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Economic Briefing To the Penang State Government

Encouraging Feedbacks So Far From Penang's Labour Market

Inside this issue:

Seagate's recent closure of its Penang operations gave a sense of gloom throughout the manufacturing sector raising concerns as to whether this is the first of many plant closures across the state in which manufacturing makes up 46% of the gross regional product. The facts are clear. The U.S., where a quarter of Malaysia's manufactured exports are destined, made a hard landing. The hopeful reprieve will be the typical pick up in demand as the Christmas season approaches for which component sourcing should begin to occur in the next couple of months. Should for some reasons the orders not come, it will take at least another year before any positive signs would appear because, other than what cushioning effect another lowering of interest rates (the fourth time in four months) by the Federal Reserve can provide, there are no clear signs of recovery in the American economy. This is why given the current low exchange rate among neighbouring countries, local exporters fear that Malaysia will not be competitive due to the ringgit's fixed dollar peg.

The ringgit's peg is no longer a variable to be considered because any policy prescribed devaluation raises the issue of non-transparency and will result in a loss of confidence in Malaysia's economy. Revisions to the fixed peg can only come from refloating the ringgit that will allow the market to fix the ringgit's eventual exchange rate. However, as was experienced in 1997, a freely floating exchange rate can result in much instability following currency speculation, requiring traders to take forward positions as a protection against exchange rate risks. Meanwhile, the more relevant question is how best to respond to the current weak overseas demand?

Human Resource Strategies

In this connection, there are lessons to be learnt from actions that are being taken by various manufacturing companies in Penang. The principle is how the labour market should be organised in the economy and how to manage the human resource within the company. Depending on the ratio of labour to non-labour inputs, taking the right action on human resources will determine how quickly the company can go back to full operational capacity when the business cycle is on the upswing once again. Each company has to weigh the cost of carrying critical human resources at the time when they cannot be fully utilised against the alternative of laying off staff and incurring the cost of recruiting and training a new set of staff when business picks up. The unknown variable in this equation is for how long will the period be if staff is to be retained on salary? For this, each company makes its own estimates and decides on one strategy or the other.

The state government is closely monitoring the labour market situation and receives reports on various actions that are being taken by individual companies. The preferred action is for companies to assure existing staff that there will be no lay-offs, because of the belief that the business cycle will soon swing upwards and the wish to go back to operating capacity quickly. Ironically the need to keep staff on stream is more critical when the labour to non-labour input ratio is low. When the production is labour intensive, presumably workers can be easily hired whenever they are needed.

Socio-economic & Environmental Research Institute (SERI)
10 Brown Road
10350 Penang, Malaysia

Phone: 604-2283306
Fax: 604-2267042
Email: seripg@tm.net.my
Website: http://www.seri.com.my

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But with capital-intensive production, machinery on the factory floor that is less easily laid off when demand is low will need people to operate them when demand suddenly picks up. In the meantime it will therefore make sense to keep machine operators on board just for their skills.

Temporary Hardships

However, existing staff must be prepared to face temporary hardships ranging from less or no overtime pay, annual increments and bonus payments, to a reduction in shifts and work week. Slowing down production involves asking staff to finish up their annual leave or for those who no longer have any, to go on unpaid leave. The issue is yes, you still have a job but you must expect a lower take home pay relative to previous years. These are the sorts of actions that bigger companies are taking. They can afford it better. But more important, they have a lot of machinery on the factory floor that will need manpower to operate when business picks up. Very fortunately for most people, the bigger companies are the ones that have hired the majority of the factory staff in Penang. By electing not to lay off staff, the sudden surge of unemployment that everyone fears is not likely to happen.

Some companies have begun to offer a voluntary separation scheme (VSS). In this regard, one has to be careful in reading the statistics. True, VSS are being offered but where this is happening it is mostly connected with the banking and finance sector because of Bank Negara's mandated institutional closures that will require much streamlining of the staff structure. It is unfortunate that the timing is bad such that the VSS has spilled over as an option that several non-bank companies have elected to follow. It must be understood that the bank's restructuring is a permanent feature. The current low export demand is a business cycle phenomenon.

But where layoffs have occurred, they are also due to the financial position of companies. The older companies are not as financially strapped. They grew over the years and their non-labour operating capacities have been bought through reinvestments of previous profits. Here, the priority is to get back to operations as soon as possible. However, many newer companies are not in the same position. Available financing at relatively low interest rates, the positive investment climate, and the once buoyant economy have today caused many companies, some fairly large, to be financially exposed. During boom times, these so-called high leveraged companies could make their margin profits despite high business costs. When recession occurs, they have large loans to service and are therefore not in a position to continue paying staff when revenues plunged.

The numbers tell the story clearly. Data reported by companies up till March 2001 show that 18101 workers are affected only by a reduction in take-home pay. These workers are being retained in preparation of the eventual pick up in business so that their companies can get quickly get back into operating capacity. The number of workers being laid off as a result of downsizing or total company closures: 305 people. The only wrinkle to the story is Seagate's plant closure. A total of 4515 workers were offered a voluntary retrenchment package or a VSS. There are another 941 workers elsewhere that are also being given a retrenchment package or a VSS.

By comparing a total of 5761 workers losing their jobs as opposed to 18101 being retained, we are talking of a ratio of 1 to 3. But a more accurate representation will be to take Seagate's closure as an isolated event, which would have occurred regardless of the current downswing in the business cycle. If we were to set aside the 4515 former Seagate employees, the number of workers loosing their jobs due to the business downswing is 1246 people compared against 18101 workers retained or a ratio of only 1 to 14.5.

