

# Of premature deindustrialisation

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DURING the early days of independence, Malaysian economy as a whole and Sabah specifically have been very dependent on the first sector economy which is natural resources, such as unprocessed agricultural and mining products among others. Tin, oil, logs and rubber for instance have long become among the important products which contributed significantly to the nation's income and the external sector.



Gradually, the country has undergone a major reform by having structural transformation. Since the 1980s, industrialization, through the manufacturing sector, became the engine of the country's economic growth.

This is also the case in the developed countries. Economy experiences structural transformation and the income is at high income level when manufacturing sector is at its peak. Eventually, developed countries economy shifted towards the service sector and it then held the biggest share in the country's economy.

In recent years, few prominent economists such as Dani Rodrik has posted an important question or phenomenon faced by developing countries. There are developing countries that have started to shift to service sector as the main sector of the economy before having expanded the manufacturing sector to its maximum, since that is the normal growth path shown by developed countries in the past. This situation is called 'Premature Deindustrialization.' Labor and other resources have been moved from agriculture, then manufacturing sector and finally to services sector prematurely. This premature movement of resources to services sector lead to underdevelopment of the manufacturing sector or slower growth of manufacturing sector.

Most developed economies have moved into a post-industrial stage of development. These nations have been deindustrializing for many years. This is an obvious trend when one looks at the employment share of manufacturing.

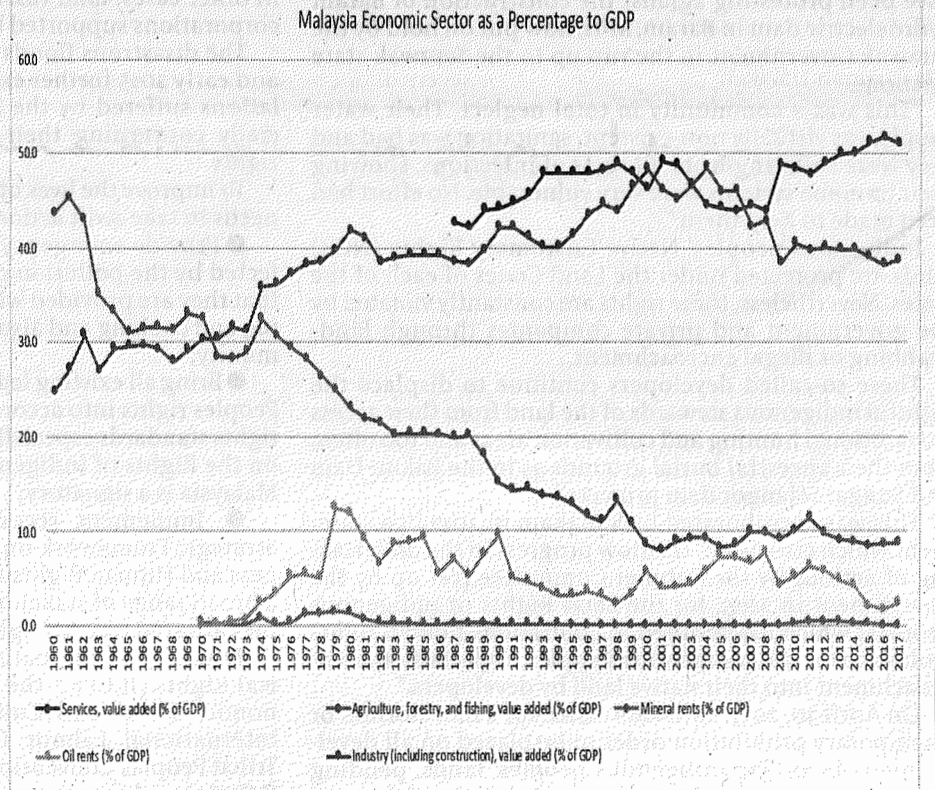
This phenomenon seems to be experienced by Malaysia in general and Sabah as well. What are the causes of this to happen? Why don't Malaysia expand its manufacturing sector to its maximum potential first before changing its direction to services sector? What is the impact of this phenomenon? This article shall address those questions.

Table 1 shows selected countries in ASEAN-6 sectors' contribution to GDP. The table clearly indicates that there are many countries which yet to reach the high-income status have witnessed services sector as the biggest sector. Figure 1 shows Malaysia's economic sector (as a percentage to GDP) since 1960s.

Table 1 depicts that the services sector of Malaysia, Phillipines, Singapore, Indonesia, Vietnam and Thailand hold the biggest share in each country's economy compared to other main sector, such as manufacturing sector. Figure 1 shows that over the period of almost 60 years, agricultural sector' share of GDP is at decreasing trend. Industry share also start decreasing after 2004, while services sector experiences a positive growth pattern. Moreover, data in the 1980s have shown that service sector has been greater than industry (manufacturing sector) before it is being overtaken by manufacturing (industry) in the 1990s for some years.

How can this be best explained? It might be due to the rapid expansion of manufacturing sector in China. When China became a member of World Trade Organization in 2001, and the fact that they were receiving many offshoring activities in China, its manufacturing sector is expanding at a high growth rate. There has been a significant relocation of manufacturing took place. When China produce at huge scale, thus achieving greater economies of scale that lead to very low unit cost of production,

Figure 1: Malaysia's Economic Sector as a Percentage of GDP



Source: derived from World Bank (2019)

it becomes harder for many developing countries to compete. Eventually, this may lead to a slower growth of the manufacturing sector prematurely in developing economies. In this regard, as I mentioned earlier, service sector has been greater than industry (manufacturing sector) before it is being overtaken by manufacturing (industry) in the 1990s for some years. In fact, Malaysia in general and the states specifically are facing a situation where services sector holding the biggest share of GDP. This includes states like Penang, Selangor, Johor and Negeri Sembilan.

What are the effects of this phenomenon? Employment deindustrialization has long been a concern in high income nations, where it becomes subject of debate in public forum with the possibility of job losses and a potential decline in innovation capacity (Dani Rodrik, 2015). This should be a big concern also for developing countries. If this trend continues, we shall experience slower growth of manufacturing sector or a further shrinking of the manufacturing sector and this definitely will affect the manufacturing sector' employment growth. It potentially also affects the country's trade balance position.

For the case of Sabah, the manufacturing size is even much smaller. The share of manufacturing sector is less than 10pc of the value of GDP. To be precise, at high aggregated level, manufacturing sector contributes around 7.3pc of the states' economy, agriculture is 18.7pc of GDP, mining and transportation about 31.3pc and services contributes approximately 39.9pc of GDP for 2017 (Department of Statistics, 2018).

In this regard, which growth path is Sabah heading to? Should we have policies that further expand the state's manufacturing sector? What are the things that need to be done?

These are among the issues of concern that I believe policy makers and think tank should consider and study. Stakeholders engagement and research on this is essential to come up with the best strategy and formulation of policies which are for the best interest of Sabah's economy. It is not a must to move from agricultural, then manufacturing (where countries reach high income status) and finally service sector but it is a phenomenon that worth attention.

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