Foreign Workers in Malaysia:
Assessment of their Economic Effects and Review of the Policy

The World Bank
International Population Conference on Migration, Urbanization and Development
July 8th, 2013
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.
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
FOREIGN WORKERS AND MALAYSIA

MAIN DETERMINANTS
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.

Note: The analysis is focuses on the working age population (15 to 64 years of age)
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.
The economy heavily relies on export-oriented manufacturing and domestic service sectors.
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
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.

Labor Force data account for about 2+ million foreign workers in Malaysia.
Estates/group housing are excluded from labor force survey. Other estimates show the total at 18% (NER, 2009) and 20% (MOF, 2009).

Foreign workers compose around 10% of the labor force
Foreign labor continues to be largely concentrated in physically demanding sectors of the economy such as agriculture and construction.
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.
ECONOMIC IMPACT

LABOR MARKETS
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 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.
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.
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.
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.
• 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
It is the large firms that employ the largest share of foreign workers.
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**

- **Agriculture**
  - Without migrants: 100,000
  - With migrants: 250,000
- **Manufacturing**
  - Without migrants: 50,000
  - With migrants: 150,000
- **Construction**
  - Without migrants: 20,000
  - With migrants: 50,000
- **Accommodation**
  - Without migrants: 30,000
  - With migrants: 70,000
- **ICT**
  - Without migrants: 300,000
  - With migrants: 320,000
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?
Overall positive impacts on medium and large firms (50+ workers) in manufacturing and construction. For plantations, Accommodation and ICT services results are not conclusive.

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

For ICT and Accommodation the analysis is conducted for firms with 5+ workers due to data availability.
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.
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.
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
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.
KEY POLICY 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.
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.
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.
Impact on Foreign Workers is...

Positive on average for both Malaysian workers and firms.

The main negative impact is on low skilled workers and firms.

The main positive effect is on medium skilled workers and larger firms, especially in manufacturing.

The effect is smaller on female, younger or highly educated workers.
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 for training, enforcement and other objectives related to foreign worker policies.

Levies can act as wage stabilization mechanisms and provide balanced wage growth paths.
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.
5) Changes in levy levels create minimal macro fluctuations.

6) Levies can be designed to help the groups that are impacted negatively from foreign workers:
   a) Low-skilled workers: used for skill-upgrading
   b) Smaller firms: designed for specific policy objectives
THANK YOU

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