The state's Economic Planning Unit has announced that as many as 1500 former Seagate employees are being absorbed by another factory. They are valuable human resource. At the recent job fair, some 36 companies were interviewing former Seagate employees.

New workers in the process of joining the labour force for the first time are an added complication. From the labour market point of view, it will be best to keep as many of this group of people out of the market, that is as a policy measure to reduce the labour force participation rate. The most effective way will be to retain part of the labour force in schools and training institutions where skill levels can increase that will later be very useful. In Penang there are many colleges and training facilities that could be mobilised as part of the strategy to organise the labour market, basically to match people with the skills that local industries and business would need in the future.

We can therefore safely conclude that if the situation does not worsen, that is if the American hard landing does not have prolonged consequences, the labour market in Penang does not appear to be serious. Companies are rightfully adopting the strategy of retaining staff to be at a level of preparedness for full operating capacities. This is a strong indication of the fact that Penang's labour force is intrinsic human capital that remains invaluable to their employers. There are cost implications to their replacements when taking into account their skills and experience. Unfortunately, some financially strapped companies are not able to do the same thing. The upside is the number of workers affected is relatively small compared to workers being retained. ***§ Chan Huan Chiang & Terence Too***

Comparative Benchmarking : Is Malaysia Competitive?

Introduction

Much has been said about Malaysia losing its comparative advantages as an investment hub to other emerging economies, especially China, Philippines and Thailand. Multinational corporations (MNCs) that once found Malaysia attractive for their off-shore manufacturing facilities are beginning to look at those three countries as alternatives.

Read-Rite was one of the first few disk drive companies in Penang. However, the company wrapped up its Penang operation during the late nineties while continuing its operations in Philippines and Thailand. Last month, Seagate announced the closure of its drive assembly plant. Its entire low-end drive assembly will move to its China facility that was set up much later than the one in Penang. Other MNCs like Intel, Motorola, Dell and Osram also have their operations in either of these locations. Whether these MNCs will emulate Read-Rite and Seagate remains a question.

This article will attempt to compare selected development indicators in these three countries as well as in Malaysia and Singapore. Investors claimed that labour costs in these three countries are lower than the labour cost in Malaysia while labour cost in Singapore is much higher than in Malaysia. The question is what makes Singapore more competitive despite being a higher cost location?

Economic Growth Trend

A comparison of GDP annual growth rates among Malaysia, China, Thailand, Philippines and Singapore shows that during the first half of the 1990s, China grew fastest at double-digit growth of 12.4 per cent. Malaysia, Thailand and Singapore experienced growth of about 8 per cent during the same period while Philippines experienced an exceptionally low growth of only 2.2 per cent.

Malaysia, China, Thailand and Singapore experienced lower growth in general during the second half of 1990s as compared with the first half of the decade. Malaysia's growth rate was on a descending trend from 1996 onwards, recording a negative growth of 7.5 per cent during the recession year of 1998 but leapt to a full recovery in 1999 by registering a growth of 5.4 per cent. Malaysia is envisaged to record slower growth in 2001 (5.2 per cent) compared with 2000 (6 per cent) because of the US economic slowdown, which results in decelerated growth in the global high-tech sectors. Similar trends are observed in Penang. Penang recorded an annual growth of 11.4 per cent during the first half of the 1990s while the state only registered an annual growth of 4.8 per cent during the second half of the 1990s.

A similar trend is observed in Thailand's economy except that their growth has always been lower than Malaysia's. A similar trend is also observed in the Philippines except for their lower growth rates and significantly low growths during the first half of the 1990s. The Philippines actually recorded improvements in terms of economic growth during the second half of the 1990s compared with the achievements during the first half of the decade except for the downturn in 1998. Singapore also recorded an almost similar trend except for the exceptionally high growth achieved in 1997.

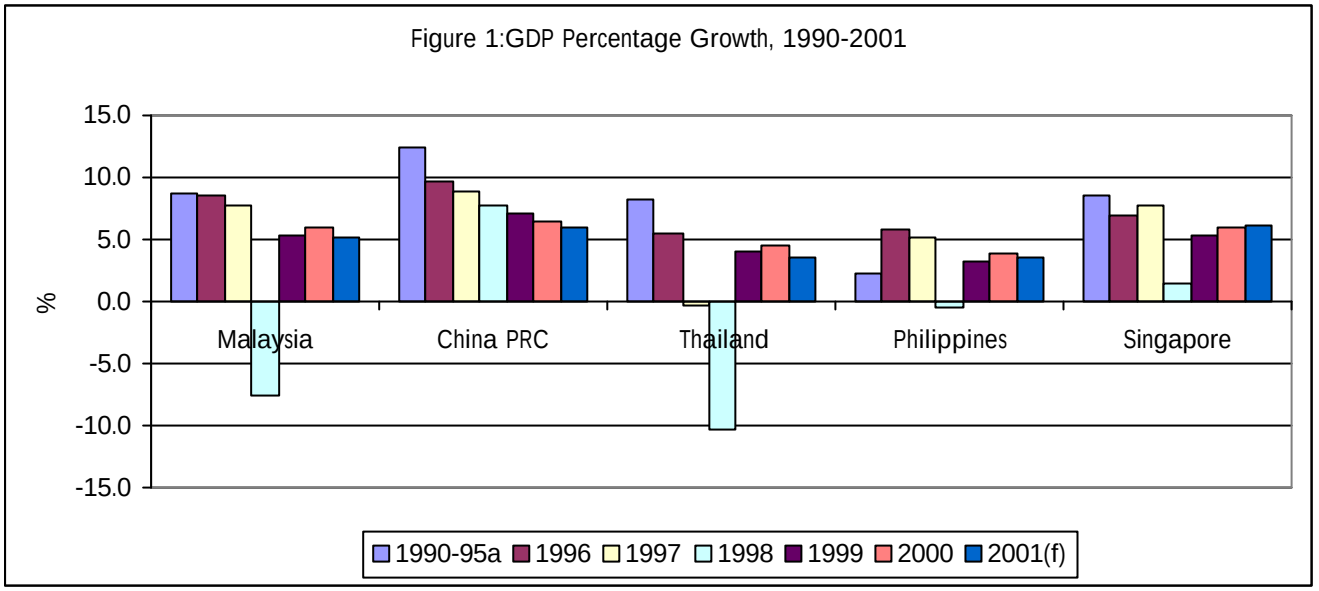
On the contrary, China did not experience trends parallel to that of the four Southeast Asian countries. China's growth rates have been higher than the other four countries over the 1990s, although on a descending trend (Figure 1).

