



Foreign Workers in Malaysia:

Assessment of their Economic Effects and Review of the Policy

**The World Bank, EASHS
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The World Bank, East Asia Pacific Region,
Human Development Dept. Social Protection & Labor Unit



This study aims to help MOHR to better...

- Manage existing human resources in the country.
- Plan for the development of future human capital needs.



Two Interlinked Components

I. Human Resource Management

1. Identify skills mismatches/gaps, and suboptimal amount of training.
2. Evaluate three key policies in the skills domain: soft skills and English language.
3. Assess skill forming policies, benchmarking and learning from international practices.
4. Future human resource requirements: Micro-simulation results.
5. Way forward to better manage human resources.

II. Immigration Management

1. Characterize labor migration in Malaysia over time, sectors and states.
2. Identify economic and social impact of foreign workers in the economy.
3. Assess current policy compared to international systems.
4. Way forward to better manage immigration.



1. **What are the potential concerns over the employment of foreign workers?**
2. **Foreign workers and Malaysia:**
 - Determinants of employment of foreign workers in Malaysia
 - Profile of foreign workers in Malaysia
3. **Economic Impact of Foreign Workers on:**
 - Labor markets
 - Firm-sub-sector productivity
4. **Potential effects of policy changes:**
 - Macroeconomic Impacts
 - Sub-sector growth and employment
5. **Foreign Workers Management:**
 - Current Policies and comparable Systems
6. **Conclusion:**
 - Key Messages



Potential Concerns over the Employment of Foreign Workers

1. **Do foreign workers hurt Malaysian workers in terms of employment and wages?**
 - Wage and employment impact on local workers
 - Impact on skill acquisition and education incentives
 - Impact on female labor force participation
2. **Do foreign workers hamper productivity increase and technological advances?**
 - Substitution of unskilled labor for technology
 - Sectoral diversification of the economy
3. **How will further restrictions on employment of foreign workers impact the economy?**
 - Macroeconomic effects - growth, investment, unemployment
 - Growth across sectors
 - Wage and employment effect across educational categories
4. **What are the social costs and benefits of employing foreign workers?**
 - Crime and social costs
 - Impact on demographic patterns and fertility



Value added of this report

This report adds to the foreign management Lab and previous analyses in four ways:

1. It uses economic tools to measure the impact of the employment of foreign workers on Malaysian workers and on productivity of firms in key economic sectors.
2. It uses simulation analysis to estimate potential changes to key policies, i.e. “levy regime.”
3. It undertakes an in-depth view of the Malaysian foreign workers management system and benchmarks it against a group of relevant countries, including Australia, Canada, Korea, Singapore, Taiwan, Thailand, and the United States.
4. It brings together the lessons from the economic analysis, simulations, and the institutional analysis to make evidence-based recommendations.



FOREIGN WORKERS AND MALAYSIA

MAIN DETERMINANTS



Education levels in Malaysia improved drastically over the last 20 years

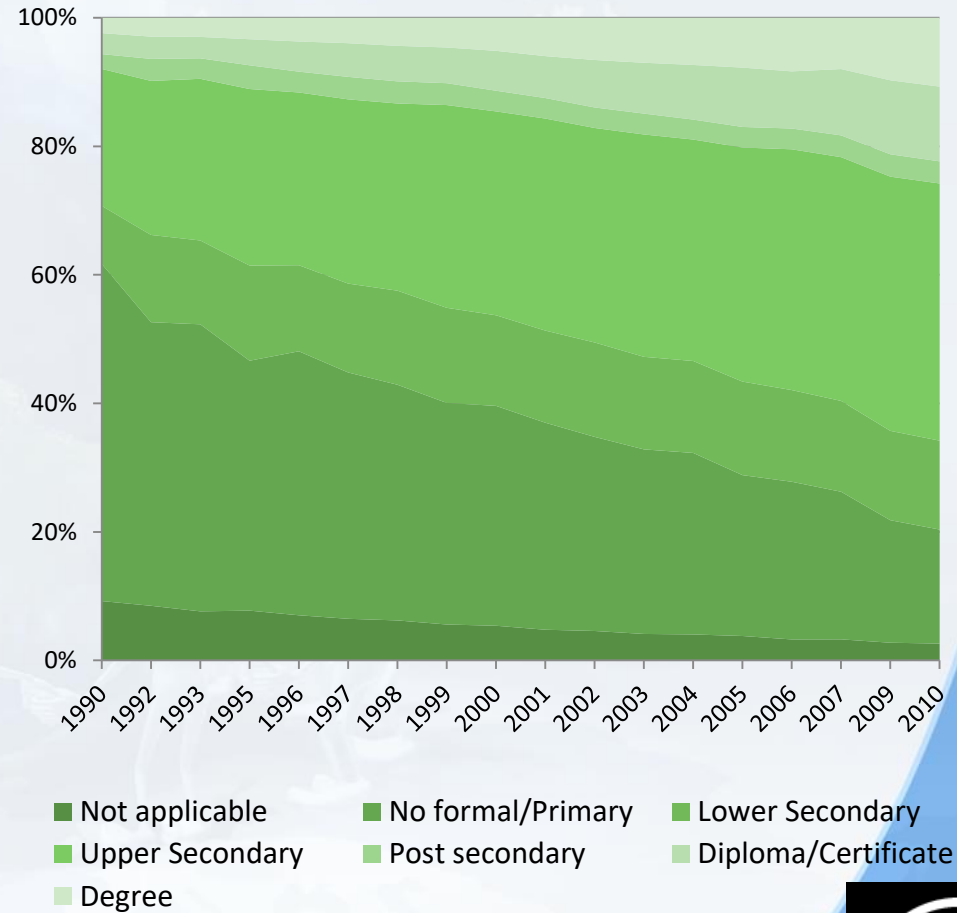
One of the most remarkable features of the Malaysian experience has been the advances achieved in education levels of the labor force over a very short period.

The share of Malaysians with (at most) primary school education declined from 61% in 1990 to 26% in 2010

The share of secondary educated (at most) increased from 34% to 56%.

The share of college educated increased from 5% to 18% in the same period.

Education distribution of Malaysian workers



Note: The analysis is focuses on the working age population (15 to 64 years of age)



Education levels of younger workers improved even faster

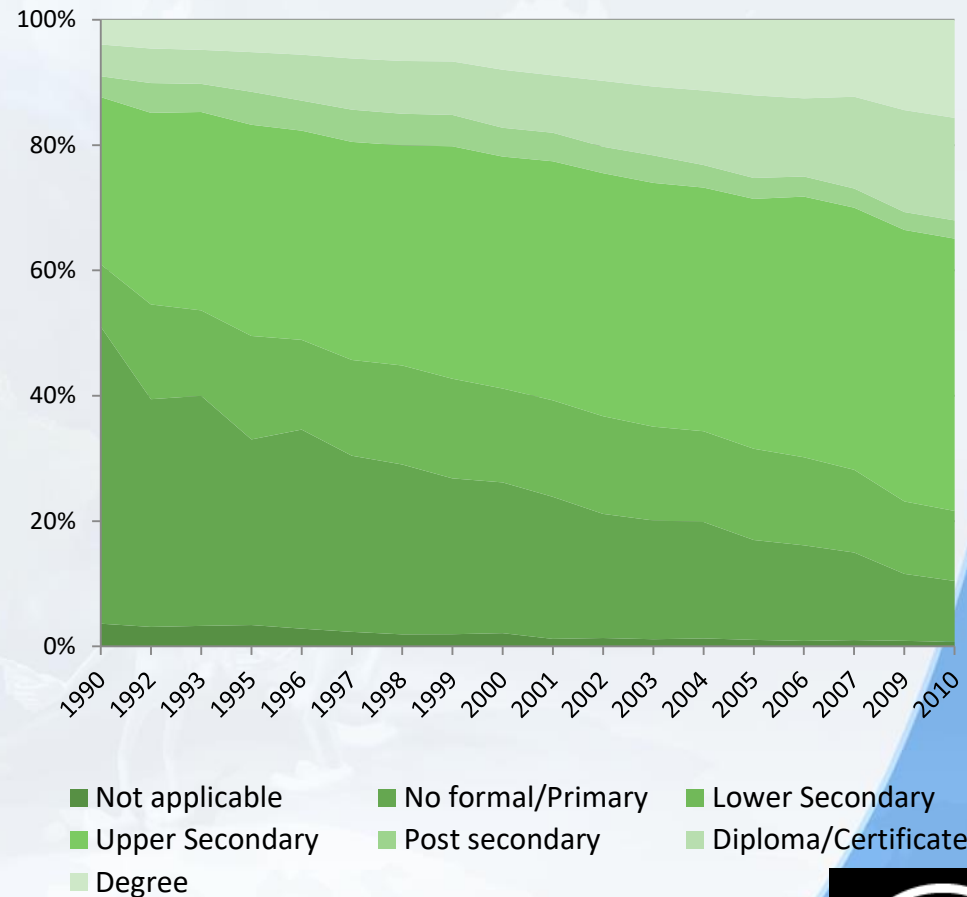
The increase in the education levels of the new entrants to the labor market - 25-35 age group - has been even more remarkable.

In 1990, over 50% of young workers had primary education (at most), 40% had secondary education and less than 10% had tertiary education.

In 2010, around 10% had primary, over 60% had secondary and close to 30% had tertiary education.

The remarkable expansion of formal education and human capital levels led to changes in job preferences of many Malaysians.

Education distribution of Malaysian workers (25-35)

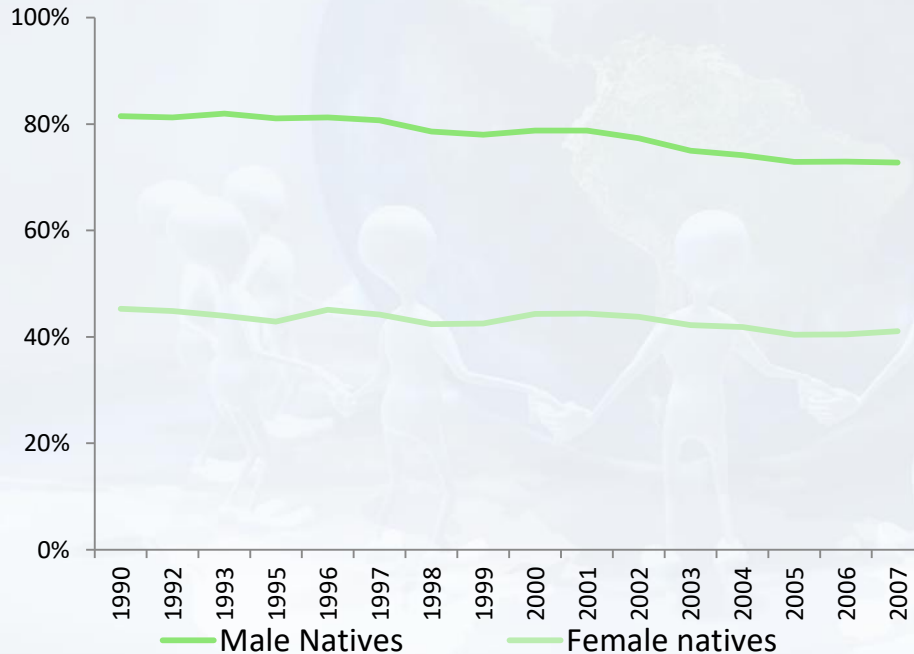


Labor Market conditions have been quite tight

Unemployment rates have always been quite low. This is partly due to rapid growth as well as relatively low labor force participation levels by women.

The inflow of foreign workers is largely attributable to demand factors in the domestic labor market.

Labor Force Participation

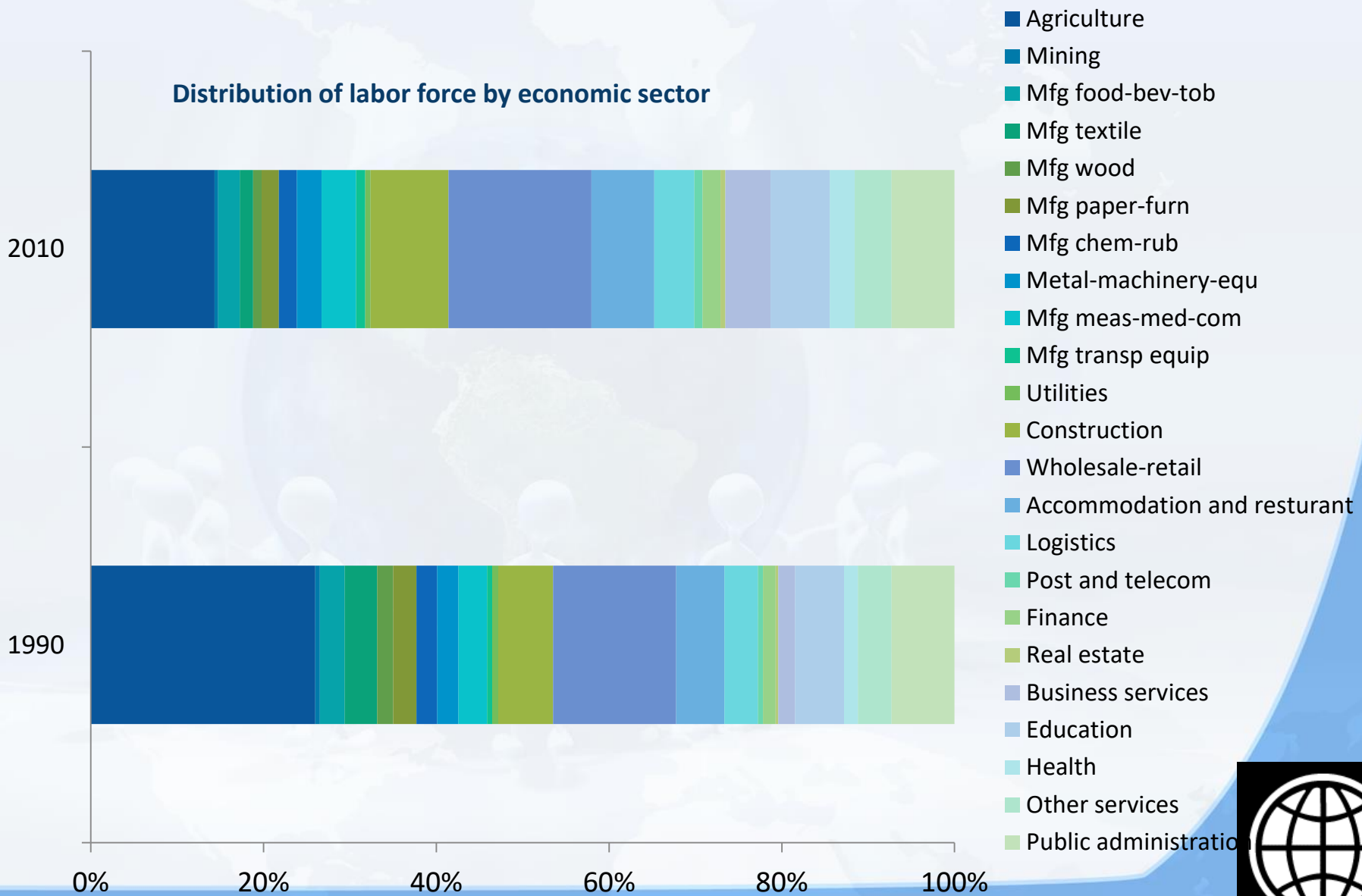


Labor Market Composition



The economy heavily relies on export-oriented manufacturing and domestic service sectors

Distribution of labor force by economic sector



The employment of foreign workers is a demand driven phenomenon

Over the last two decades, Malaysian labor markets experienced ...

