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Malaysia labor income share rises, inequality falls, but it isn't a good sign

The share of national income earned by workers has been falling in most countries, and inequality has been rising as a result. The opposite is true in Malaysia. But what seems to be good news there is masking a worrying trend.

Income share has become a focus of economists and social policy advocates as the share of income taken by workers has fallen and that earned by the owners of capital has risen. It's a global version of "the rich get richer" in effect, and has been seen throughout the world in recent years.

So, it makes sense that when labor income share was seen to be rising in Malaysia, and inequality evening out, the trend would draw attention.

Unfortunately, the reason behind what would seem on the surface a positive shift in Malaysia can likely be blamed on the country's de-industrializing, says researchers for a working paper for the Asian Development Bank Institute.

Malaysia has been importing cheaper low-skilled foreign workers and using more labor in its output. More workers are doing lower-skilled tasks than when the country was styling itself as the next technology manufacturing center.

In an economic plan put forward in 2015, Malaysia's Economic Planning Unit said the government was targeting an increased labor income share to put the country on a par with other middle- and high-income countries.

It isn't likely that they wanted it to happen this way, though. As the researchers wrote in their paper: "If the overarching objective is for Malaysia to become a more advanced economy, the use of the labor income share as a target is clearly not a very meaningful one in this case."

The declining share of income for labor has been blamed on the decoupling in many countries of the relationship between productivity growth and wages. In the past, as workers became more skilled, they produced more and were paid more for their work. In recent years, a combination of automation and offshoring of jobs has meant productivity has been rising but worker wages have remained stagnant or have even been falling, when inflation is taken into account.

In contrast to this global trend, Malaysia's labor income share has been increasing since the country started producing official statistics on it since 2005. Not surprisingly, statistics that measure income inequality have been improving at the same time.

The labor income share including self-employed workers increased from 35.4% in 2005 to 42.9% in 2016. The Gini coefficient is the ratio used to describe inequality, with 1 being perfect inequality and 0 being perfect equality. Malaysia's Gini coefficient decreased from 0.455 in 2005 to 0.399 in 2016.

So far so good. But when the details of those statistics are analyzed, the picture begins to worsen.

In much of the rest of the world, wages have failed to keep up with rising productivity. In Malaysia, the trend is going the opposite way. Wages per worker increased by 44.2% from 2005 to 2016, but labor productivity increased only by 19.1%.

The researchers noticed that the service sector saw the biggest gains in labor income share and was taking up more of the country's employment overall. The labor income share for the service sector grew 4.12 percentage points between 2005 and 2016 while the share of total employment taken by the service sector grew to 62.2% from 56.2%. Employment in manufacturing fell to 15.9% in 2016 from 19.8% in 2005.

Digging deeper, they found that the mismatch between productivity and wage growth was clearly visible in the service sector, with wages rising 44.7% over the period and productivity increasing just 29.5%.

The income share gains were greatest for semi-skilled workers and within small and medium-sized companies.

When they put all the clues together, the picture that emerged was not positive. Since at least 2005, labor has been shifting away from capital-intensive, skilled manufacturing toward service sector work in small and medium-sized companies.

The majority of small and medium-sized companies in Malaysia are involved in traditional work, things like fishing or stamping out metal parts, as opposed to "modern" service jobs like information technology.

At the same time, Malaysia has been importing an increasing share of foreign workers in low-skilled jobs.

Overall, it is as if the owners of capital have decided they can do better using less-skilled workers to do basic tasks in small companies than they can by investing in factories with high-tech machinery and skilled workers.

That isn't good for Malaysia's growth or its productivity in the long term.

The authors suggest that the lesson from Malaysia is that labor income share on its own may not be a measure policy makers should focus on too much. They also suggest that while the government should continue to assist small and medium-sized companies as an important source of employment, it should pay more attention to the nature of those companies when it chooses which to promote.

This podcast was based on *What Explains the Increase in the Labor Income Share in Malaysia?* a working paper for the Asian Development Bank Institute by Allen Ng, director of research at Malaysia's Khazanah Research Institute, and research assistants Tan Theng and Tan Zhai Gen at the institute.

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