Foreign Direct Investments

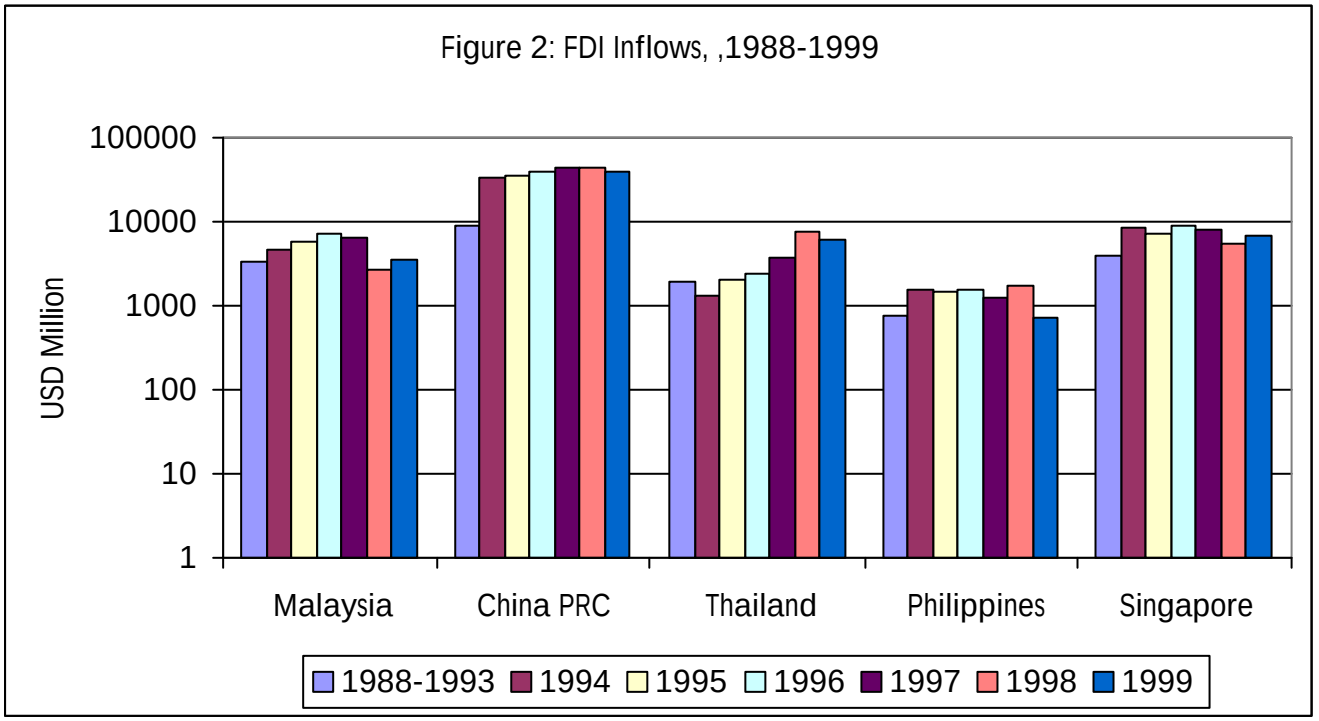
Between 1998 and 1999, China had received the highest amount of FDIs compared with the other four countries. Amounting to more than USD 247 billion, China's FDI inflow was almost 10 times that of Thailand's, 27 folds of Philippines, 5 times of Singapore's and more than 7 folds of Malaysia's. Figure 2 shows the FDI inflows to the five countries during the 1988-1999 period.

Malaysia recorded a growth of 25 per cent and 26 per cent in terms of FDI inflows in 1995 and 1996 respectively but FDI inflows declined by 11 per cent and 59 per cent in 1997 and 1998 respectively. In 1999, FDI inflow to Malaysia grew by 31 per cent over the 1998 figures.