- * Rapid increases in human capital and education levels
- * Low unemployment and labor force participation
- * Increased diversification across sectors
- * Continued importance of several export and domestic service sectors

The large inflow of foreign workers is largely attributable to ...

- * Demand factors in the domestic labor market in labor intensive sectors
- * Relative shortage of unskilled workers
- * Remarkable economic success of Malaysia relative to neighboring countries



FOREIGN WORKERS AND MALAYSIA

PROFILE OF FOREIGN WORKERS

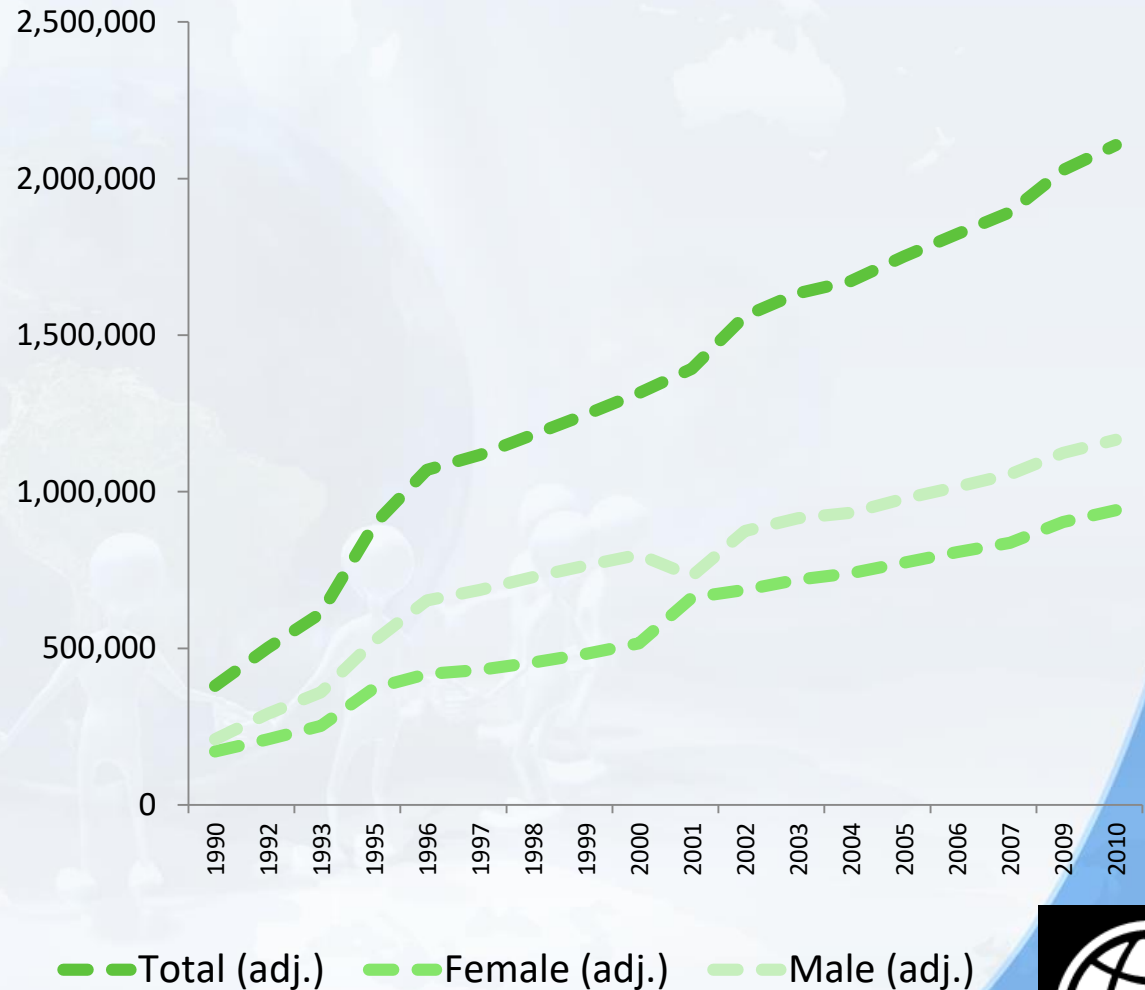


Labor Force data account for about *2+ million* foreign workers in Malaysia

Foreign Workers in Malaysia, 1990-2010

Inflows of foreign workers have steadily increased since the early 1990s, when the government introduced formal guidelines on foreign workforce management.

Due to large number of unregistered undocumented workers, it is difficult to get a more precise estimate.

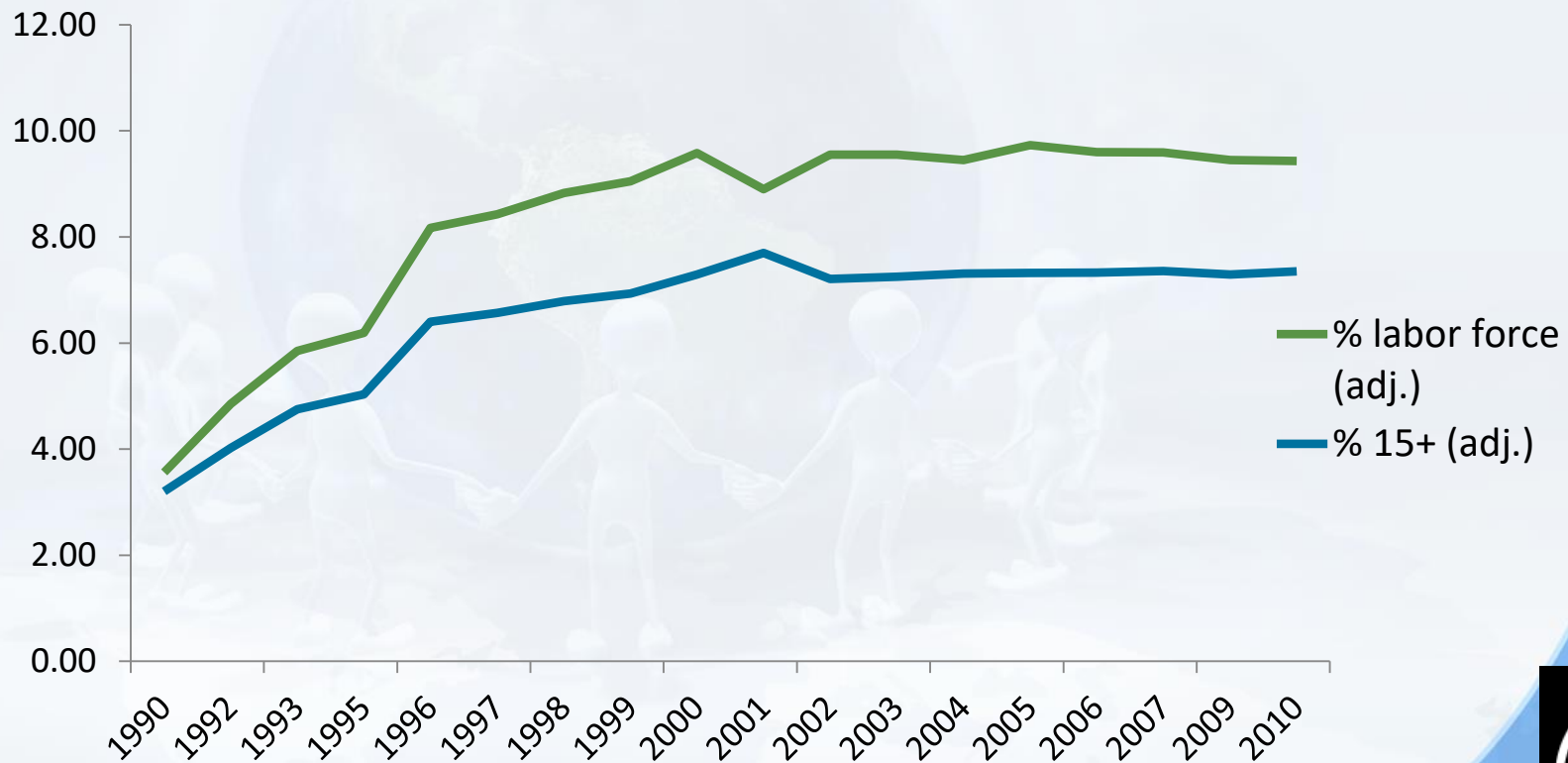


Foreign workers compose around 10% of the labor force

Estates/group housing are excluded from labor force survey.

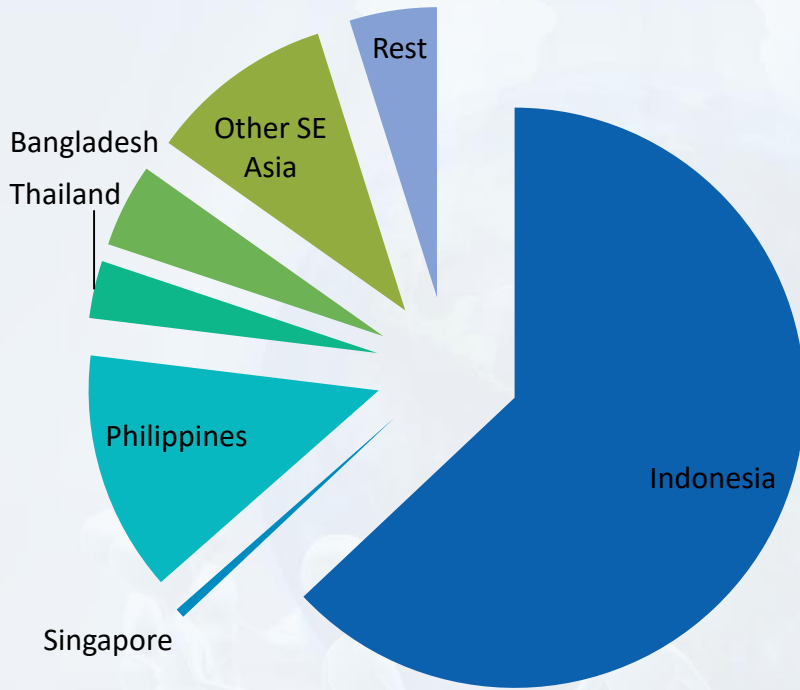
Other estimates show the total at 18% (NER,2009) and 20% (MOF, 2009).

Foreign Workers as share of the Labor Force

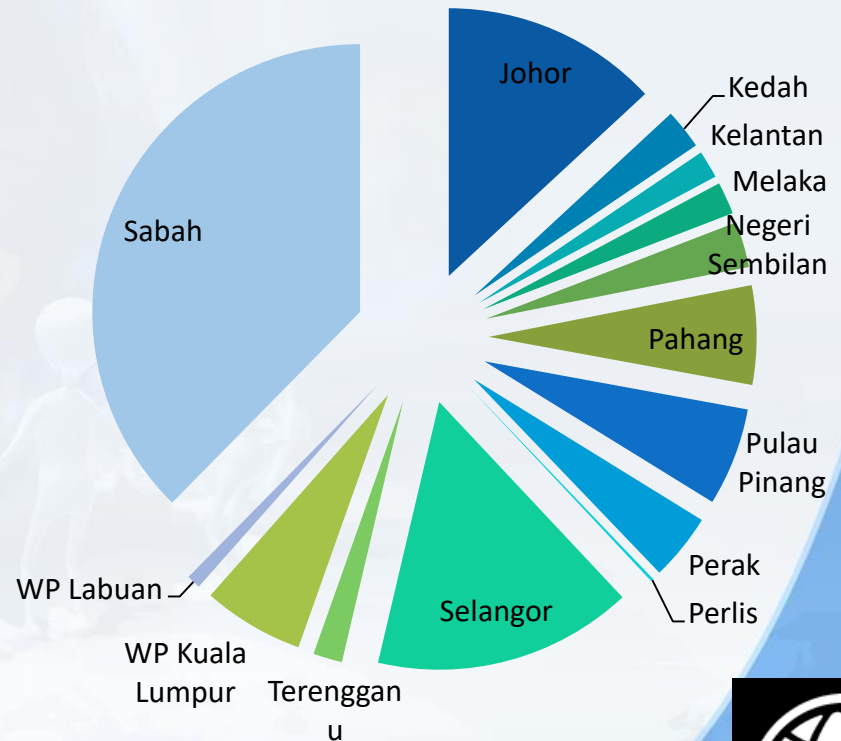


Indonesia is the main sending country and Sabah the main recipient state

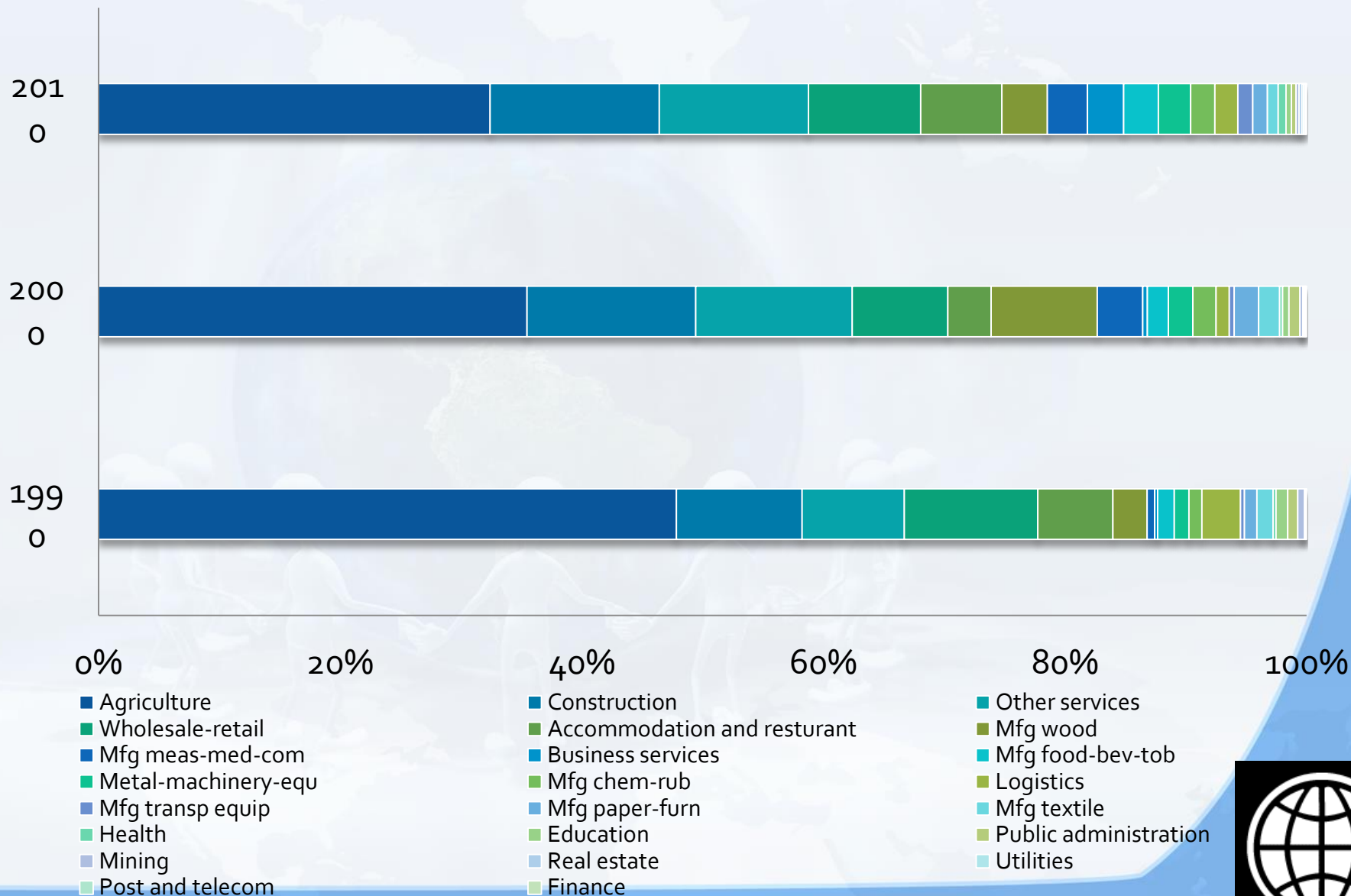
Nearly two-thirds of foreign workers in Malaysia are in three states – Sabah, Selangor and Johor.



