Sources, Adjusters for Low-Wage

The labour market accounts for over two-thirds of household income. Labour is a supply-side variable whose amount and composition are determined by demand-side factors such as exports and investment expenditures.

As a result, it is critical for policymakers to integrate both the demand and supply sides of the economy in labour market planning to improve the situation toward a high-value economy, the report said.

By partitioning the contribution of GDP according to expenditure components, the demand side of the economy influences labour compensation to some extent. Although investment expenditure has an equal distribution of labour compensation and GOS, government consumption is the most equitable component, accounting for 81.3% of labour compensation.

"In reality, the compensation multiplier shows that every ringgit of government consumption creates RM0.60 in labour compensation — the most of any final demand.

"Hence, it is vital to highlight that the structure of employment shapes the distribution of ultimate demands on labour compensation, since total employment is split according to GDP by expenditure components," the report stated.

Employment Distribution

The report added that skilled employees account for roughly one-fourth of total employment created by private consumption, investment and exports.

Government consumption is the sole final demand component that generates the most trained workers with 47%. Overall, lower salaries are the outcome of a high concentration on low- and semi-skilled jobs.

In the last 30 years, the economy created 61% more positions for semi- and low-skilled workers compared to 39% for trained workers. This can be validated by looking at the size of employment elasticity-to-GDP, which increased from 0.52 (between 1991 and 2005) to 0.67 (between 2006 and 2020).

"According to the empirical assessment, the prevalence of low-wage paying jobs is a product of a labour-intensive economy.

"Although the country's economy is mostly labour-intensive, this does not exclude a more generous distribution of wealth between employers and employees," the report said.

Higher Wages Help Drives the Economy

The report also stressed the necessity to raise salaries in the aftermath of the Covid-19 pandemic as workers believe it can compensate the increasing pricing for products and services.

The report highlighted several reasons why higher wages would help the economy and among them are greater wages diminish income disparity, higher wages would prompt greater consumption of products and services which then resulted to more profits for the business sector and more women participation in the labour force.

"Other than that, it will also promote technological adoption in different sectors, as well as improve economic efficiency by reducing the size of the shadow economy and promote labour productivity growth," the report said.
The report added that any labour activity that occurs in the shadow economy is considered to be part of the shadow labour market or informal labour market.

“As such, people may be barred from the formal labour market due to a lack of possibilities or they may choose to leave the formal sector freely due to the financial and non-monetary benefits of informality,” the report explained, adding that for every 1% rise in labour remuneration, the size of the shadow economy is projected to shrink by 0.5%.

“In this sense, pay is regarded as an indirect policy intervention, in addition to direct interventions to increase the formalisation of the economy. Wages in the formal sector can be raised to attract more people to choose working in the regular sector,” the report said.

The report highlighted that labour productivity growth is the key driver of long-term economic growth and increasing salaries.

“According to the so-called ‘efficiency wage’ theory, employees will invest greater effort in response to increased earnings. Hence, workers may be more motivated to work with higher remuneration, in turn contributing to higher productivity,” the report said, adding that higher wages can also reduce the dependency on low-skilled foreign labour.

Previously, Home Affairs Ministry stated that low-skilled foreign workers in Malaysia will account for around 8% of total employment or 1.2 million people in 2021. Over 90% of non-Malaysian citizens worked in low- and semi-skilled occupations. The economic implications of relying heavily on low-skilled labour in Malaysia would reduce local wage growth and harm productivity growth.

“Therefore, wage adjustment is the most effective market-based price mechanism to use as a policy instrument to minimise reliance on low-skilled overseas labour, accord- ing to a World Bank study.

“For every percentage rise in labour remuneration, the number of foreign workers can be lowered by 2.3%,” the report said.

Lastly, the report said higher wages can reduce the size of skills-related underemployment. “According to the **Department of Statistics Malaysia**, skills-related underemployment expanded by 6.3% in 2021 to 1.9 million workers from 1.8 million in 2020,” the report added.

In a nutshell, ideal wage levels must give a sufficiently high standard of living for the economy to be sustained by consumption expenditure. Higher consumption spending implies a higher (lower) standard of life, which encourages (restrains) long-term economic growth.

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