Over the five-year period, FDI inflows to Singapore and the Philippines have been fluctuating. Both countries experienced contraction in FDI inflows in 1997. Although China experienced only moderate growth rates in terms of FDI inflows during the period concerned, it also did not experience excessive decline in FDI inflows as experienced by the other locations. Declines in FDI inflows recorded in China were less than 10 per cent compared with contraction of between 10 and 60 per cent in the other locations. Despite the fact that Thailand was the hardest hit by the Asian financial crisis of 1997-98, FDI inflows to Thailand increased by 55 per cent in 1997 and 100 per



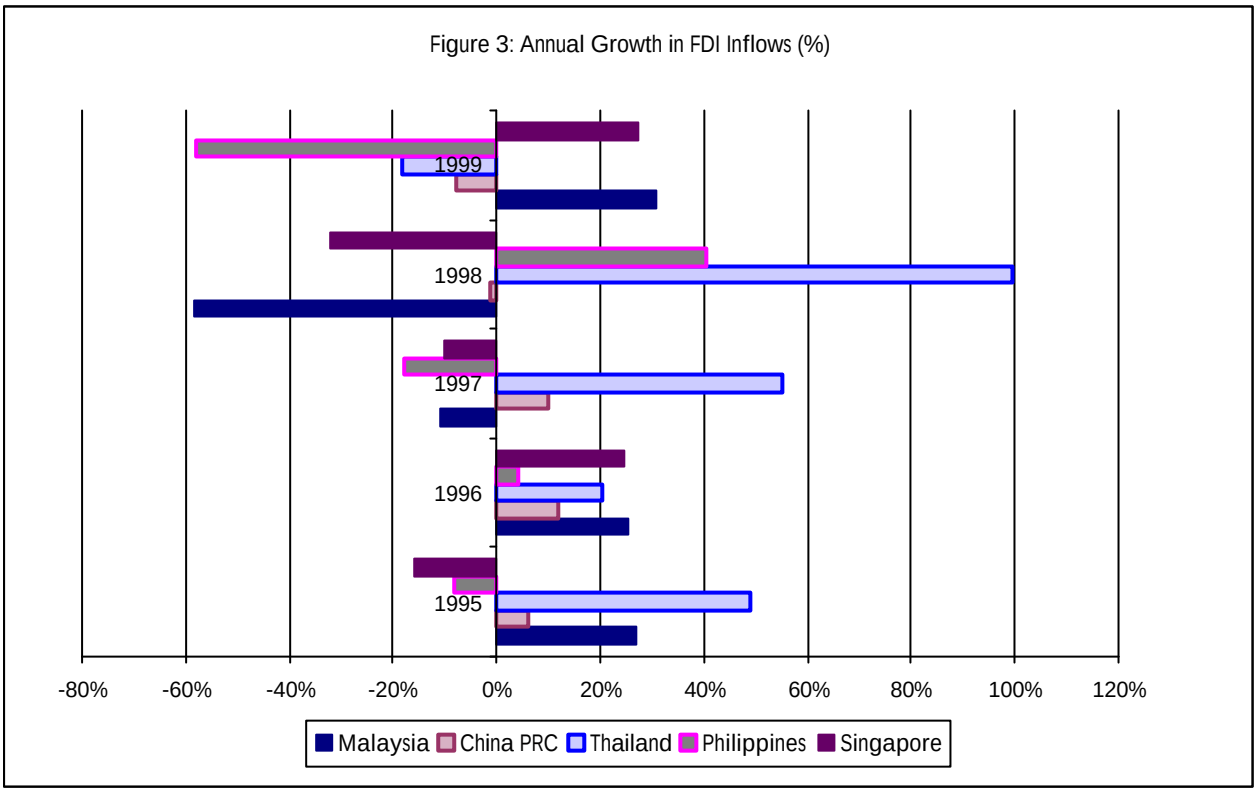
Source: Derived from UNCTAD, Trade & Development Report, 1999 and ADB, Asian Development Outlook, 2000 & Asia Recovery Report



Source: Derived from UNCTAD World Investment Report 2000

cent in 1998. This is mainly due to the pro-active role played by Thailand's Board of Investment (BOI) in attracting foreign investments to boost the economy of the country (Figure 3). The growth in FDI inflows in Thailand during the crisis years indicates that Thailand was the preferred location among the foreign investors.

Table 1 shows the FDI Inward Stock. The FDI inward stock for China between 1980 and 1999 grew by 22.7 per cent, higher than the other four countries. Growth of FDI inward stock in Thailand ranked second, at 19 per cent for the 1980-1999 period. The Philippines registered the lowest growth in FDI inward stock, at 12.1 per cent per annum during the same period. Although Malaysia ranked fourth in terms of FDI inward stock, its FDI inward stock grew at



Source: Derived from UNCTAD World Investment Report 2000, MIDA (for Penang)

only a slightly higher rate than the Philippines, at 12.5 per cent during the same period. The significant growth in FDI inward stock over the past 19-year period indicates that both China and Thailand are preferred locations of the foreign investors as compared with Singapore, Malaysia and the Philippines.

FDI inward stock in China grew to an incredible 41 per cent per annum during the first-half of the 1990s and maintained a significant 25 per cent growth per annum during the 1995-1998 period. Likewise, Thailand achieved a significant growth of 33 per cent during the second-half of the 1980s and in 1999 the country registered a growth of 30 per cent in terms of FDI inward stock over the 1998 figures.

Table 1: Compounded Annual Growth Rate of FDI Inward Stock, 1990-1999

	1980-1985	1985-1990	1990-95	1995-98	1999	1980-1999
Malaysia	7.4%	6.9%	22.7%	16.3%	7.8%	12.5%
China PRC	10.9%	18.7%	40.9%	24.6%	15.2%	22.7%
Thailand	15.3%	32.6%	16.3%	5.4%	29.7%	19.0%
Philippines	15.2%	4.7%	13.2%	15.2%	20.4%	12.1%
Singapore	16.0%	17.0%	15.8%	6.7%	9.6%	14.4%