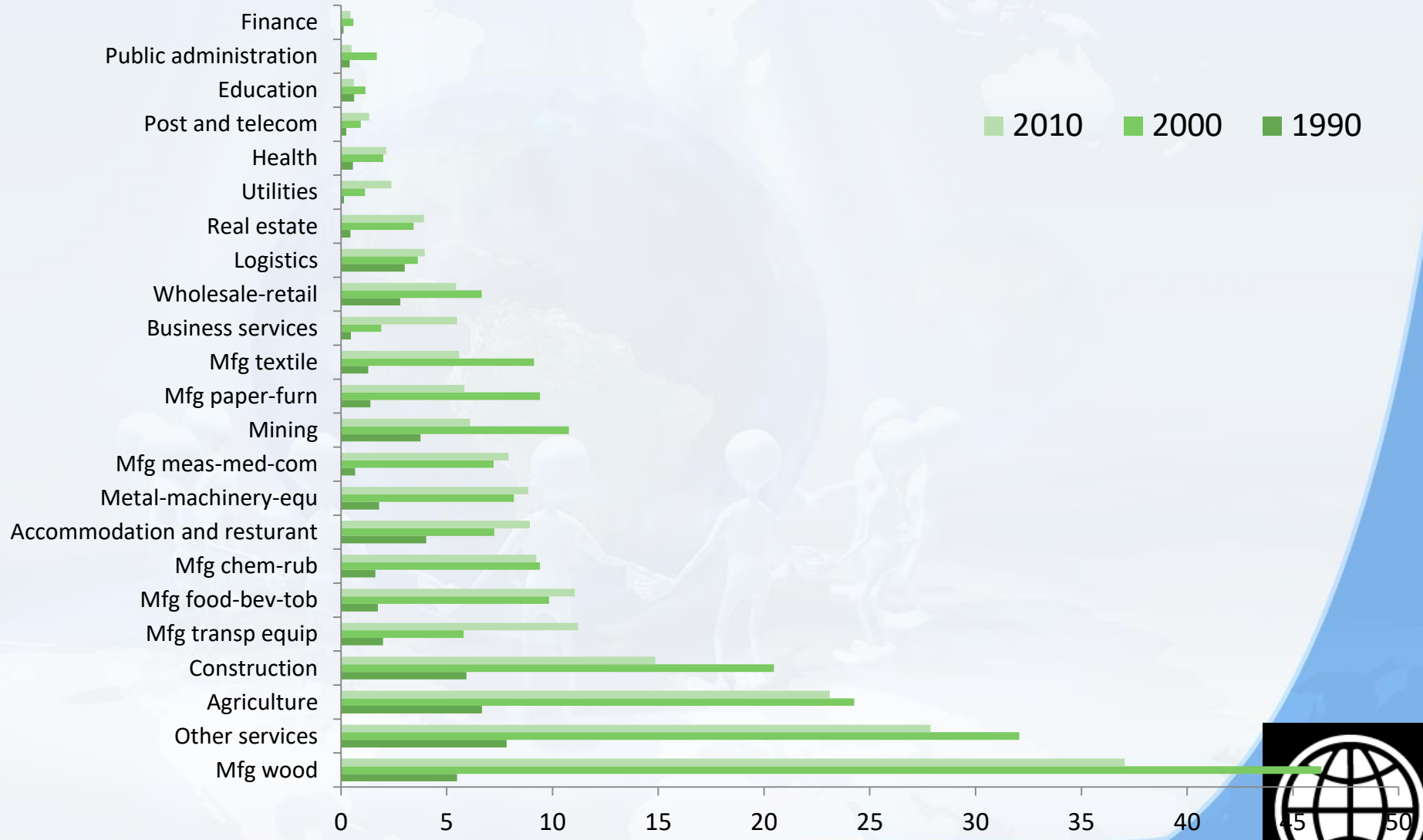
Almost two-thirds of the foreign workers come from Indonesia. The next largest group are from the Philippines (13%).



Foreign labor continues to be largely concentrated in physically demanding sectors of the economy such as agriculture and construction



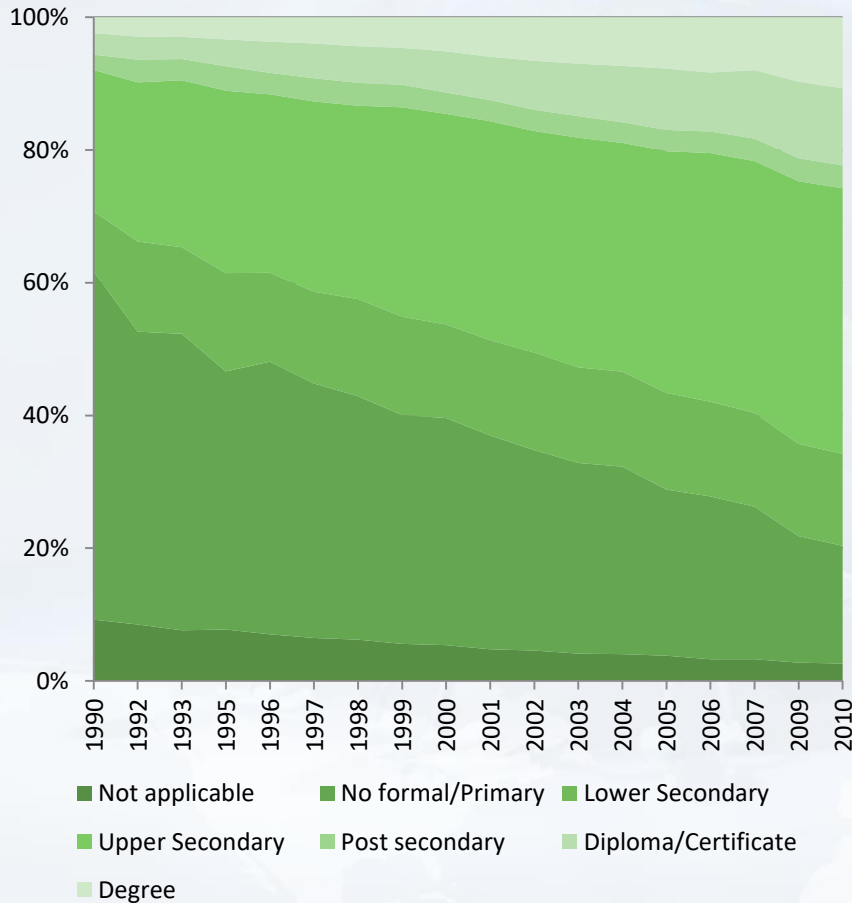
Foreign workers make up the largest share of the labor force in wood products, other services and agriculture sectors



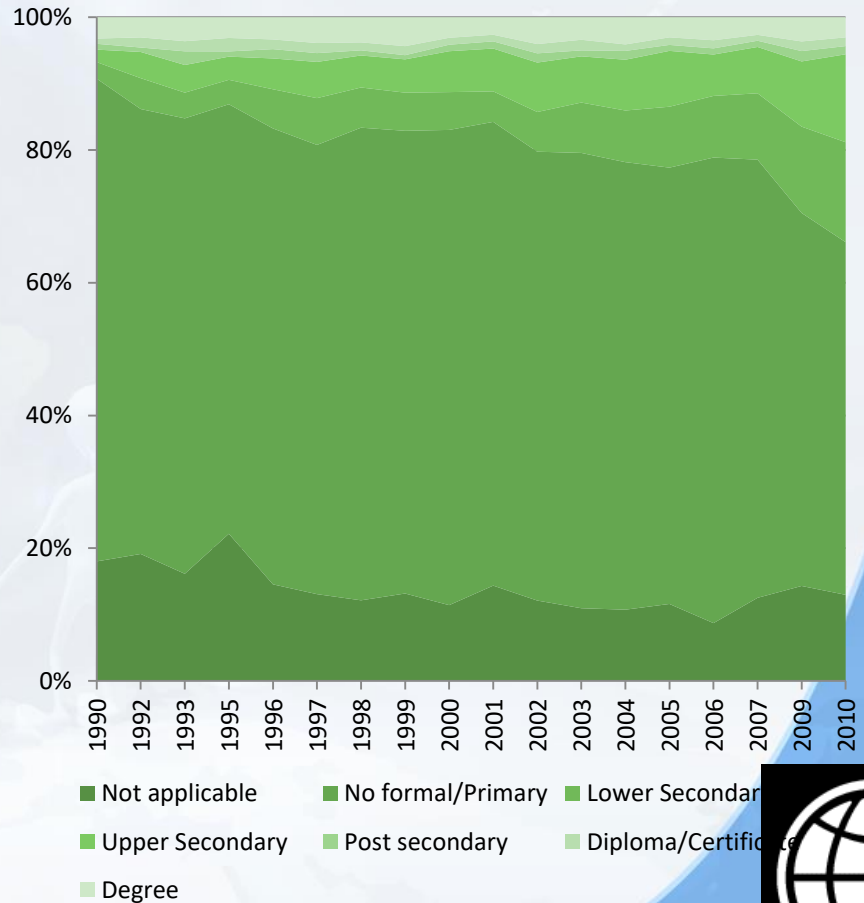
Foreign workers are significantly less educated than Malaysians...

Their educational distributions that have been more stable over time. This pattern is simply due to demand factors in the Malaysian labor market.

Education distribution of Malaysian workers



Education distribution of foreign workers



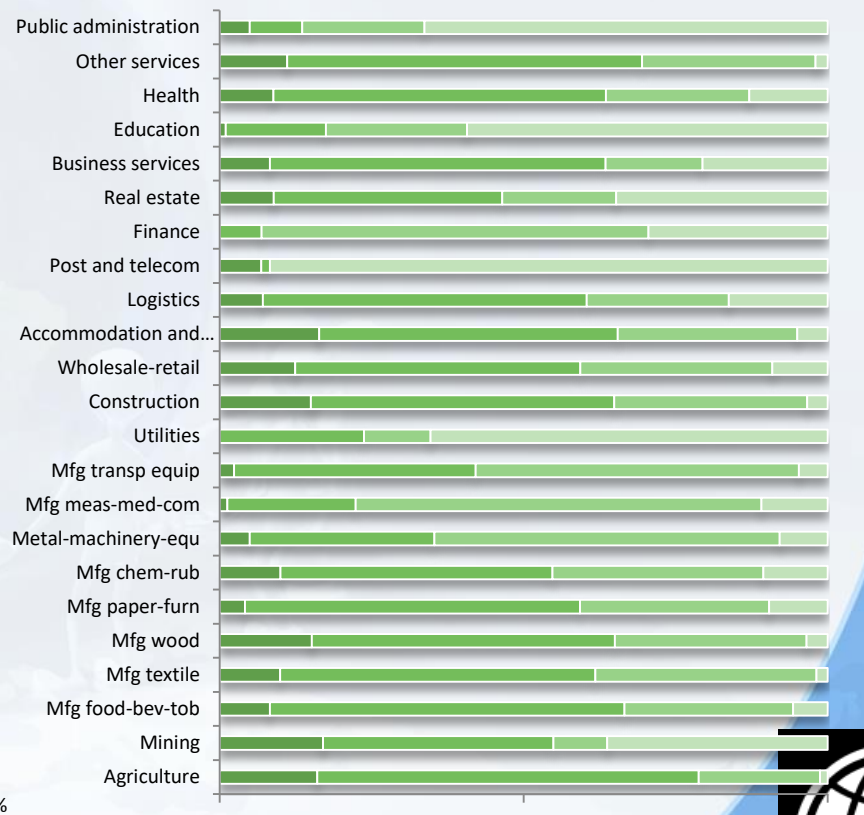
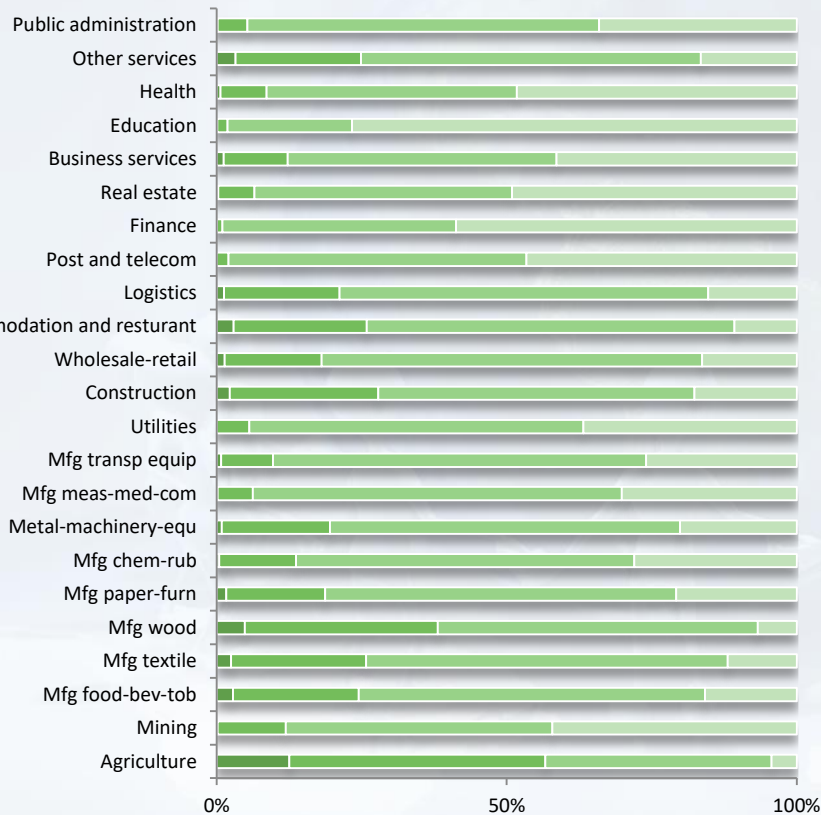
Labor intensive economic sectors rely on foreign rather than Malaysian labor

Even when employed in capital intensive sectors, foreign workers hold low skill occupations.

