Policy Brief
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Tapping Economic Opportunities Through Foreign Labour Protection

Summary

- The rapid economic growth experienced by Malaysia in its pursuit of becoming a high-income nation has been charted by higher labor utilization. The employment elasticity to an increase in gross domestic product (GDP) has been observed to intensify over the past three decades.

- According to the official statistics, the number of foreign labor was recorded at 1.01 million in 2005 and increased to 2.23 million in 2019. In fact, between 2001-2021, it is estimated that around 4.5 million jobs have been created in the economy, with 27% filled by the foreigners.

- The cost of foreign labor dependency can also be associated with the difference between the outflows and inflows of compensation of employees (COE). Widening deficits in balance of payment for COE hinders consumption-based growth for the country, indicating loss of expenditure opportunities on the domestic economy.

- Streamlining social fund management, encouraging employer participation, improving foreign worker monitoring, and collaborating with industries, can facilitate shift towards a bottom-up foreign worker policy and ensure that foreign workers are better protected and integrated into the society, while at the same time protecting the domestic economy from the widening outflows.

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The decades of high labor utilization

Over the last three decades, Malaysia has experienced raise in the education level of its adult population. Today, the working-age population with minimum secondary education accounted more than 87.7%, as compared to 43.3% in 1980. Though this means that the share of low-skilled working population in the labor force has fallen, employers continue to require less-educated workers in the economic sectors such as agriculture, construction, manufacturing, building cleaning and maintenance, and other low-end jobs. Foreign labors have stepped in to provide a ready source of manpower, given to abundant cheaper labor resources from neighboring countries. Alas, either legal or illegal immigrants have been an important source of low-skilled labor supply to the Malaysian economy for many decades.

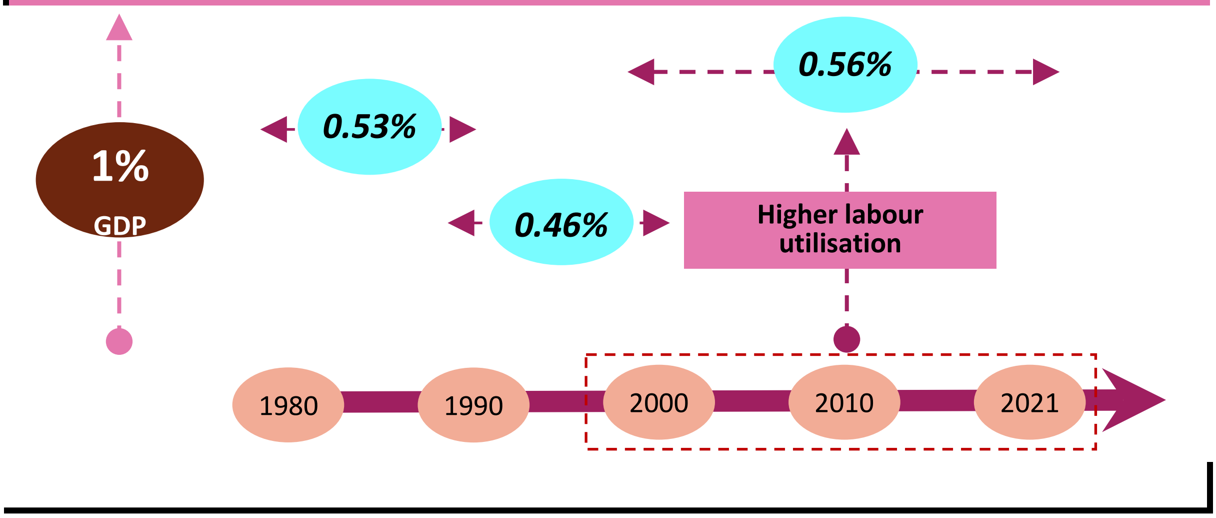
On the other note, the rapid economic growth experienced by Malaysia in its pursuit of becoming a high-income nation has been charted by higher labor utilization. Evidently, the employment elasticity to an increase in gross domestic product (GDP) has been observed to intensify over the past three decades (see Figure 1). In particular, the elasticity was recorded at 0.53% between 1980 and 1990, indicating that for every 1% increase in GDP, employment increased by 0.53%. Although the elasticity had decreased to 0.46% between 1990 and 2000, it had leaped up to 0.56% from 2000 until 2021, indicating that the economy was again relying on labor to drive growth.