Source: Derived from UNCTAD World Investment Report 2000

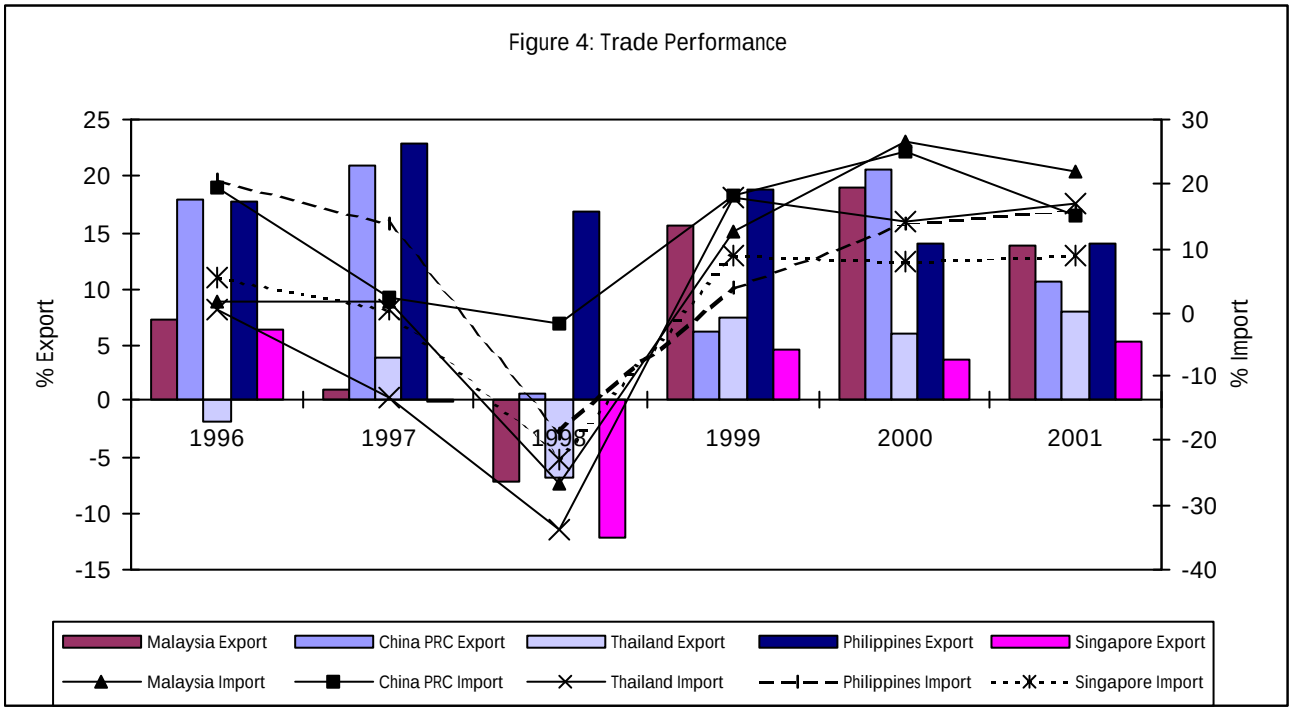
Trade Performance

Export growth in Malaysia slowed down in 1997 to 0.9 per cent from 7.3 per cent in 1996. There was a further contraction of 7.3 per cent in 1998. However, by 1999, export growth in Malaysia rose to a significant 15.6 per cent and grew even faster in 2000, at the rate of 18.9 per cent. However, a slowdown is anticipated for 2001 during which export growth is envisaged to register only 13.8 per cent over the 2000 figures. On the other hand, growths in imports have been lower than exports during the 1996-1998 period. However, by 1999, import growth

reached 12.6 per cent and by 2000, it reached 26.5 per cent, higher than the export growths for the same period. Import growth is anticipated to slow down for 2001, but forecasted at 2.2 per cent, import growth will still be higher than export growth. Figure 4 shows the trade export & import performance of the five countries.

Almost similar situations are observed for the other four countries. Although they are also export-oriented economies, import content remains high and growing. All the countries experienced negative growth in imports during the crisis year of 1998, while Malaysia, Thailand and Singapore also experienced negative growth in exports during that year. Both China and Philippines, on the other hand, experienced growth in exports, particularly Philippines, which experienced a double-digit growth of 17 per cent.

Figure 4: Trade Performance



Source: ADO 2000 Update & ADO 1999 Update

Table 2 compares the export & import indices for Malaysia, Thailand and the Philippines. The export index for Malaysia dropped from 1996 to its lowest at 94.7 in 1998 before picking up in 1999 (108.2) and reaching 125.7 in 2000. On the other hand, the export index for Thailand increased to 106.4 in 1997 despite the onset of the Asian financial crisis. However, Thailand's export index dropped to 97.5 in 1998 before picking up again in 1999. The export index in the Philippines has been growing since 1996. Data on the export index alone indicates that Malaysia was harder hit among the three countries during the Asian financial crisis in terms of exports.

As for the import indexes, Malaysia's import indices dropped to 79.9 in 1998 from its base year in 1996 and improved slightly in 1999 (89.9). The import index for Malaysia in 2000 was 113.0 compared to the export index of 125.7, indicating a positive trade balance because the export sector performed better than the import sector. On the other hand, for Thailand, there is a clear indication that the export sector out-performed the import sector. Although Thailand registered growth in imports in 1999 and 2000 compared with 1998, the import indices remained below the 1996 base year. Similar trends were observed in the Philippines during the same period. Both the export and import indices for these three countries indicate that Thailand and Philippines registered more positive trade performance compared with Malaysia during the crisis and post-crisis periods.