Education Levels by Economic Sectors, 2010

Malaysian workers

Foreign workers



■ Not applicable
■ Primary/No formal
■ Secondary

■ Primary/No formal
■ Tertiary



ECONOMIC IMPACT

LABOR MARKETS



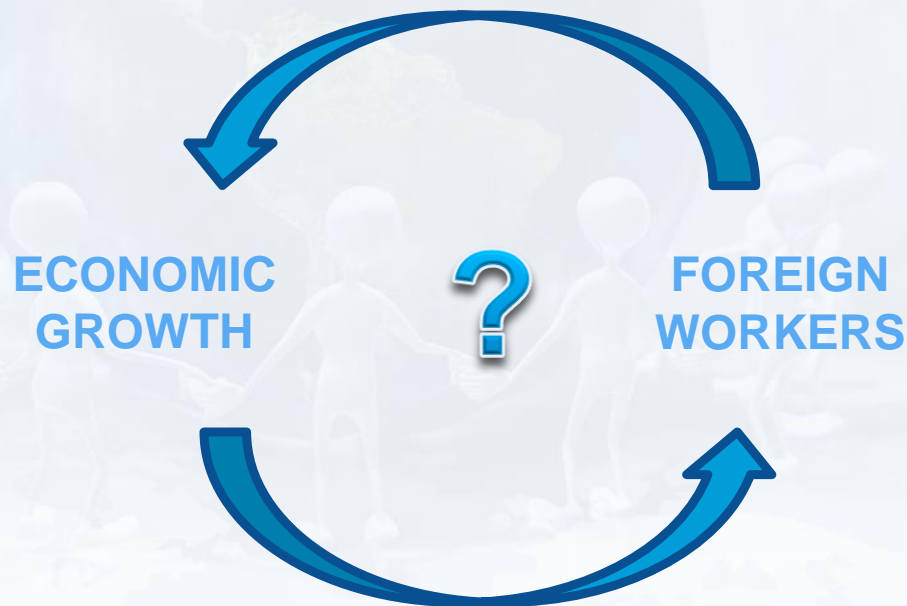
Which way does the causality between economic performance and foreign labor go?

FACT:

We tend to find higher numbers of foreign workers in rapidly growing industries and regions across the world.

QUESTION:

Do foreign workers contribute to economic growth or are they simply attracted to booming areas?



Pull vs. Push Factors

Pull factors in the destination countries and push factors in the origin countries jointly determine the inflows of foreign workers.

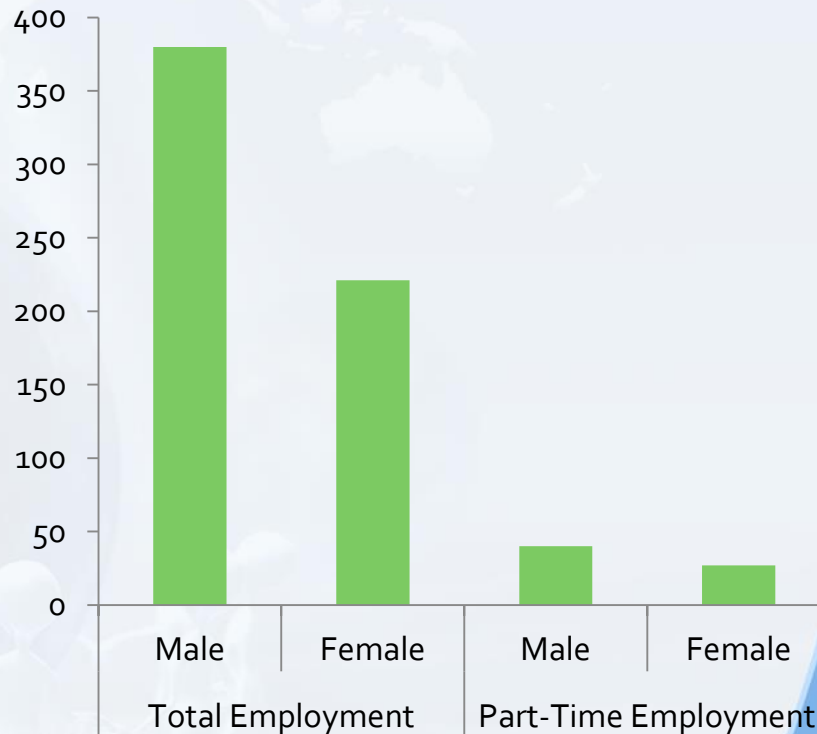
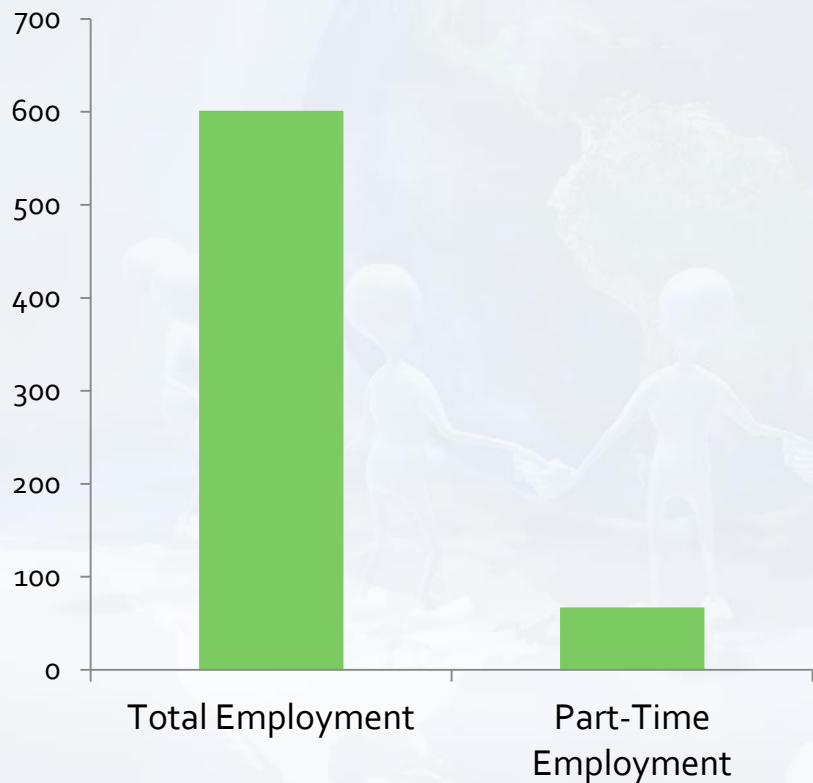
These two effects need to be separated to identify the effect of foreign labor on economic outcomes in destination countries.

Using demographic data from the main origin countries and historical migration patterns by sector and state, our econometric methodology is able to identify the causal effect of foreign labor on the labor market outcomes in Malaysia.



Employment of foreign workers leads to job creation for Malaysian workers

601 new full-time jobs (of which 67 are part-time) are created for Malaysian workers in a given sector in a state as a result of the entry of 1000 new foreign workers. This is mainly a reallocation effect

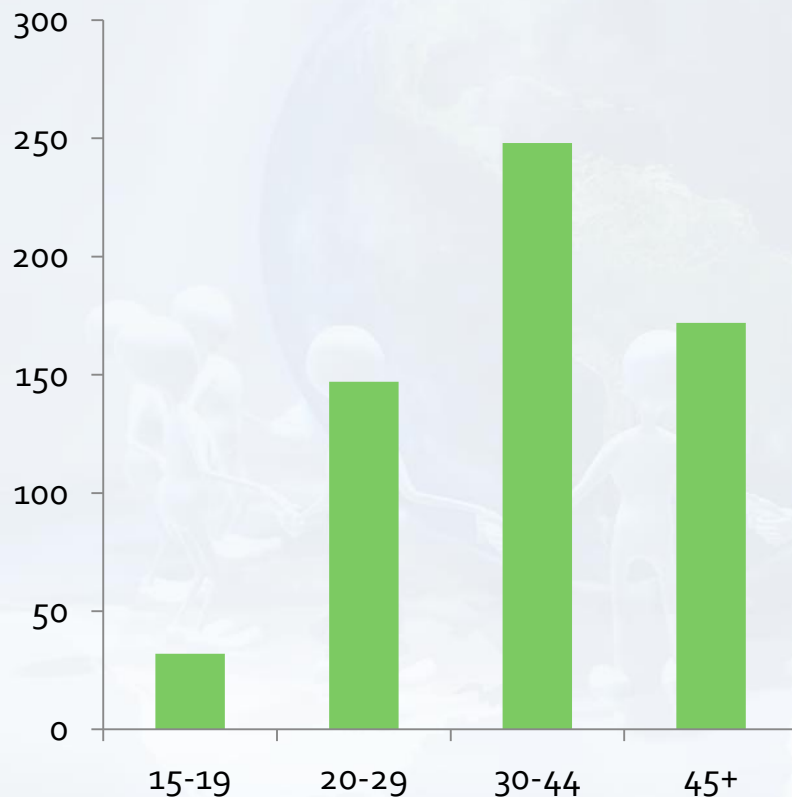


The effect on men and women seems to vary significantly, especially in terms of total employment.



Effects are heterogeneous across age groups and sectors

Small effect on young workers, while much larger positive effect on other age groups.

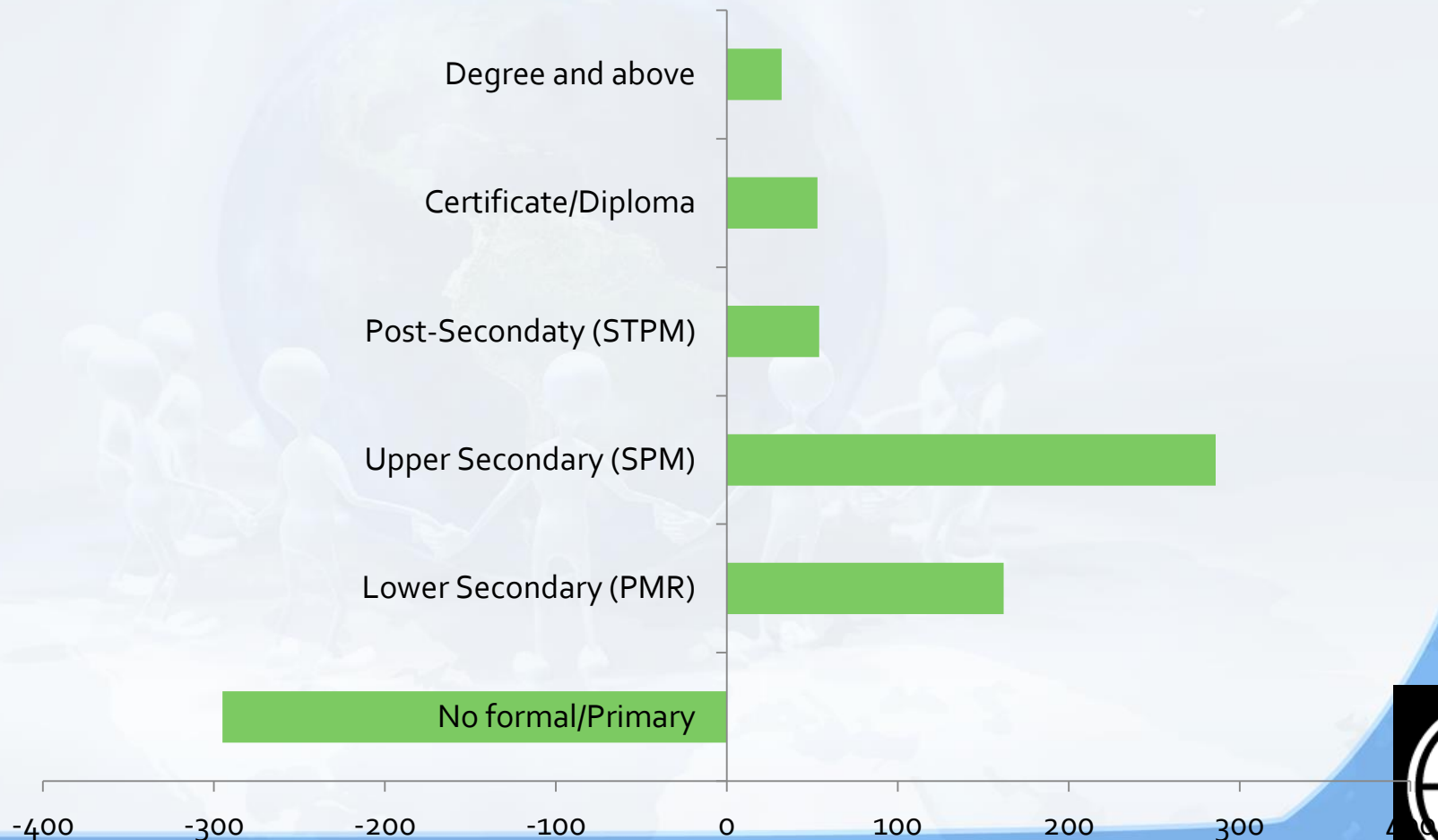


The employment of foreign workers leads to increased employment of Malaysians in every major sector.



Effects Also Differ Across Education Categories

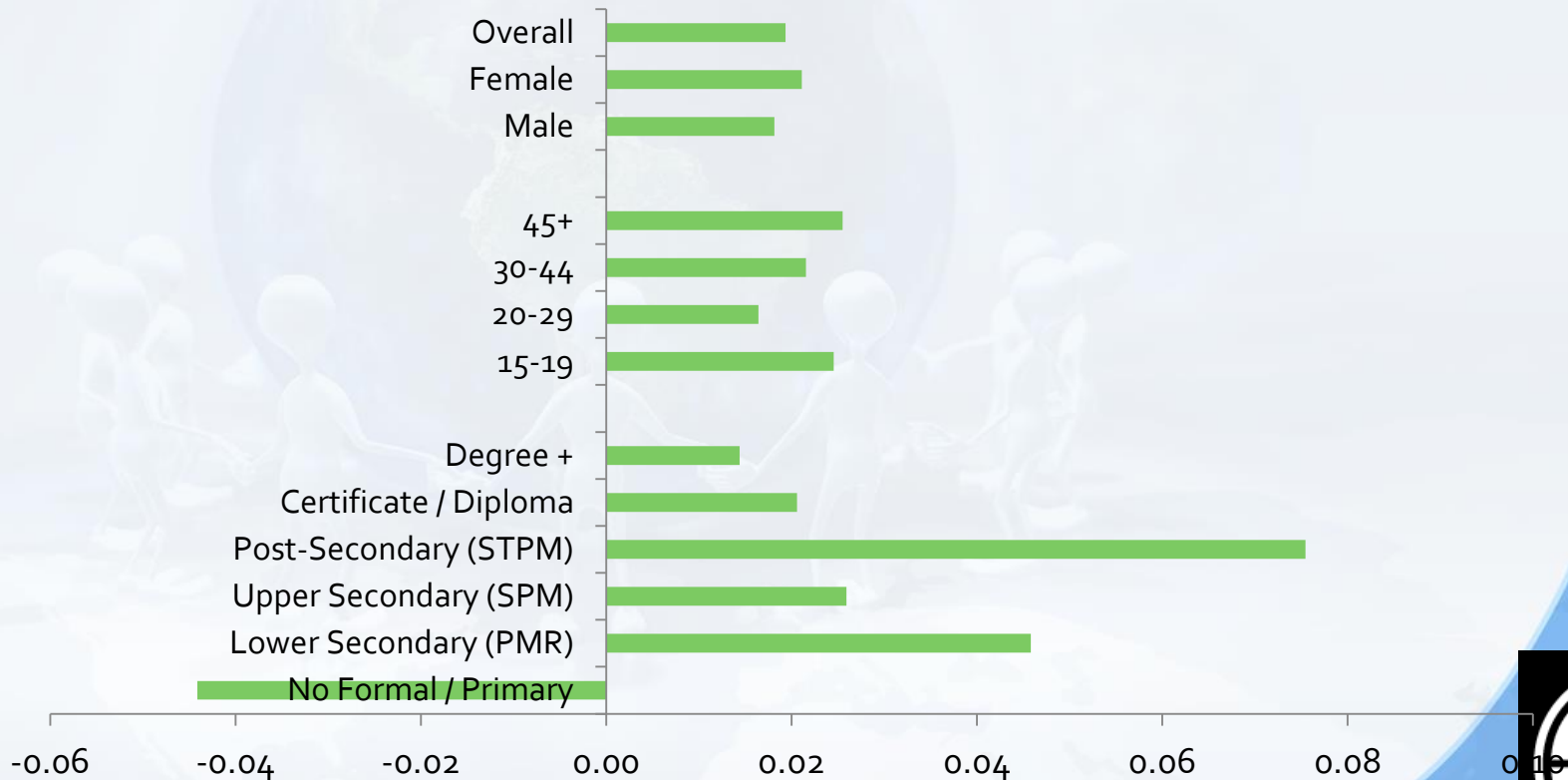
Low educated/unskilled workers are hurt, while the impact on tertiary educated are much smaller. The main beneficiaries are Medium Skilled/Educated Workers.