Furthermore, from 2001-2021, it is estimated that around 4.5 million jobs have been created in the economy, with 27% filled by the foreigners (see Figure 2). It suggests that close to one-third of the jobs created have been occupied by the non-natives. Out of the millions job created within two decades, 74% of the jobs are created for semi- and low-skilled categories, with the later occupied 17% of the total jobs. Knowing that in most cases low-skilled jobs are filled by non-natives, this condition echoed the argument that foreign labour dependency is hardly weaned-off from the labor-intensive production, inevitably creating hiccups on the journey of becoming an advanced high-income nation.

High labor utilization is noticeable in industries such as construction and services, which heavily rely on low-skilled labor. This situation may be due to the increasing costs of technology and automation, making it more cost-effective for businesses to use human labor instead of investing in capital. In fact, it is claimed that to achieve high-income status, national policies have increased the demand for foreign labor, as local talent shortages and reluctance to take on 3D (Dirty, Dangerous, Difficult) jobs have made foreign workers an essential part of the Malaysian labor market (Marhani et al., 2014). However, over-reliance on foreign labor has drawbacks, such as the potential for exploitation, limited opportunities for local workers, and the hindrance to developing higher-value industries, ultimately limiting the country's long-term economic potential..

Figure 1

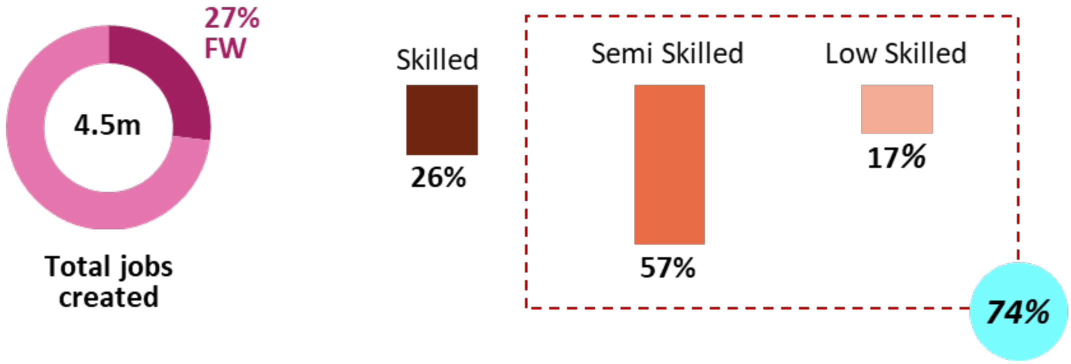
Employment elasticity to increase in GDP



Source: Data are sourced from Labour Force Survey, various years (DOSM) and analyses and estimation by EU-ERA.

Figure 2

Job creation 2001-2021

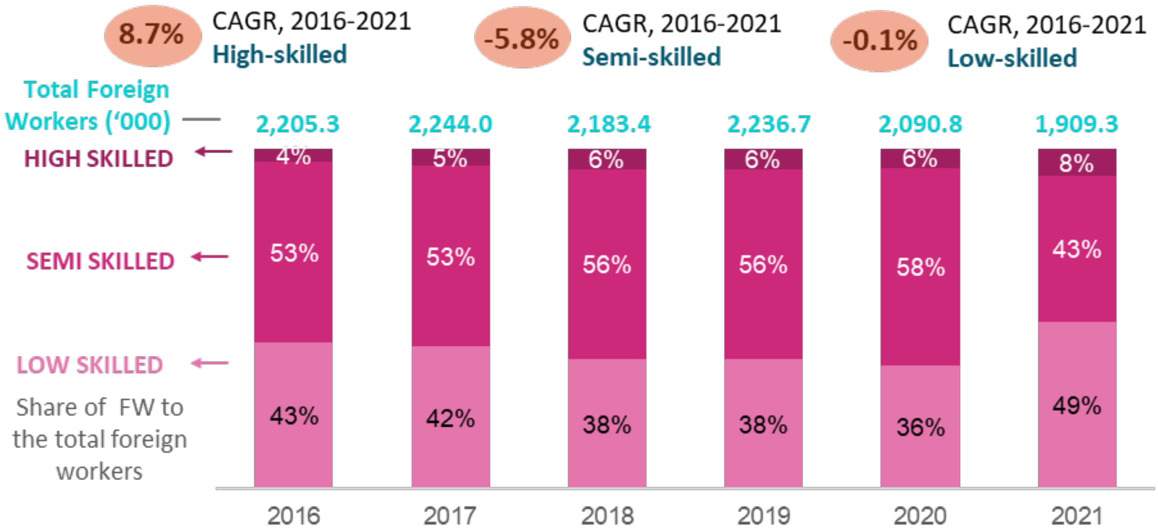


Source: Data are sourced from Labour Force Survey, various years (DOSM) and analyses and estimation by EU-ERA.