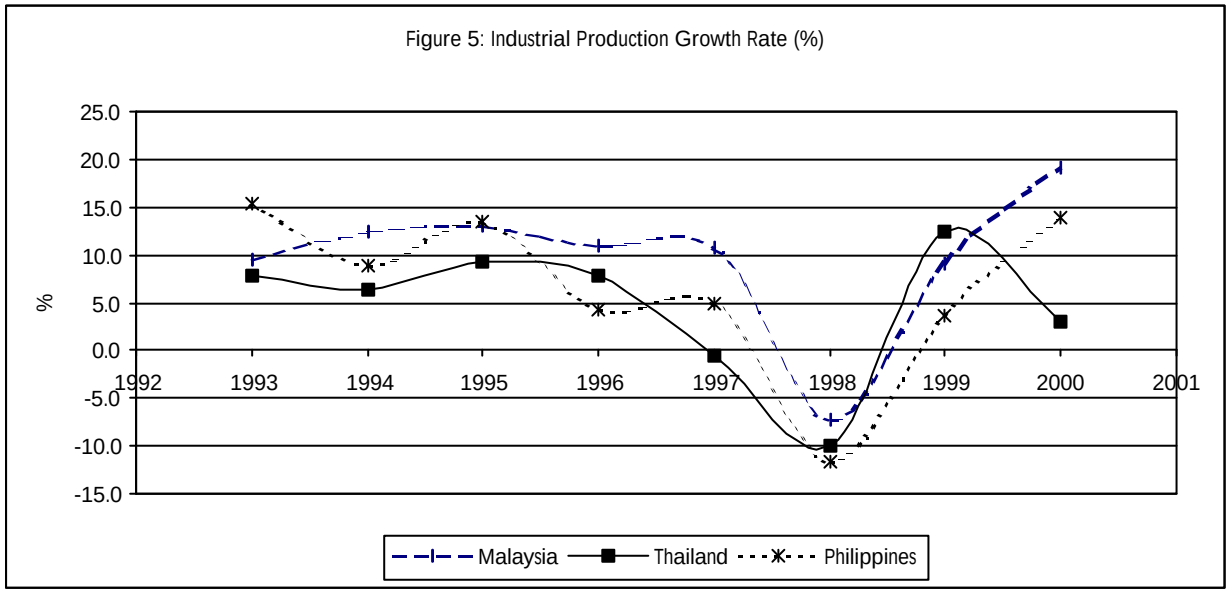
Production Performance

Industrial/manufacturing production growth in Malaysia between 1993 and 2000 peaked at 13.1 per cent in 1995 and tapered off after that, to register a growth of 10.7 per cent in 1997. Industrial production contracted in 1998 and recorded a negative growth of 7.2 per cent but recovered in 1999 with a growth of 9.1 per cent. Industrial production in Malaysia performed even better in 2000, achieving a growth rate of 19.2 per cent over

Table 2: Export & Import Indexes for Selected Countries, 1993-2000, (1996=100)

	1993	1994	1995	1996	1997	1998	1999	2000
Export Indexes								
Malaysia	60.2	74.7	99.6	100.0	97.5	94.7	108.2	125.7
Thailand	66.3	81.2	101.3	100.0	106.4	97.5	104.8	123.7
Philippines	55.4	65.6	84.9	100.0	124.3	143.8	170.5	185.4
Import Indexes								
Malaysia	58.9	75.7	98.6	100.0	101.8	79.9	89.9	113.0
Thailand	63.7	75.3	97.9	100.0	84.8	59.3	69.7	85.5
Philippines	55.2	66.9	82.8	100.0	112.7	93.0	96.4	98.4

Source: Derived from ADB website (http://aric.adb.org/indicators)



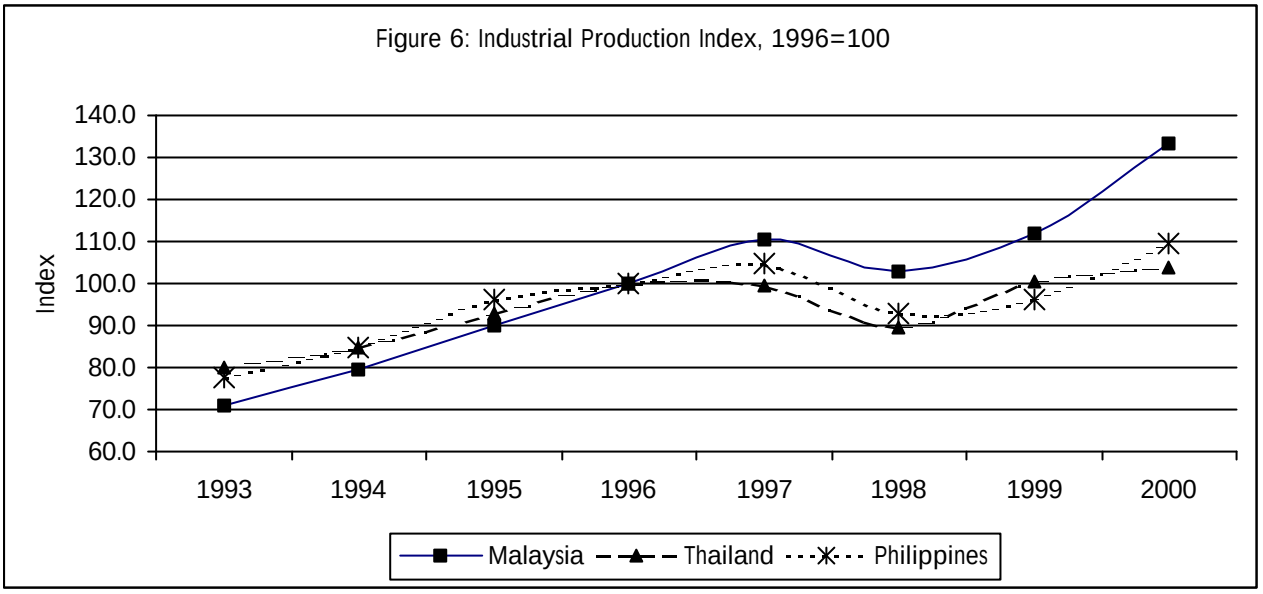
Source: Derived from ADB website (http://aric.adb.org/indicators)

the 1999 figure. Figure 5 shows the trends for the three countries.