Impact on Wages of Malaysian Workers

Changes in employment due to increases in employment of foreign workers (for a given region and sector) do not lead to significant changes in the wages of Malaysian workers, mainly due to tightness of labor markets

Personal characteristics (age, gender, education) play a role on how much Malaysians can benefit in terms of higher wages.



When Additional Foreign Workers enter the Malaysian Labor Market...

- The main effect is re-allocation from other sectors and regions. Entry of foreign workers into a sector leads to further expansion by employment of additional Malaysian workers.
- There is no contraction in national employment levels of Malaysians workers
- Malaysian workers' wages increase by a small amount.
- Existing foreign workers' wages decline considerably.



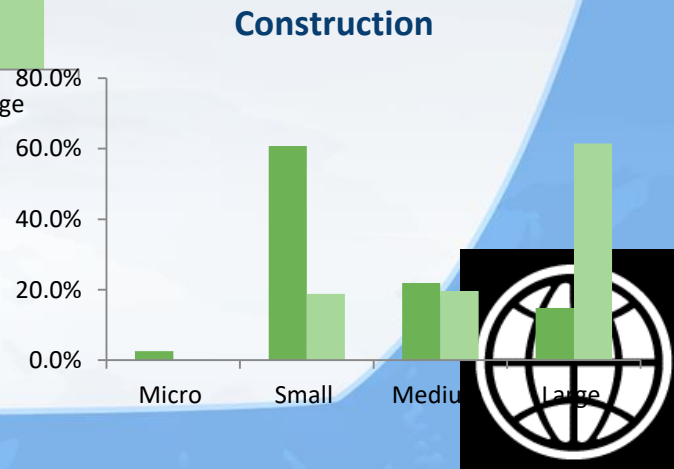
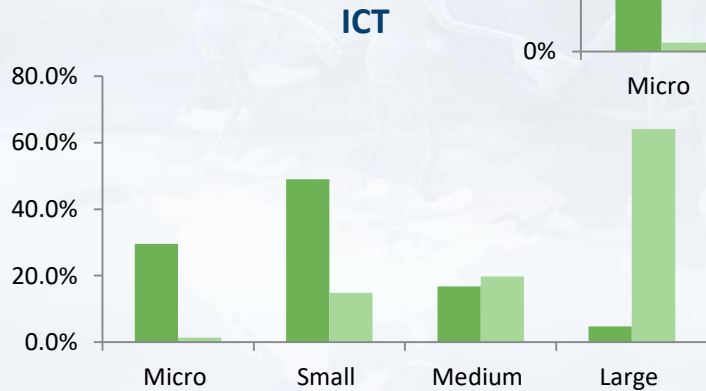
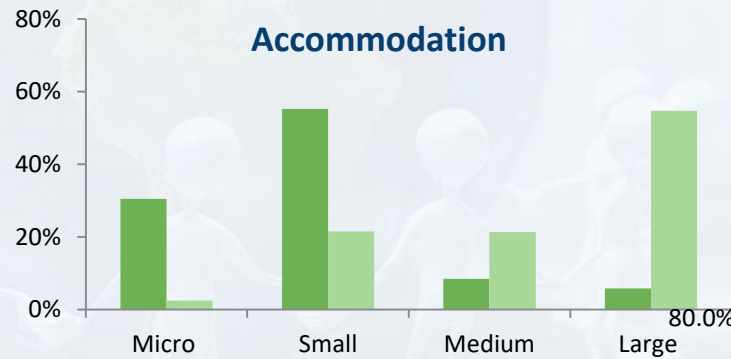
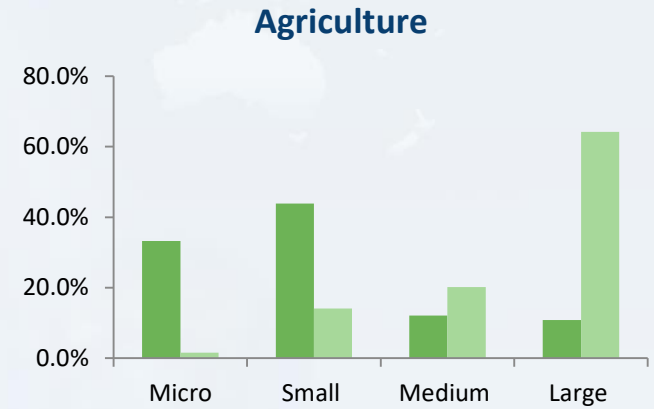
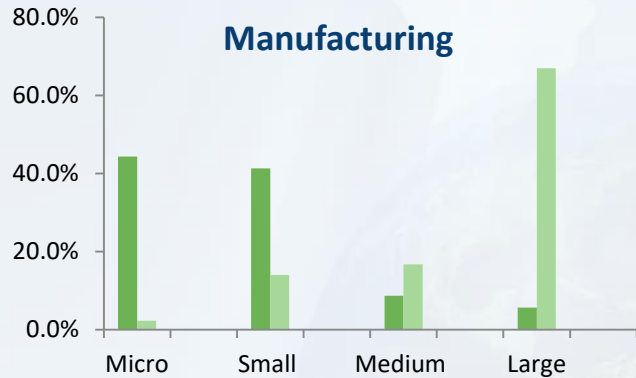
ECONOMIC IMPACT

FIRMS & PRODUCTIVITY



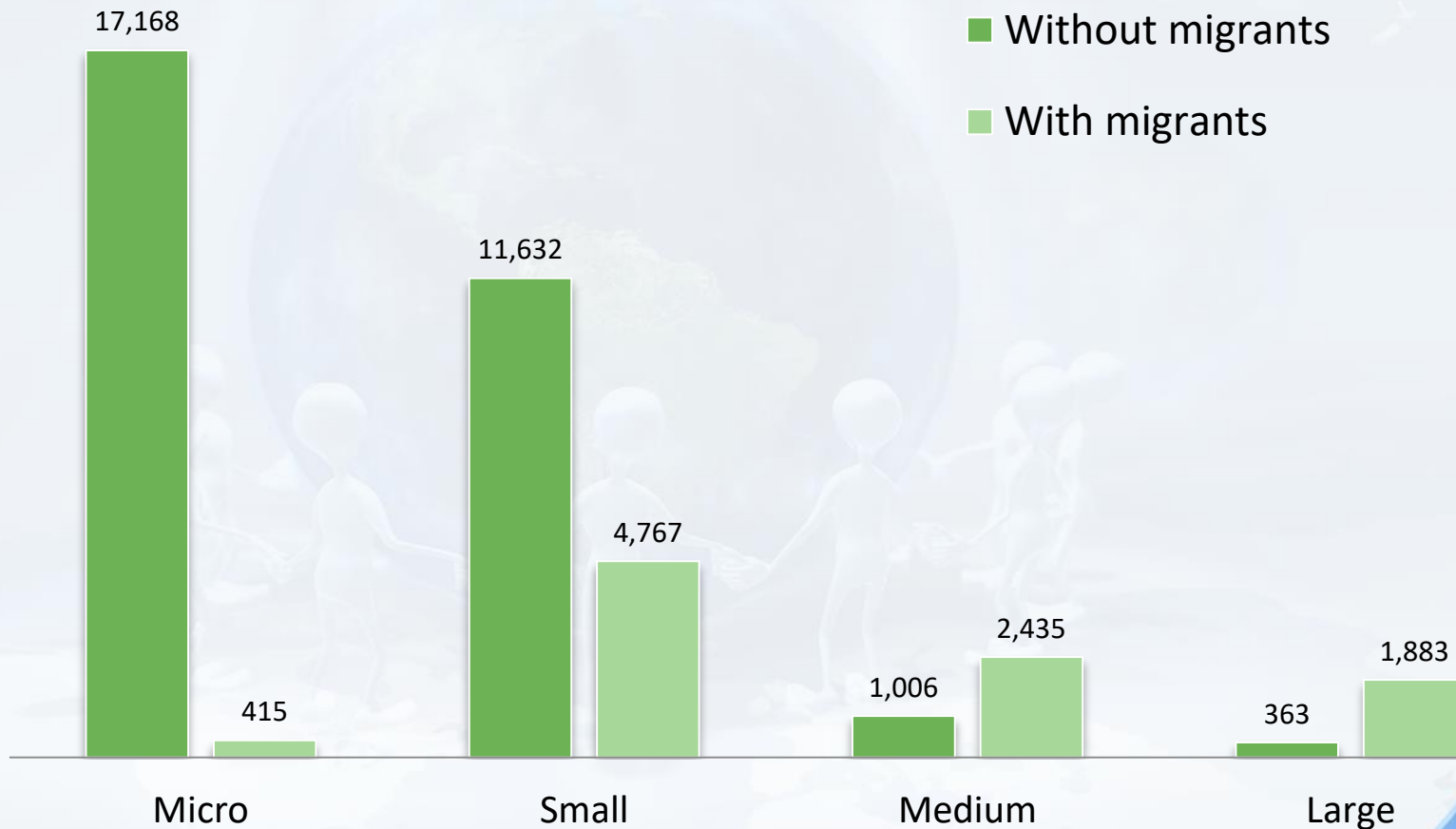
Establishment census data covers formally registered firms

■ % of Establishments
 ■ % of Labor force



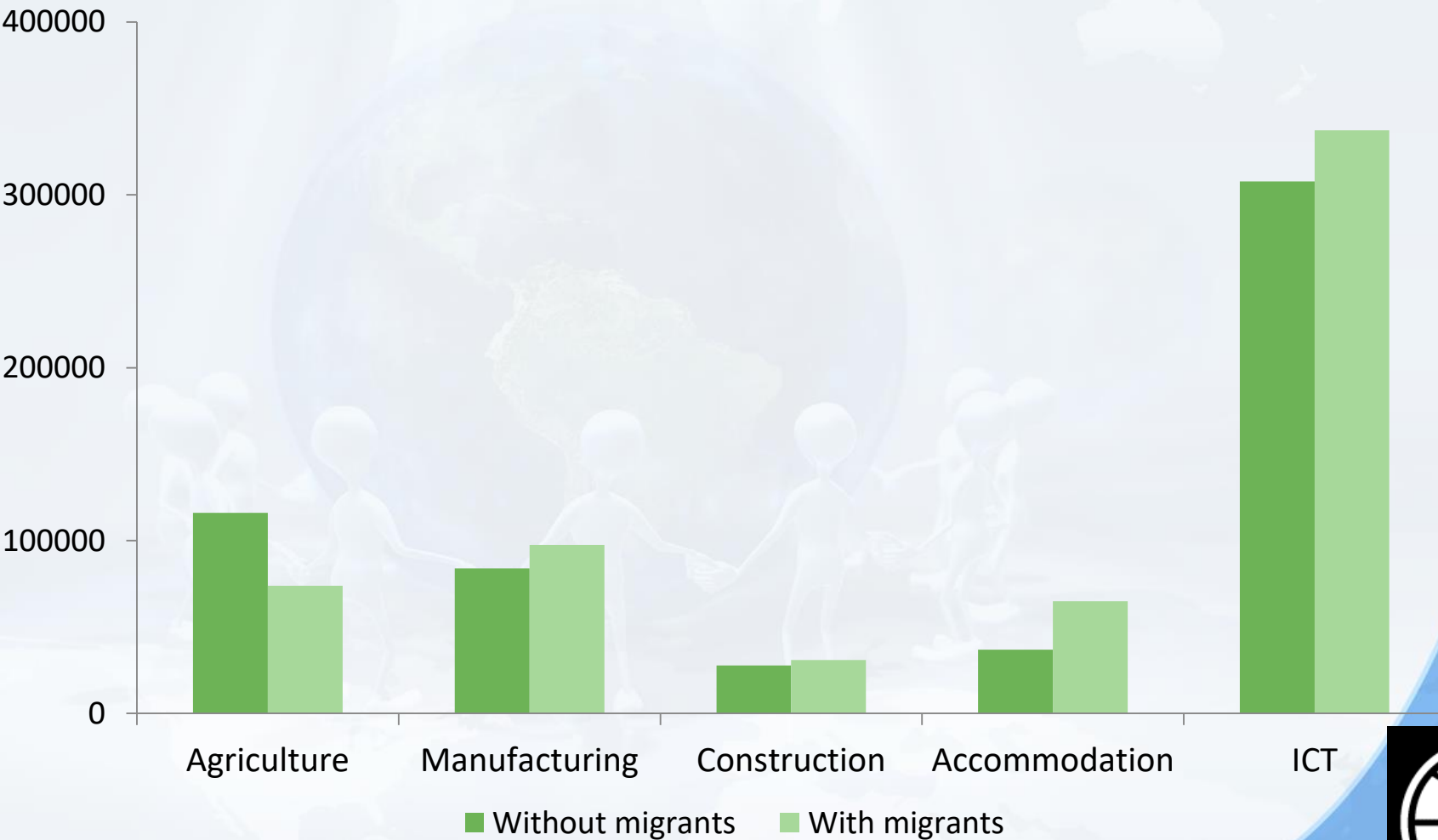
It is the large firms that employ the largest share of foreign workers

Establishments With/Without Foreign Workers in Manufacturing



In all sectors (except agriculture) value added per workers is higher in establishments that employ foreign workers

Average Value added per worker by Workforce Composition and Sector, 2010



Again, the causality between productivity and foreign labor is critical

FACT:

We tend to find foreign workers in large firms and in firms with higher value added .