According to the official statistics, the number of foreign labor was recorded at 1.01 million in 2005 and increased to 2.23 million in 2019, as shown in Figure 3. However, the COVID-19 outbreak settled on 2020 and 2021, which has affected economic and labor market disruptions, has drawn decreasing foreign labors' demand in the country, receding from 2.1 million in 2020 to 1.9 million in 2021. From 2016-2021, there are few major patterns in the foreign labor market. First, dependency on the low-skilled foreign labor arbitrarily unchanged. This is because, in spite of decreasing number of foreign labor, from 2.2 million in 2016 to 1.9 million in 2021, the low-skilled foreign labor dominates more than one-thirds of total foreign labor, surging up to 49% in 2021. Second, there is slow rebalancing in term of foreign labor utilization. This is shown based on the increase in the growth of high-skilled foreign labor at 8.7%, while low-skilled foreign labor marginally declines at -0.1%. As referred to the share, the growth of the high-skilled foreign labor would not give significant impact, although it is highly perceived that high-skilled foreign labor could boost innovation and growth inducing (Aydemir, 2020)..

Figure 3

Foreign labour according to skill level, 2016-2021



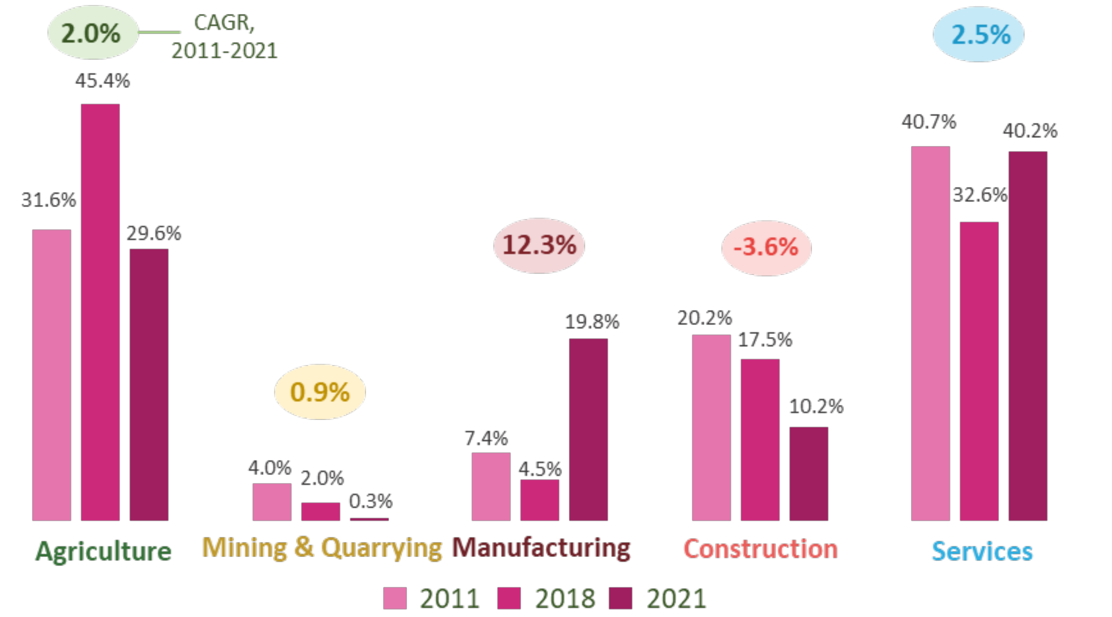
Note: Domestic worker is included in the calculation of the foreign labour
Source: Data are sourced from Labour Force Survey, various years (DOSM) and analyses and estimation by EU-ERA.