On the other hand, industrial production growth in Thailand have never exceeded 10 per cent during the 7-year period except for 1999. As in the case of Malaysia, industrial production in Thailand dropped from its relatively high growth in 1995 (9.2 per cent) to 7.8 per cent growth in 1996. Industrial production in Thailand contracted by 0.5 per cent in 1997 and contracted further by 10.0 per cent in 1998 before picking up and achieving a growth of 12.5 per cent in 1999. In 2000, Thailand's industrial production recorded a moderate growth of only 3.1 per cent over the 1999 figure.

Industrial production in the Philippines fluctuated between double-digit and single-digit growth rates during the 9-year period. Similar to both Malaysia and Thailand, growth began to slow down after 1995 and contracted in 1998 before picking up in 1999.

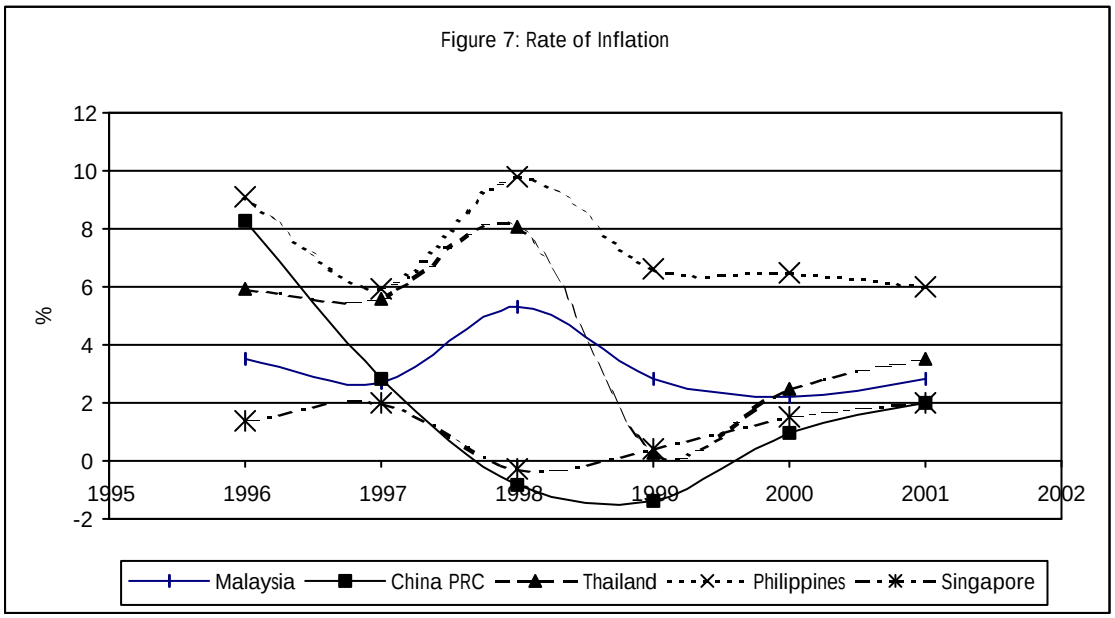
Figure 6 shows the production index for the three countries. Only Malaysia recorded higher indices throughout the 1997-2000 period, despite the Asian financial crisis. Although industrial production contracted in 1998 compared with 1997, the index was still higher than the 1996 base year. Both Thailand and the Philippines recorded indexes of below 100.0 during the crisis years. This indicates that Malaysia has performed significantly well in terms of industrial production during the past four years.



Source: Derived from ADB website (http://aric.adb.org/indicators)