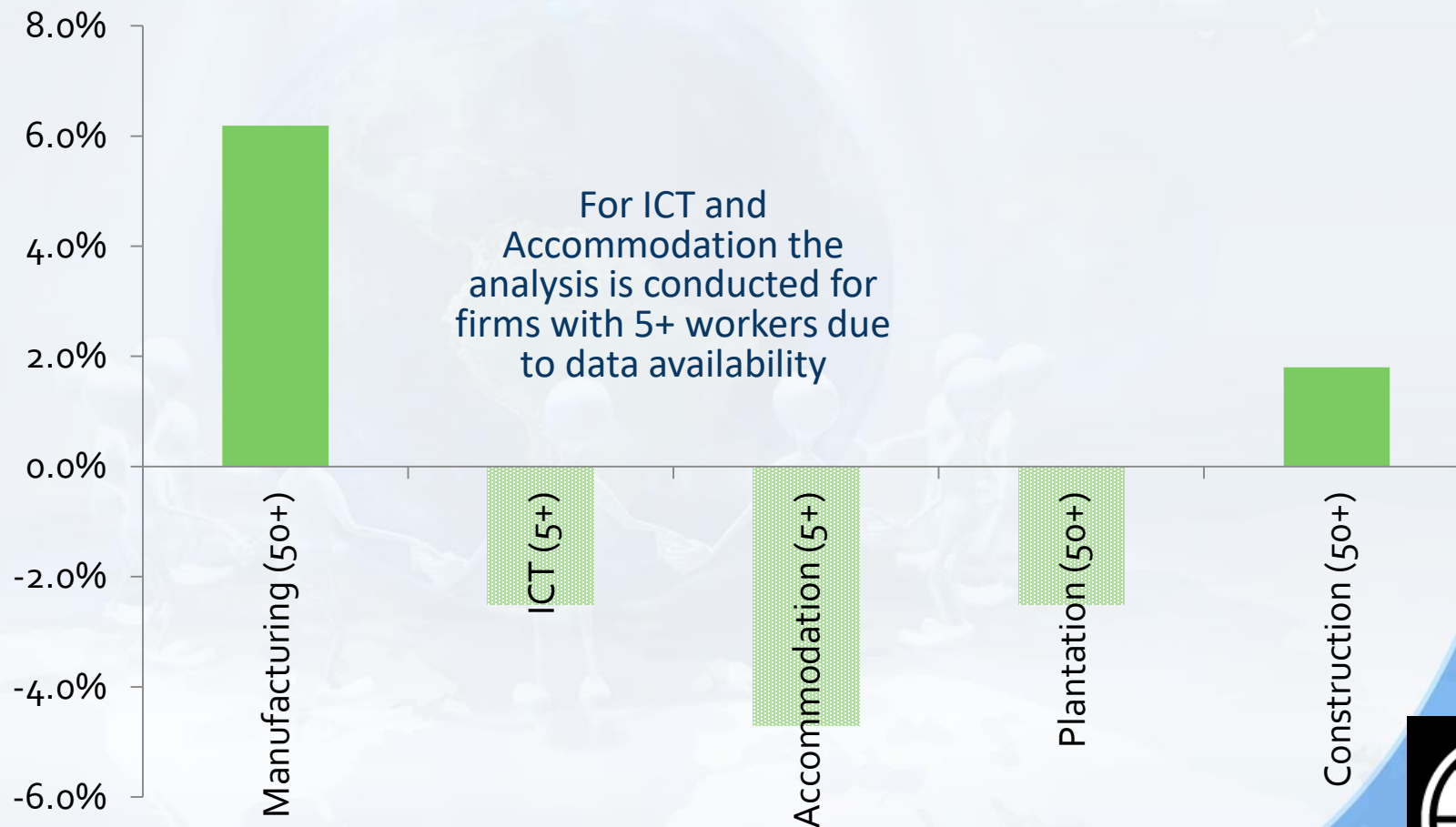
QUESTION:

Do foreign workers contribute to higher productivity or larger/more productive firms hire foreign workers?



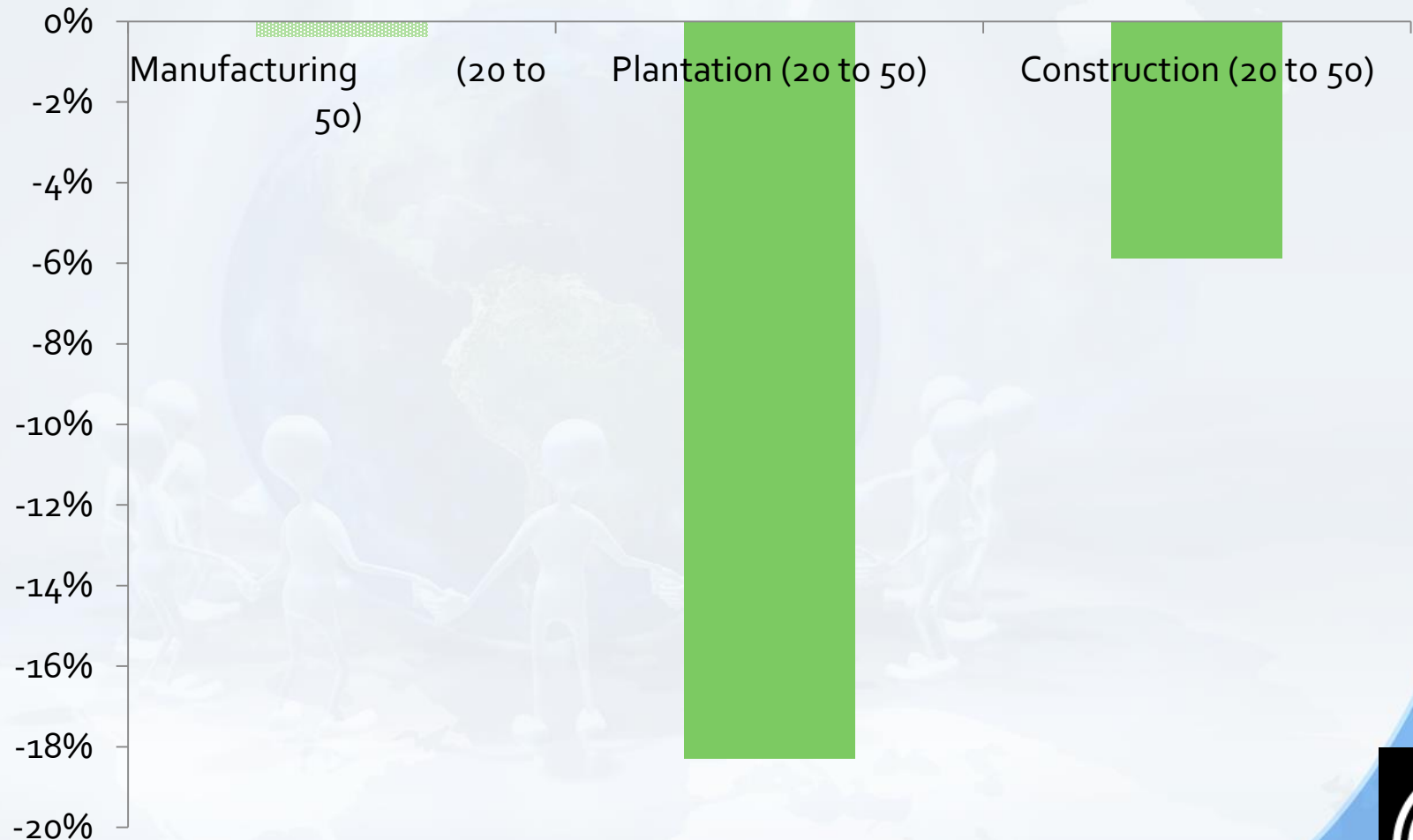
The impact of foreign labor on productivity varies by sector...

Overall positive impacts on medium and large firms (50+ workers) in manufacturing and construction. For plantations, Accommodation and ICT services results are not conclusive.



...and by firm size

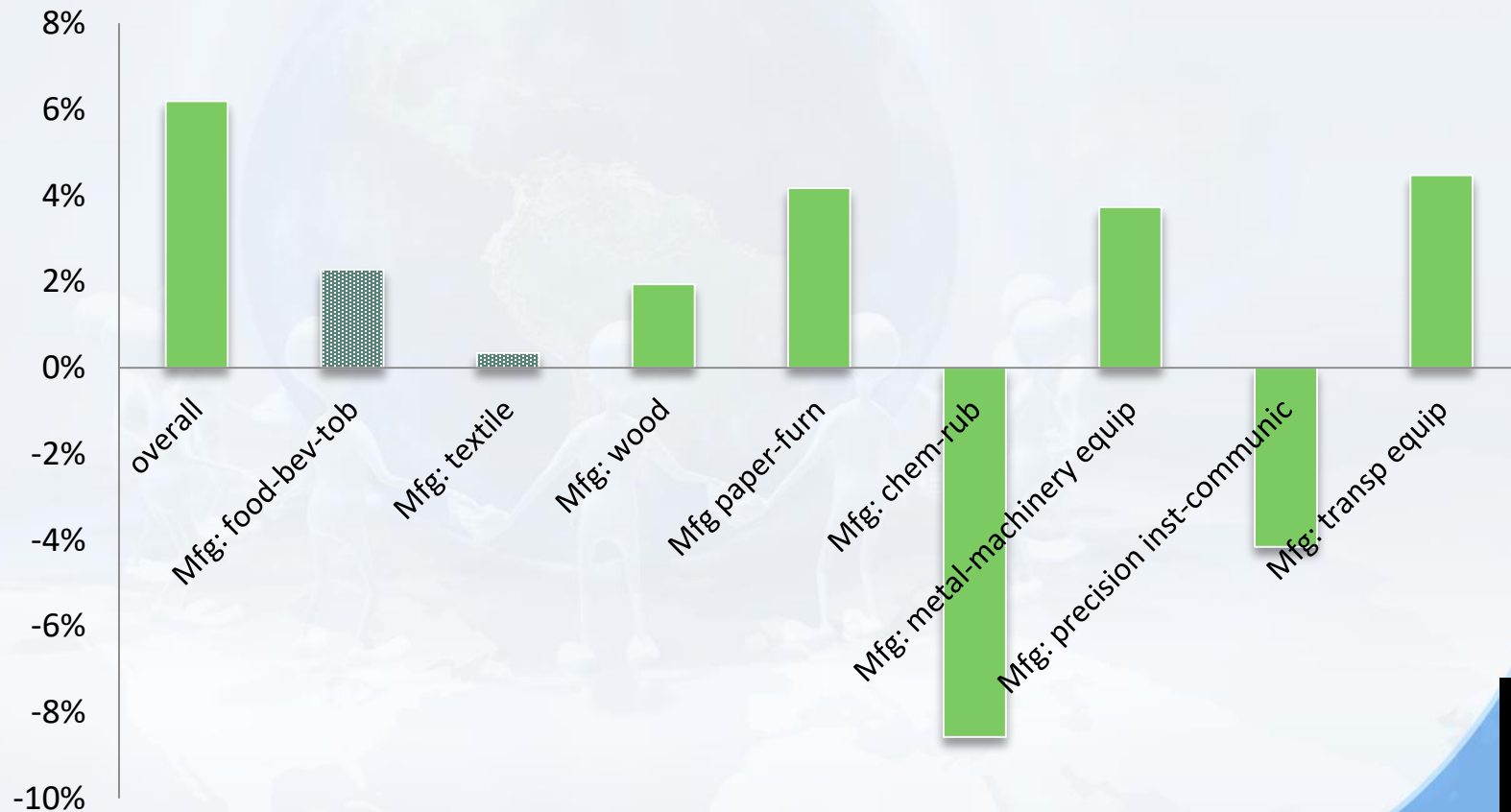
For smaller firms (20 to 50 workers) the results are very different.



Impact of foreign labor within manufacturing (50+ workers)

Within the manufacturing sector, the effect is significant in all subsectors except on Food-beverages-tobacco and Textile.

The effect is negative in Chemicals/rubber, precision and communication instruments and transportation equipment. It is positive in wood, paper/furniture, metal/machinery equipment and transportation equipment.



Effects are Heterogeneous Across Industries and Firms

- In general, the effect on productivity is positive, especially in manufacturing and construction.
- The main beneficiaries are large firms. Foreign workers impact productivity of small firms, especially in plantation and construction negatively ..
- Within manufacturing firms, capital intensive sectors are hurt but they do not employ large number of foreign workers anyway.



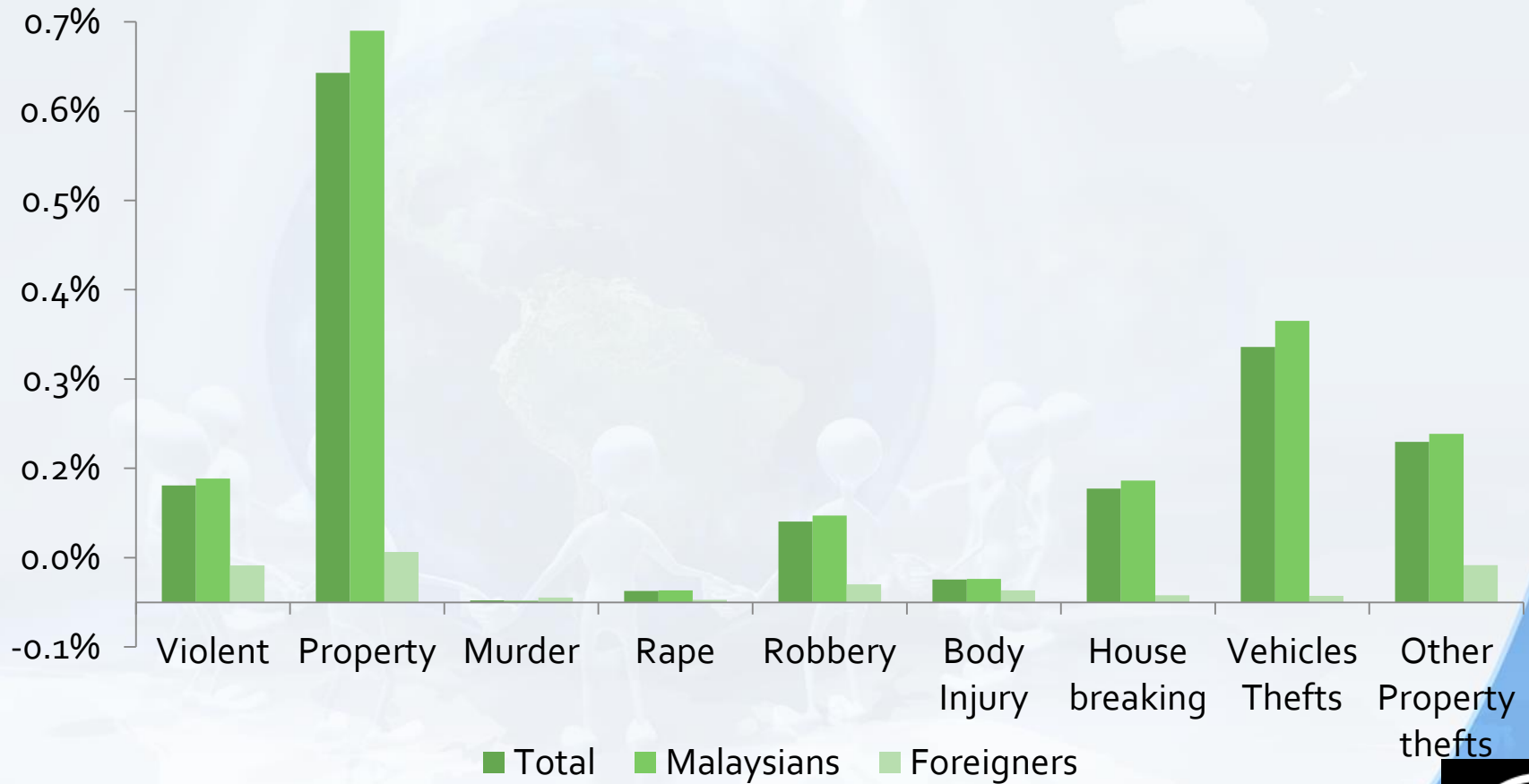
SOCIAL IMPACT

CRIME



Crime rates for immigrants are lower than for Malaysians (except murder)

Average Crime Rates of Malaysians and Foreigners, 2003-2010



Source: Author's calculations with Data from the Royal Malaysian Police



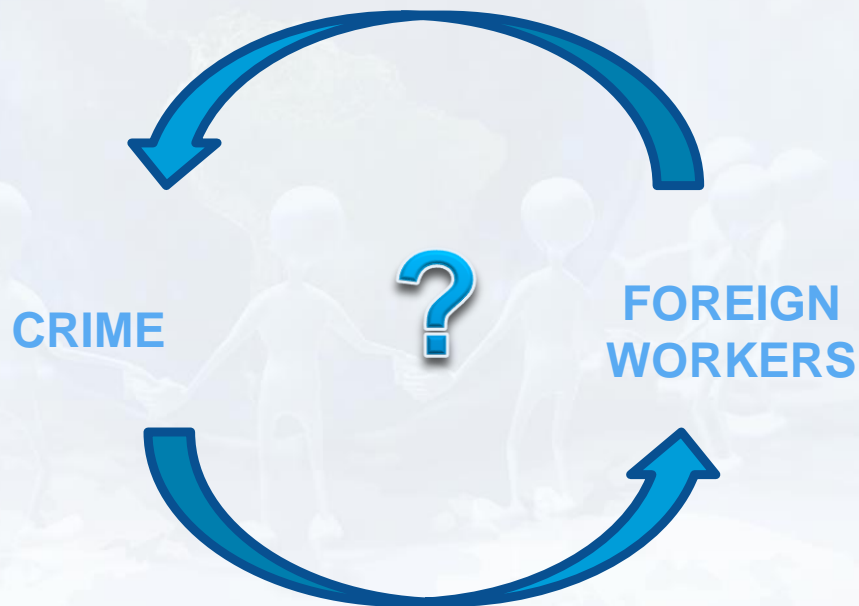
Does immigration lead to higher rates of crime?