The employment of low-skilled foreign labor in the economic sectors is crucial particularly for the low value-added activities. Based on Figure 4, it is shown that Services, Agriculture, and Manufacturing sectors are the main sectors that employ low-skilled foreign labors in Malaysia. In particular, the Agriculture sector has recorded fluctuations in its low-skilled foreign labor concentration within a decade, with a peak of 45.4% in 2018 before dropping to 29.6% in 2021. On the other hand, the Mining & Quarrying sector has registered a continuous slower growth in the low-skilled foreign labor employment, expanding at only 0.9% per annum. Moreover, the employment of low-skilled foreign labor has soared from 7.4% in 2011 to 19.8% in 2021 with 12.3% growth per annum. Meanwhile, the Construction sector had decreased the low-skilled foreign labour employment between 2011-2021, particularly due to the COVID-19 outbreak. Lastly, the Services sector has maintained a high concentration of low-skilled foreign workers, with more than 40% are employed in this sector in 2021.

Given to the current condition, the conundrum of high dependency on foreign labor remains debatable. This is because, substituting foreign labour for locals remains a good option in the country as it is relatively cheap and cost-effective. Theoretically, this could incentivize businesses to hire more foreign labor. In addition, absence of comprehensive foreign labor hiring policy and lax enforcement contribute to unstable foreign labor management, particularly for the low-skilled foreign labor. For that reason, it is crucial to reemphasized on the importance of creating a balance in the domestic labour market. Thus, this policy brief attempts to uncover the costs and benefits of foreign labor dependency to the nation. Empirical evidence is provided together with discussion on the way forward to rebalance the consequences of foreign labour dependency and promote efforts to reduce the reliance for spurring growth, while at the same time tapping opportunities to generate wealth for the nation.

Figure 4

Distribution of low-skilled foreign labor in five main sectors (%)



Note: Domestic worker is included in the calculation of the foreign labour
Source: Data are sourced from Labour Force Survey, various years (DOSM) and analyses and estimation by EU-ERA.

Costs to the Nation

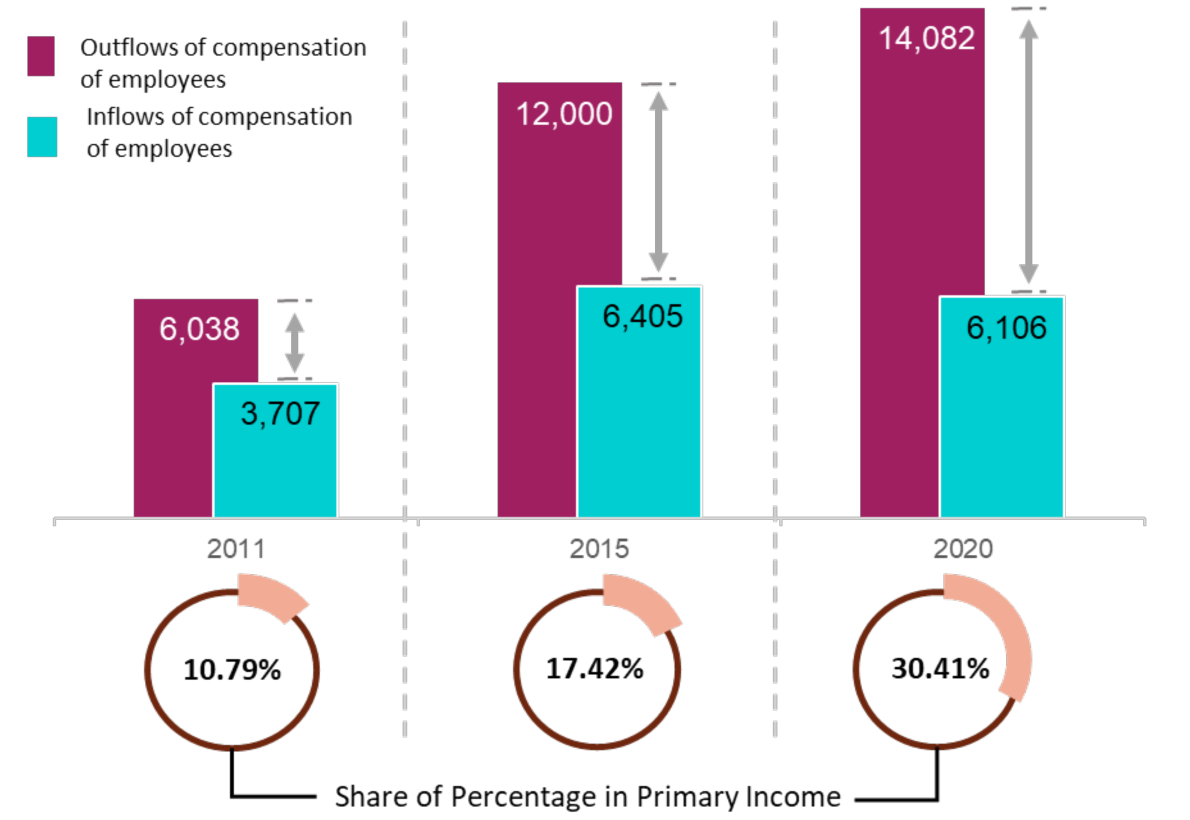
In economics, hiring foreign labor creates opportunity costs to the nation. Among others, on one hand, the foreign labour could have positive effect on employment (Moheeldeen et al., 2015) (Tsay & Lin, 2001), innovation (Aydemir, 2020) (Solheim & Fitjar, 2018) and productivity (Jordaan, 2018) (Suriati et al., 2017). They fill the labour shortage gap to support production, which eventually contribute to economic expansion. On the other hand, dependency on foreign labor leads to negative effects such as slow wage growth (Athukorala & Devadason, 2012) (Richard Adams & Ahmad Ahsan, 2014), substituting local employment opportunity (Abdul Rahim et al., 2019) and increase social welfare cost (Hanson, 2009), though these effects could differ depending on the skill levels.