Cost of Doing Business – Inflation

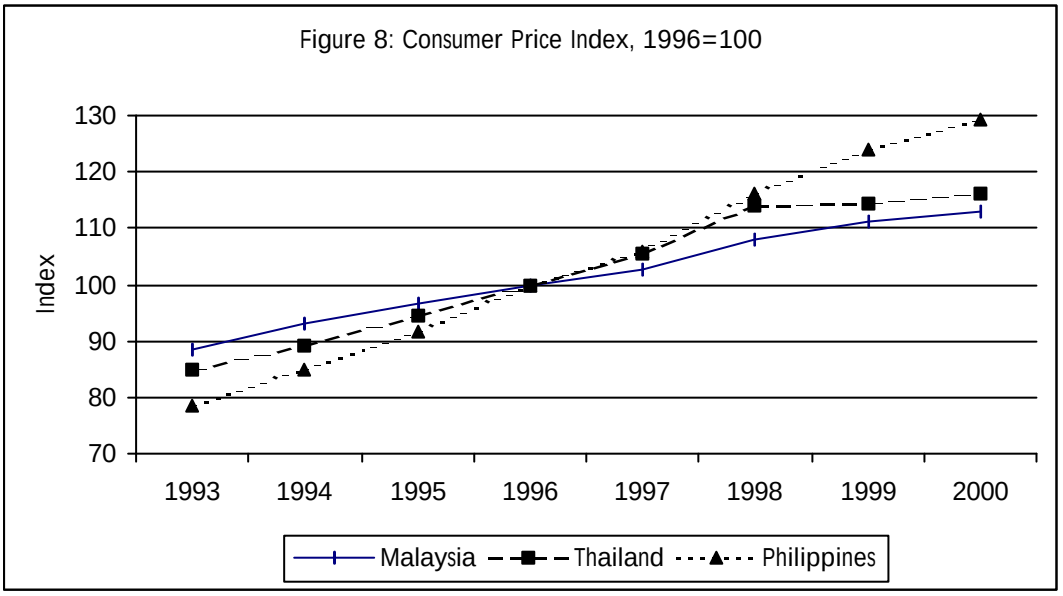
Inflation, in general is lowest in Singapore among the five countries, not exceeding 2 per cent during the past 6 years. Inflation at 5.3 per cent was highest in Malaysia in 1998 but upon recovering from of the Asian financial crisis, inflation in Malaysia declined to below 3 per cent. On the other hand, inflation in China was at a high 8.3 per cent in 1993 but the country experienced deflation in 1998 and 1999. Inflation was only at 1 per cent in 2000 but is expected to rise to 2 per cent in 2001. Inflation in Thailand was higher than 5 per cent prior to the Asian financial crisis. The figure rose to 8.1 per cent in 1998 but in 1999, inflation declined to less than 1 per cent. However, inflation once again rose and reached 2.5 per cent in 2000 and is expected to reach 3.5 per cent in 2001. Philippines, on the other hand experienced high inflation throughout the past five years. However, the country seemed to record a slight decline in inflation and for 2001, inflation in Philippines is expected to decline to 6 per cent from its peak of 9.8 per cent in 1998 (Figure 7).



Source: Derived from ADO 2000 Update & ADO 1999 Update

Although wages in Singapore is considered higher than the other countries, and wages in the Philippines, Thailand and China are considered relatively lower, the cost of doing business is higher among those countries than in Singapore due to relatively higher rates of inflation.

Figure 8 compares the consumer price indexes (base year 1996) of Malaysia, Thailand and Philippines. The steep gradient on the Philippines chart indicates that the consumer price index (i.e. inflation) in Philippines has been rising sharply over the past 7 years. The consumer price index in Malaysia has been under control as shown in the moderate gradient on its graph. The consumer price index in Thailand, on the other hand was more stable during the past three years, namely after the Asian financial crisis. Comparisons of consumer price index in these 3 countries indicate that the Philippines could be a higher cost location for doing business as indicated in the rapid increase in its consumer price index.



Source: Derived from ADO 2000 Update & ADO 1999 Update

Unemployment

Unemployment is an indicator that shows the extent of the development of a location. Unemployment could also be an indicator of the potential labour force to be tapped and the willingness of the labour force to follow instructions and specifications. Table 3 shows the unemployment rates. Although the unemployment rates for China and Singapore are only available for 1999, it should suffice to show that Singapore and Malaysia were experiencing full employment and Thailand was moving towards full employment. However, unemployment remained an issue in Philippines and China. This indirectly shows that the populace of Philippines and China are probably more willing to take up any job opportunities.

Table 3: Unemployment Rate

	1993	1994	1995	1996	1997	1998	1999	2000
Penang	2.2	n.a	1.4	0.7	1.1	2.3	2.4	1.7
Malaysia	3	2.9	2.8	2.5	2.6	3.2	3.4	3.1
China PRC	n.a	n.a	n.a	n.a	n.a	n.a	9.5	n.a
Thailand	1.5	1.3	1.1	1.1	0.9	4.4	4.2	3.6
Philippines	8.9	8.4	8.4	7.4	7.9	9.6	9.4	10.1
Singapore	n.a	n.a	n.a	n.a	n.a	n.a	2.9	n.a

Source: Derived from ADB website (http://aric.adb.org/indicators), DOS (Malaysia) for Penang data, 8MP for Penang & Malaysia 2000 data

Unit Labour Cost & Remunerations

The unit labour cost ratio indicates the proportion of labour cost to total output. A high ratio indicates high labour cost, which could be due to labour shortage and lack of skilled labour or poor labour mix or even high turnover. A negative growth in unit labour cost indicates that less wages are required to produce a Ringgit worth of output compared to the previous year. This also indicates efficient or productive labour force. Table 4 shows that Singapore recorded a negative growth in unit labour cost in the manufacturing sector in 1998 over the previous year's figure. Malaysia recorded a low 0.7 per cent increase in unit labour cost. The data for manufacturing for Thailand and China are not available, Singapore is shown to be the most efficient, followed by Malaysia and Philippines. Data on the services sector also indicates that Singapore is more efficient than the rest of the countries. The data also indicates that China is more efficient than Philippines in the services sector.

A comparison between Penang and Malaysia on the whole indicates that the manufacturing sector in Penang was much more efficient than the whole country during the first half of the 1990s. Although unit labour cost in the manufacturing sector in Penang increased by only 0.9 per cent during the second half of the 1990s, unit labour cost for the whole of Malaysia contracted by 1 per cent during the same period. (Table 5) ***§ Anna Ong***

Table 4: Percentage Change in Unit Labour Cost, 1998

	Manufacturing	Services
Malaysia	0.7	n.a.
China PRC	n.a.	3.9
Thailand	n.a.	n.a.
Philippines	4.45	4.67
Singapore	-0.9	1.92

Source: IMD, The World Competitiveness Report, 1999

Table 5: Percentage Change in Unit Labour Cost In the Manufacturing Sector, 1990s

	Penang	Malaysia
1991-1995	2.1	5.5
1996-2000	0.9	-1.0

Source: SERI, Department of Statistics (Malaysia)

(To Be Continued Next Month)