FACT:

Increasing sentiment that the presence of foreign workers is associated with higher rates of crime.

QUESTION:

Do foreign workers increase the propensity to commit crime or do regions with high crime rates employ more migrants ?



Does immigration lead to higher rates of crime?

Using the same econometric technique as in the previous sections, we find that changes in the supply of immigrants to a state result in a fall in the number of crimes committed in a state.

Impact of Immigration on Crime (for every 100,000 immigrants)



The effect on crime rate is even more pronounced.

Source: Author's calculations with Data from the Royal Malaysian Police



Potential channels of transmission from immigration to crime

- Economic activity (unemployment, wages, sectoral growth, etc...)
- Different opportunity costs of crime for immigrants and locals
- Social tensions

The report demonstrates that immigration increases economic activity from which Malaysian workers benefit. This in turn is likely to decrease criminal activity.



POTENTIAL EFFECTS OF POLICY CHANGES

MACROECONOMIC IMPACT



Goals of the Computable General Equilibrium (CGE) Model

- Detailed model of production with 23 sectors and 21 separate skill categories to capture a wide range of policy options.
- Allows us to simulate different levy scenarios – as well as from whom they are collected.
- Identify the effect on macroeconomic variables – growth, investment
- Identify the effect on wages and unemployment of Malaysian workers in different sectors and different skill levels.
- Identify the effect of minimum wage policies on these variables.



The Model Has 23 sectors

Sectoral Growth Rates 2005-2010

1 AGRICULTURE

2 MINIG

MANUFACTURING

3 Mfg food-beverage-tobacco

4 Mfg textile

5 Mfg wood

6 Mfg paper-furniture

7 Mfg chemical-rub

8 Metal-machinery-equip

9 Mfg measurement-med-com

10 Mfg transport equip

11 UTILITIES

12 CONSTRUCTION

SERVICES

13 Wholesale-retail

14 Accommodation and restaurants

15 Logistics

16 Post and telecom

17 Finance

18 Real estate

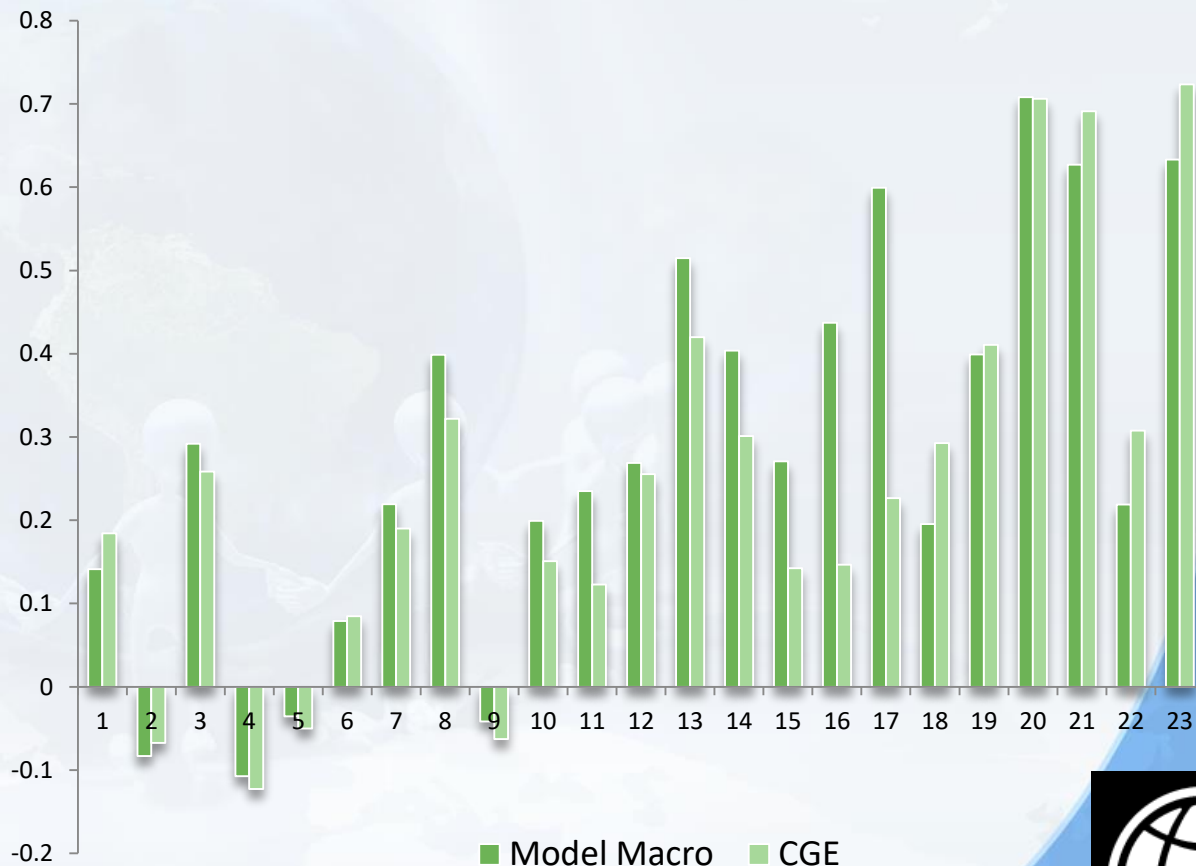
19 Business services

20 Education

21 Health

22 Other services

23 Public administration



The Model Has 21 Educational Categories Tracked Over Time

Skill Levels

Lower Skill - Secondary or less

- 1 No schooling
- 2 UPSR/UPSA equivalent
- 3 PMR or equivalent
- 4 SPM or equivalent
- 5 STPM or equivalent

Medium Skill -Certificate/Diploma

- 6 Arts & Humanities
- 7 Social science, business, law
- 8 Science, math, IT
- 9 Engineering

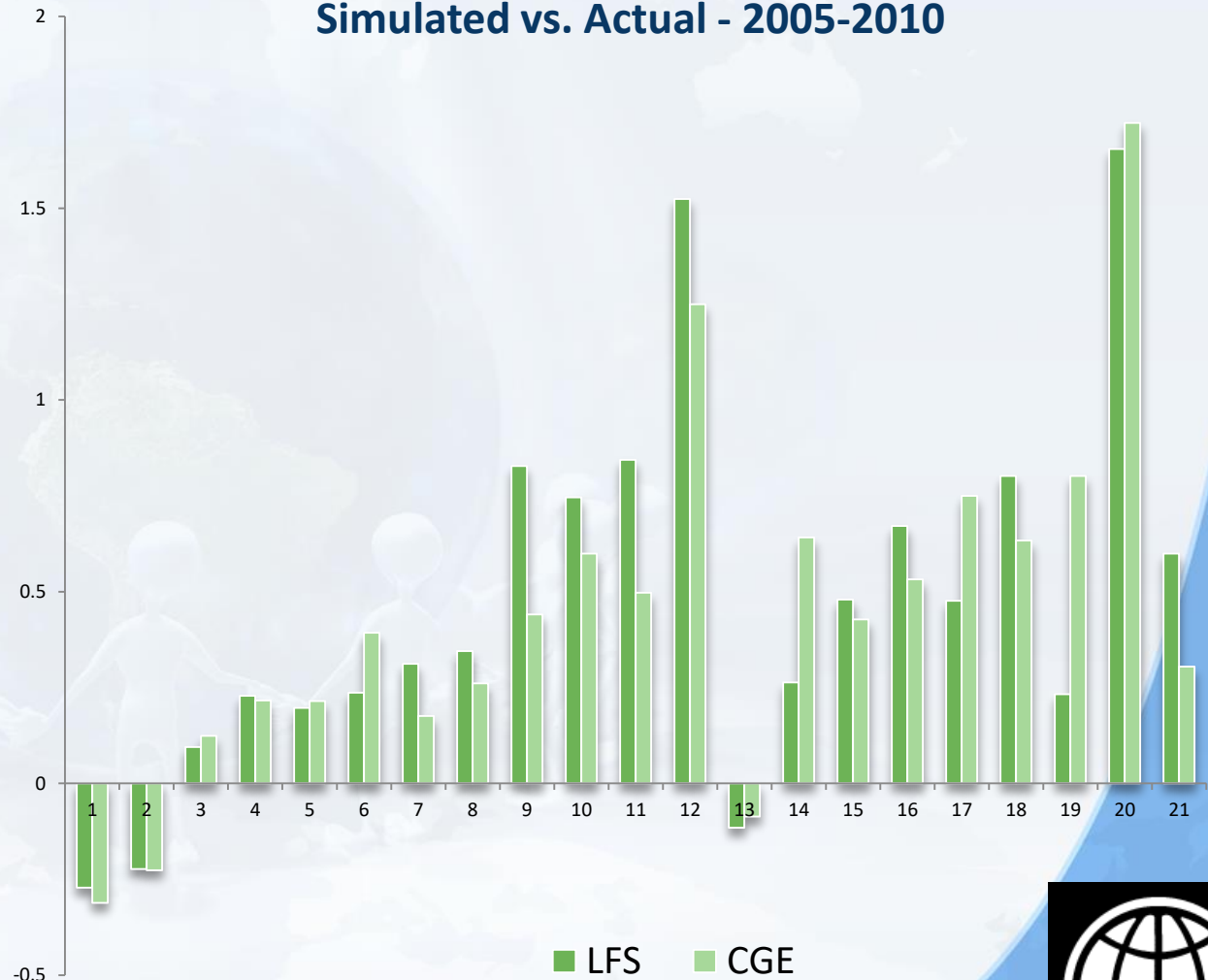
- 10 Agriculture
- 11 Health
- 12 Services
- 13 Education

Higher Skill -University Degree

- 14 Arts & Humanities
- 15 Social science, business, law
- 16 Science, math, IT
- 17 Engineering
- 18 Agriculture
- 19 Health
- 20 Services
- 21 Education

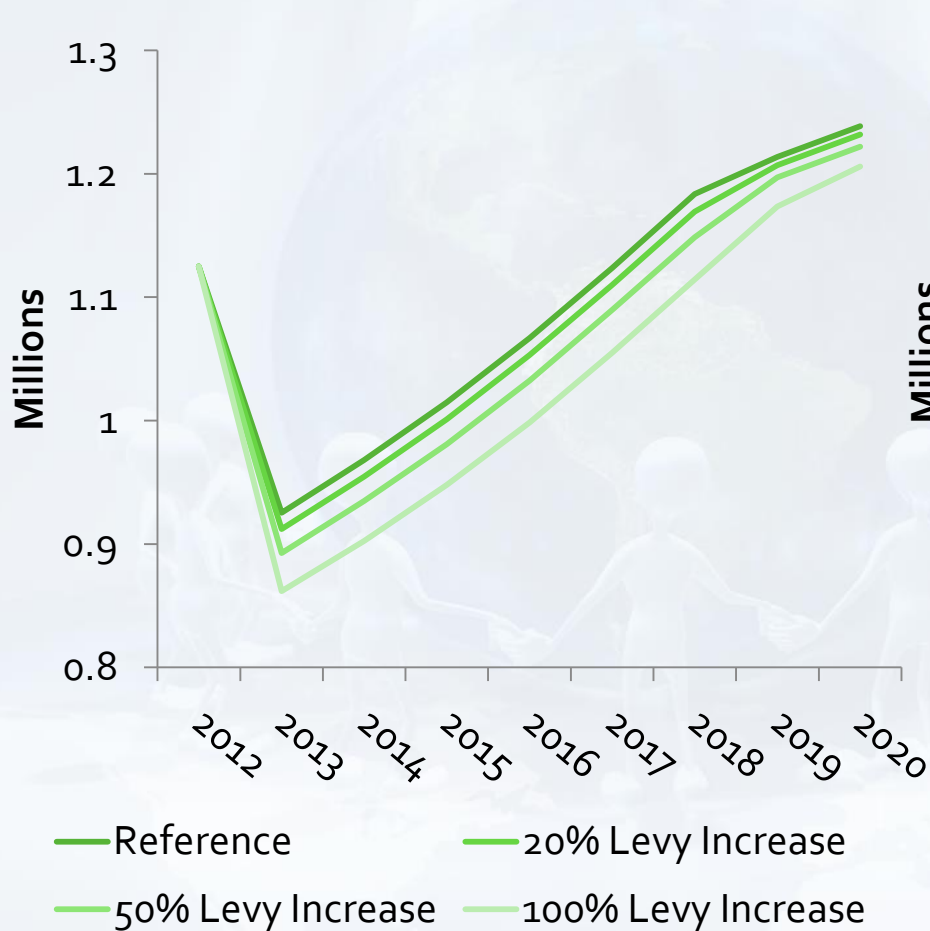
Evolution of Labor Supply by Skill Level

Simulated vs. Actual - 2005-2010

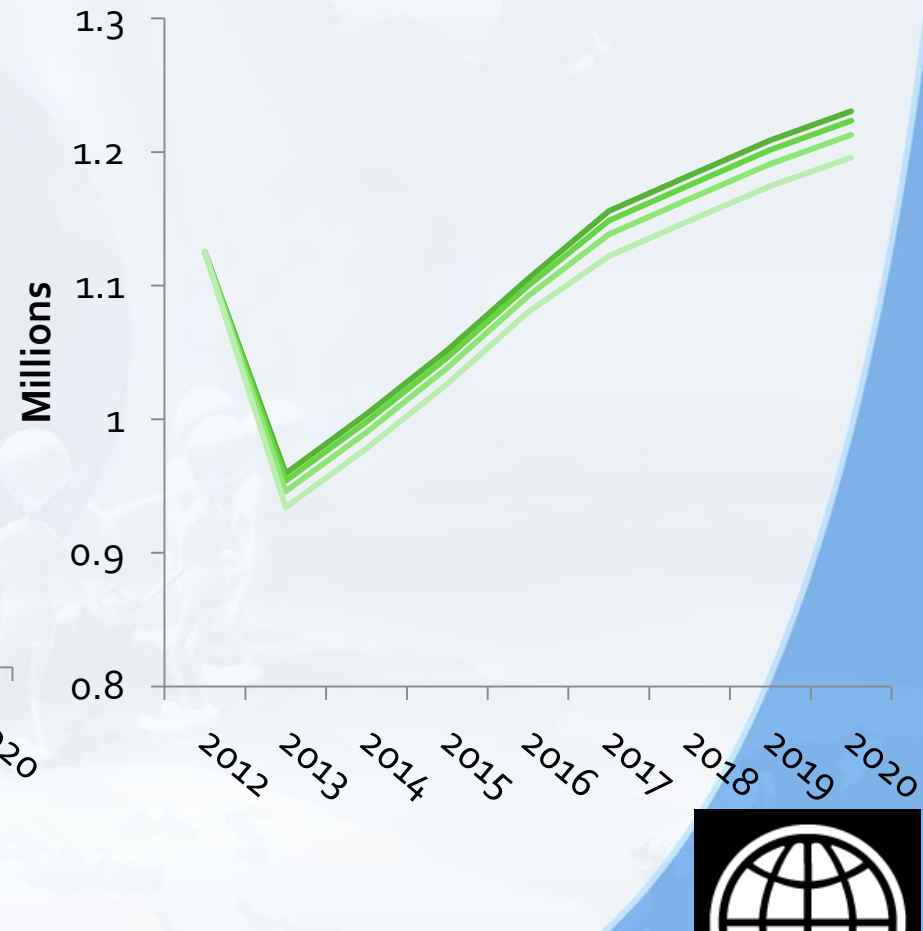


Once Levy Costs are Adjusted, Legal International Immigration is expected to fall