Furthermore, the cost of foreign labor dependency can also be associated with the difference between the outflows and inflows of compensation of employees (COE), as shown in Figure 5. The COE outflows refer to wages generated in the Malaysian economy and paid to non-residents or foreign workers. It is found that the outflows and inflows of COE have been consistently widening from 2011 to 2020. This trend is attributed to the fact that in 2020, the COE outflows amounted to RM14,082 million while the inflows amounted to RM6,106 million. In comparison, the COE outflows were RM6,038 million and the inflows were RM3,707 million in 2011. As such, COE outflows to other countries have been steadily increasing. Reducing COE outflows through special treatments and strategies could help Malaysia benefit more from the contributions of foreign workers.

As the result, deficits in balance of payment for COE hinders consumption-based growth for the country. This is because private consumption is the highest contributor to the GDP share. Increase in consumption would stimulate business activities as well as the national income. Nonetheless, the outflow of COE would indicate loss of expenditure opportunities on the domestic economy, which should have been spent on by the foreign labor locally.

Figure 5

Balance of payment for Compensation of Employees (RM, million)



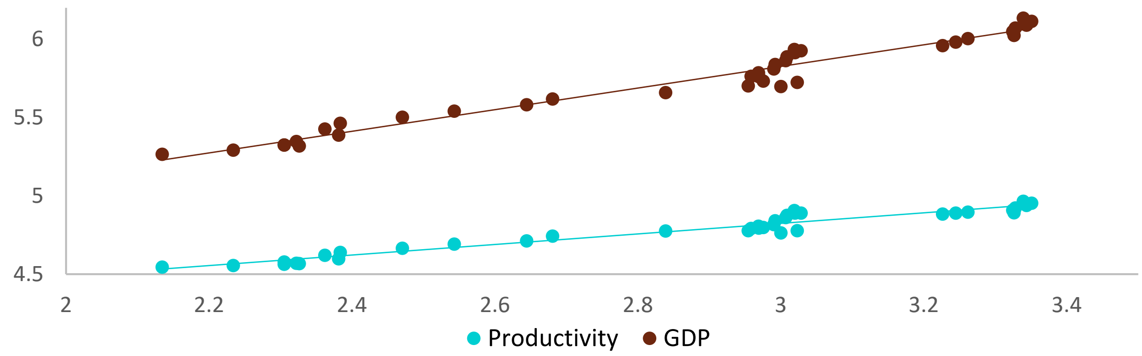
Source: Data are sourced from Quarterly Balance of Payment (DOSM) and analyses by EU-ERA.

Would there be benefits to growth?