International Immigration Employers Pay for the Levy

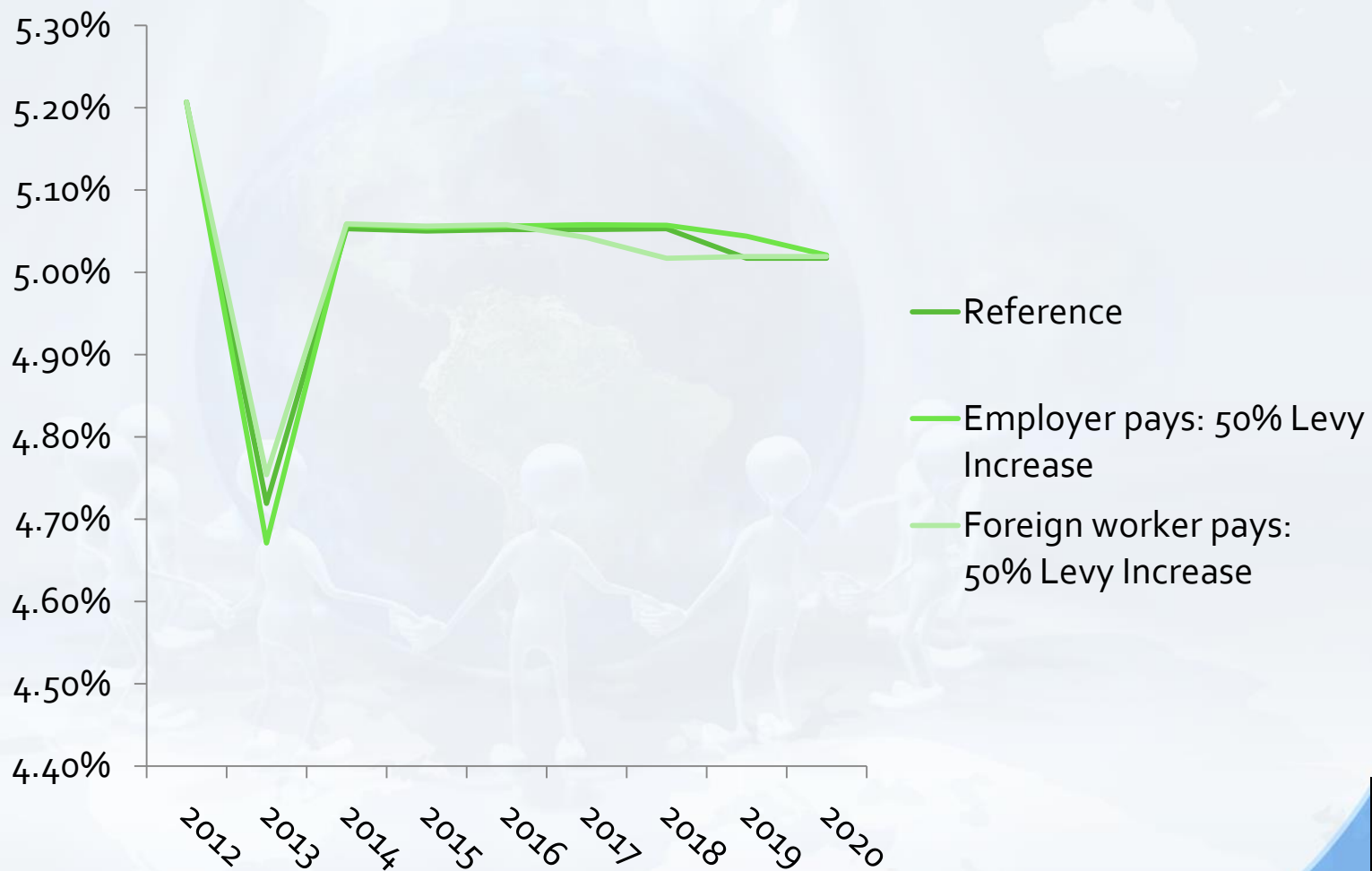


International Immigration Workers Pay for the Levy

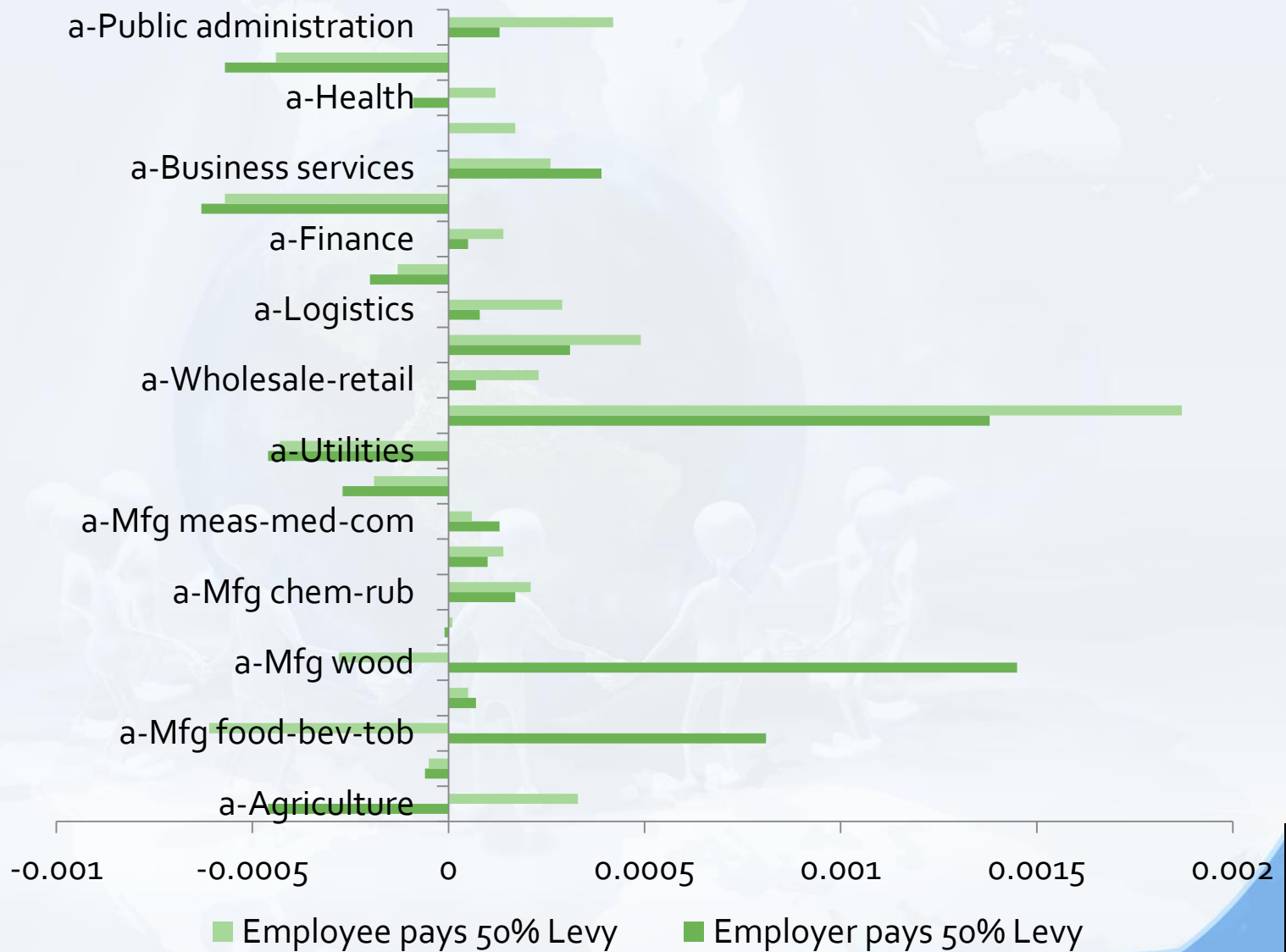


The Impact on GDP Growth is Marginal in all the scenarios, irrespective of whom pays the levy

Evolution of GDP Growth Rate



The Impact of a Levy Increase is Marginal in Most Economic Sub-Sectors



Wages of Medium-skill Workers are not affected by a levy increase



Workers with no formal education or at most primary school see a marginal rise in their wages.



Wages of Foreign Workers are Affected by Levies



This is particularly true for lower-skill workers.



NEW LAWS AFTER THE REPORT WAS COMPLETED



Minimum Wage and Levies

- **Minimum Wage Deferral for Foreign Workers – March 2013:**

The Malaysian government has approved the **delayed implementation** by small and medium-sized enterprises (SMEs) of **new minimum wage standard** for their **foreign workers**. The National Wages Consultative Council, which is responsible for the implementation of the standard, said in a statement that the employers in SMEs are permitted to defer the implementation until Dec. 31.

- **Levy to be Paid by Foreign Workers– January 2013:**

“The minimum wage, which came into force this year has raised the salary for all workers on an average of between 30 per cent and 50 per cent, or from RM600- RM700 per month to RM900 monthly.”

“The Government’s move to **impose a levy on foreign workers** will not be a burden to them as the levy paid is between RM34.16 and RM154.16 per month as compared to a salary increase of between RM300 to RM500 per month”

Second Finance Minister Datuk Seri Ahmad Husni Hanadzlah



FOREIGN WORKFORCE MANAGEMENT

POLICIES AND COMPARABLE SYSTEMS



Designing Immigration Policies

Building an immigration system is a complex task with a repercussion on a multiplicity of spheres.

Learning from other countries is important, but a one-size-fits-all approaches do not exist.

Key factors to take into account are:

1. **Age structure and dynamics** of the population
2. **Labor Market** conditions (unemployment, labor force participation, wage growth, etc...)
3. **Education levels** of natives and migrants (supply, demand and skill gaps)
4. **Geographic and cultural** factors



Flexibility of Policy Regime

Institutional bodies in charge of immigration need the flexibility to respond to sudden changes in the economic environment.

Basic levies, fees and taxes can be used to influence total number of foreign workers. Differential levies can be used to channel foreign workers to targeted sectors which face shortages and have national priorities.

South Korea has a very flexible approach with sector specific quotas revised regularly.

The **Singaporean** system is regularly adjusted based on market conditions by using the foreign workers levy system that differs by sector, skill and firm size.

Malaysia: annual **levy** system and **quotas** at the sectoral and sub-sectoral level. This system does not fully respond to underlying market conditions and their rapid evolution.



Consultations with stakeholders

Policy decisions should be taken in consultations with key stakeholders, in particular the private firms in sectors that critically depend on foreign labor. Such consultations should take place on a regular basis and be clearly structured.

In **Singapore**, extension of the maximum employment period for foreign low skilled workers (from 6 to 10 years) to maximize productivity gains.

In **Australia** every a list of occupations in need is compiled in consultation with representatives of unions and industries.

In **Canada**, reports of consultations with unions, employers and experts are made public.

Malaysian stakeholders revealed that consultations are ad-hoc and do not effectively inform the government of market conditions on a regular basis.



Preventing Undocumented Workers

When it comes to undocumented workers, a country should remove the economic incentives (high levies/visa fees, high minimum wages etc) for undocumented migration by:

- (1) having repercussions for employers hiring undocumented workers
- (2) imposing reasonable costs and fees for employing documented foreign workers so that incentives for undocumented migration stays low
- (3) having in place a clear legislation regulating the activities of *migration agencies*

In **Malaysia**, several measures to prevent illegal migration (Anti-Trafficking in Person Act, stricter conditions for private agencies to be licensed by MOHA, implementation of a new regularization (6P) program).

Only countries with natural barriers (e.g. **Australia**) can properly manage to limit undocumented migration.

In countries with large porous borders (**United States** and **European Union**) unskilled workers have relatively easy access through irregular channels.



KEY POLICY INSTRUMENTS



QUOTAS

Almost every government in the world uses **quantitative restrictions** to control the number of migrants and foreign workers entering their jurisdictions.

Economics literature and policy discussions are full of examples showing why **price mechanisms** – taxes, tariffs, levies – can be more efficient and effective than quantity restrictions.



BENEFITS OF LEVIES

Levies provide **flexibility** to government agencies to respond to sudden changes in the economic environment.

Levies allow governments to **raise revenues** as a taxation mechanism. This revenue would otherwise accrue to the recruiting agencies and employers. They can be used training, enforcement and other objectives related to foreign worker policies.

Levies can act as wage stabilization mechanisms and provide balanced wage growth paths.



Towards a new system: Critical features

An **ideal mechanism** for Malaysia would involve:

- 1) Maintaining **more relaxed quotas** with **more strategically designed levies** across sectors.
- 2) Levies that are not occupation-specific but **sector-specific**. The definition of sectors should be neither extremely broad or narrow.
- 3) Levies that are **reviewed and adjusted periodically** – possibly every 2-3 years – using signals from the **labor market**. The critical observation will be the sector-specific wage levels.
- 4) **Effective enforcement**, especially given the minimum wage laws are likely to encourage non-compliance and informality.



CONCLUSION

KEY MESSAGES



Key messages

Malaysia's rapid economic growth accompanied with labor market shortages for unskilled workers continue to attract foreign workers from neighboring countries.

The differences in growth differentials and overall educational gaps between the labor forces of Malaysia and its more populous neighbors, such as Indonesia and the Philippines, are the key pull and push factors that fuel the current migration patterns.

Appropriate policies need to be designed with these economic fundamentals in mind.



Key messages

An abrupt disruption of foreign unskilled labor supply could cause unpredictable effects in the economy.

Since unemployment levels are low and vast majority of the Malaysian workers do not compete with foreign workers, benefits to domestic workers from a decline in the inflow of foreign labor are limited.

Thus, the government is highly encouraged to review its foreign workers program and design nuanced policies to accommodate the economy's particular needs by sector and human capital categories.



Key messages

Large number of firms in labor intensive sectors would not exist without the cost advantages provided by low-skilled low-cost foreign labor.

Given the types of activities and markets that some of these companies operate in (low value added), they will continue to rely heavily on low skill (low cost) foreign labor in the foreseeable future.

Without foreign labor, these sectors would simply disappear and lead to unemployment of significant number of mid-skilled local workers in the short to medium term.



Key messages

There are also skills gaps on the higher end of the labor market spectrum.

It takes a long period for the education and training systems to produce new core skills. It is possible that the country will have to rely on foreign talent to fill these occupational gaps to avoid having bottlenecks.

Government should consider more flexible entry regimes and promising long-term opportunities in order to attract and retain skilled foreign workers, including university students.



Key messages

Another clear lessons to emerge is to invest in the collection of reliable, high quality, regular and detailed data on all workers—local and foreign— and firms to track the labor market conditions, properly understand the effects of foreign labor and evaluate future policy changes.

The data collection program has to be a joint effort of all relevant agencies that are responsible for labor markets, education, taxation and domestic security.



Key messages

It is beneficial to maintain a list of occupations and sectors in short supply of skills, namely a “workforce dashboard.”

This tool requires periodically updated data to be shared by all relevant government agencies. The system prevents overuse of foreign workers and bring objectivity into the process, instead of the government relying on potentially subjective data provided by the employers.



THANK YOU!!!

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