As mentioned earlier, the benefits of foreign labor could be in the form of economic expansion and productivity enhancement effects. Based on these two perspectives, it is found that there is positive association between foreign labor, economic growth and productivity. However, a substantial gap is identified on these relationships, as illustrated in Figure 6. Likewise, it is also empirically attested that the impact of foreign labor on the economic growth is larger than that of the impact on productivity (see Figure 7). Specifically, 1% percent increase in foreign labor could spur the economic growth by 0.50%, whereas 0.07% increase on the productivity. These finding gives two significant highlights. First, although higher economic growth could be generated for hiring more foreign labor, this situation is rather expected due to foreign labor plays a vital role to support economic production, particularly to fill the labor shortage gap. Instead, the impact of foreign labor on productivity is relatively low. Secondly, given to high composition of low-skilled foreign labor in the economic sectors, it is not deniable that this situation will hamper productivity-led growth. This is because to be high-income nation, boosting productivity is a priority in generating higher growth through innovation and technology adoption, which reducing dependency on low-skilled workers becomes one of the pre-requisites

Figure 6

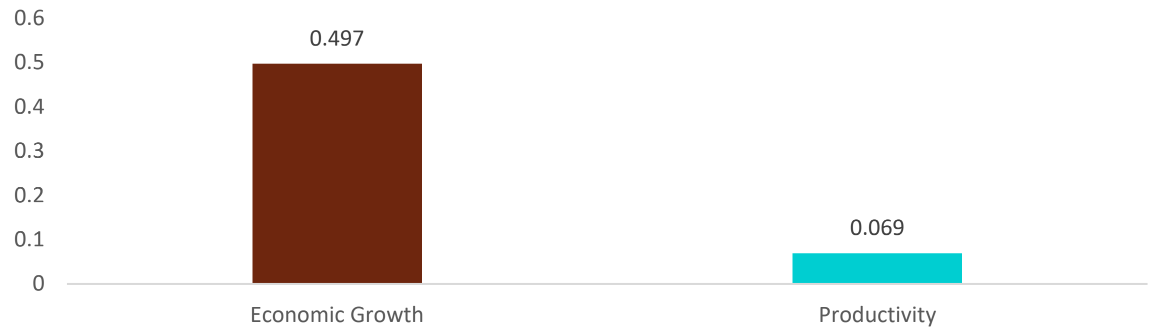
Foreign labour, GDP and Productivity, Malaysia



Source: Data are sourced from the Department of Statistics Malaysia (various years)

Figure 7

The impact of foreign labour on economic growth and productivity



Source: Data are sourced from the Department of Statistics Malaysia (various years) and analyses and estimation by EU-ERA. Results are estimated using econometric models, as presented in Appendix 1.

Recommendation: Protecting foreign labor while weathering the economy

Institutionalizing social fund and personalized account. Utilization of foreign labor in Malaysia has experienced significant growth in recent years, resulting in substantial outflows of compensation of employees (COE). These outflows have imposed economic losses for the Malaysian economy. Given that current practice limits social protection for the foreign labor that is based on voluntary basis1, the government could consider to establishing a social fund to the foreign labor. The purpose of this social fund is to improve social welfare ecosystem for the foreign labor and safeguard their wellbeing. This strategy shall be equipped to a personalized account for the individual foreign labor to minimize informality and tax evasion.

A regulatory body to manage foreign labor contribution. Furthermore, it is essential to streamline the management of the social fund to enhance its efficiency and utilization. The government should also consider establishing an independent regulatory authority to oversee the social fund management, thereby enhancing transparency and accountability. Notably, Canada is one of the countries that have introduced the social fund to foreign workers in the country (Box Article 1). Additionally, employers should be encouraged to participate in the social fund scheme and to make regular contributions. Incentives such as tax breaks or subsidies could be provided by the government to encourage more employers to participate. Such measures would increase the participation rate of employers in the social fund scheme, thus ensuring better protection of foreign workers.

Industry syndication is paramount. To ensure that all foreign labors are registered under the social fund scheme and that their contributions are being made regularly, the government should improve its monitoring of foreign labor, particularly those working in informal sectors. The government should also collaborate with industries to shift towards a bottom-up foreign worker policy. Industries should be encouraged to take the initiative to register their foreign workers under the social fund scheme and ensure that their contributions are regularly and diligently made. This would enable foreign workers to have better protection and integration into society.

In conclusion, managing the social fund and account for foreign workers in Malaysia is an issue that requires attention. The recommendations outlined in this policy brief can help Malaysia effectively manage the social welfare of foreign workers and alleviate the economic burden on the economy. By increasing awareness, streamlining social fund management, encouraging employer participation, improving foreign worker monitoring, and collaborating with industries, Malaysia can shift towards a bottom-up foreign worker policy and ensure that foreign workers are better protected and integrated into the society.

Protection to Foreign Labour and Wealth of Nations

The Canada Pension Plan (CPP) is a vital retirement scheme that provides financial security to Canadians in their retirement years, including foreign workers who contribute to the Canadian economy. This article examines the requirements for foreign workers to contribute to the CPP retirement scheme, and the exceptions that may apply to them.

Foreign workers in Canada are required to contribute to the CPP retirement scheme, just like Canadian citizens and permanent residents. This requirement applies to all foreign workers who are not covered by a social security agreement with Canada. The contribution rate and amount of payment are the same as those for Canadian employees, and the maturity period for CPP withdrawal is effective when the contributor reaches 60 years old.

However, foreign workers who are covered by a social security agreement with Canada may be exempted from contributing to the CPP retirement scheme, depending on the terms of the agreement. Social security agreements are reciprocal agreements between Canada and other countries that provide pension benefits to people who have lived or worked in both countries. These agreements eliminate double taxation and ensure that workers are not left without retirement benefits when they return to their home countries.

The CPP retirement scheme is managed by the Canada Pension Plan Investment Board (CPPIB), an independent organization established by the Canadian federal government that manages CPP investments. The organization is responsible for investing CPP assets in various asset portfolios, including public securities and real estate. CPPIB is accountable to the federal government and CPP contributors.

In conclusion, the CPP retirement scheme recognizes the contributions of foreign workers to the Canadian economy by requiring them to contribute to the program. This requirement ensures that all workers in Canada have access to a secure source of retirement income. The exceptions for foreign workers covered by a social security agreement with Canada eliminate double taxation and provide pension benefits to workers who have lived or worked in both countries. The CPP retirement scheme is managed by CPPIB and administered by ESDC, ensuring the long-term sustainability of the program and providing financial security to Canadians in their retirement years.

[1]According to the Employee Provident Fund Act 1991 – Part VIIA, non-citizen could elect for contribute to the fund, based on contribution listed in the Third Schedule of the Act. It means that Malaysia currently practising voluntary contribution for foreign labors.

Appendix 1 – Quantitative Impact of Foreign Worker

The policy brief employs an economic growth and productivity model that includes production factors such as foreign labour, average wage, capital and income alongside Malaysia's trade openness and resource rents that represent economic structures. The models are specified as follows:

Model 1

$$GDP_t = a_0 + \beta_1 Foreign_t + \beta_2 Wage_t + \beta_3 Capital_t + \beta_4 Resource_t + B_5 Openness_t$$

Where GDP_t is the Real Gross Domestic Product, $Foreign_t$ is the Foreign Worker, $Wage_t$ is the Average Wage, $Capital_t$ is the Capital, $Resource_t$ is the Resource Rent and $Openness_t$ is the Trade Openness.

Model 2

$$Productivity_t = a_0 + \beta_1 Foreign_t + \beta_2 Wage_t + \beta_3 Capital_t + \beta_4 Resource_t + B_5 Openness_t$$

Where $Productivity_t$ is the Labour Productivity, $Foreign_t$ is the Foreign Worker, $Wage_t$ is the Average Wage, $Capital_t$ is the Capital, $Resource_t$ is the Resource Rent and $Openness_t$ is the Trade Openness.

The following information was used to collect data on various economic indicators for the purpose of this study. Gross Domestic Product (GDP), foreign labour, and average wage were collected from the Department of Statistics Malaysia. Labour productivity was calculated by EU-ERA based on data from the Department of Statistics Malaysia. Capital, resource rent and trade openness were gathered from the World Development Indicators database.

The results of the specified models above are summarized as follows:

Dependent variable: Gross Domestic Product (GDP)

Independent Variables	Coefficient
Foreign Worker	0.50
Average Wage	1.61
Capital	0.16
Resource Rent	0.36
Trade Openness	-0.17

Source: Analyses and estimation by EU-ERA using Model 1.

Dependent variable: Labour Productivity

Independent Variables	Coefficient
Foreign worker	0.07
Average Wage	1.42
Capital	0.20
Resource Rent	0.13
Trade Openness	0.10

Source: Analyses and estimation by EU-ERA using Model 2.

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EU-ERA Policy Brief

EU-ERA Policy Brief offers a short note with combined analysis and policy recommendations in addressing developmental issues that are directly and indirectly affect the labor market in Malaysia. This policy brief aims to generate a forward-looking and proactive discussion among policymakers, researchers and stakeholders in identifying emerging trends, challenges, and opportunities in the economy. The orientation is toward the real-world policy challenges and opportunities, with an emphasis on providing practical recommendations that can help guide decision-making.

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