

Re-engineering Economic Growth for Greater Prosperity

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Introduction

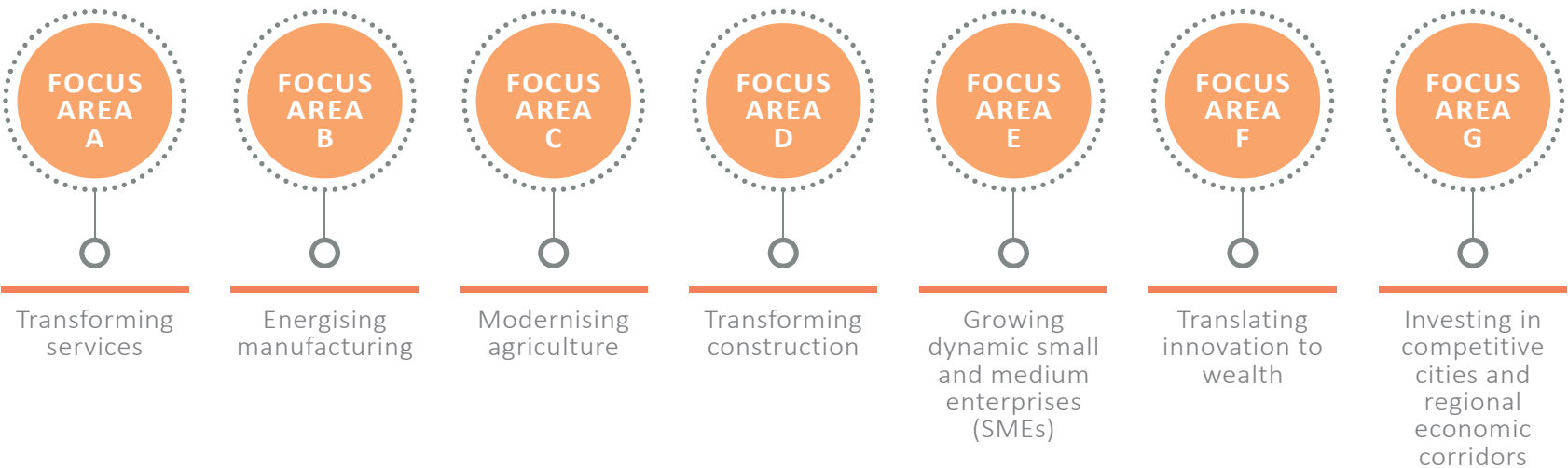
In the Eleventh Malaysia Plan 2016-2020, the thrust on re-engineering economic growth focuses on strengthening the economic foundation to propel Malaysia from a middle-income to a high-income economy premised on innovation, creativity and high value-added activities. In this regard, strategies and initiatives are outlined to accelerate the momentum of economic growth by expanding knowledge-intensive activities, increasing productivity, propelling digital-based activities and producing complex and high value-added products as well as developing regional economic corridors and competitive cities. At the same time, the economic sectors continue to face structural challenges, complex regulatory framework as well as low innovation and technology adoption. There is also a need to upskill the workforce while reducing reliance on low-skilled workers and improve environmentally friendly measures that are sustainable.



Past Performance, 2016-2017

During the review period, 2016-2017, all sectors except agriculture sector, recorded steady progress in the areas of productivity, exports, investment and employment. With favourable income growth and stable labour market conditions, private consumption expanded, which contributed to the expansion of the domestic economy. However, there were cyclical weaknesses in export-oriented sectors, which were largely due to the challenging external

environment in 2016 as world demand and trade slowed down. Subsequently in 2017, manufactured exports rebounded strongly while higher commodity prices supported the strong recovery of the agriculture sector. Meanwhile, the regional economic corridors continued to attract investments and create jobs. Various initiatives were implemented through the seven focus areas as follows:



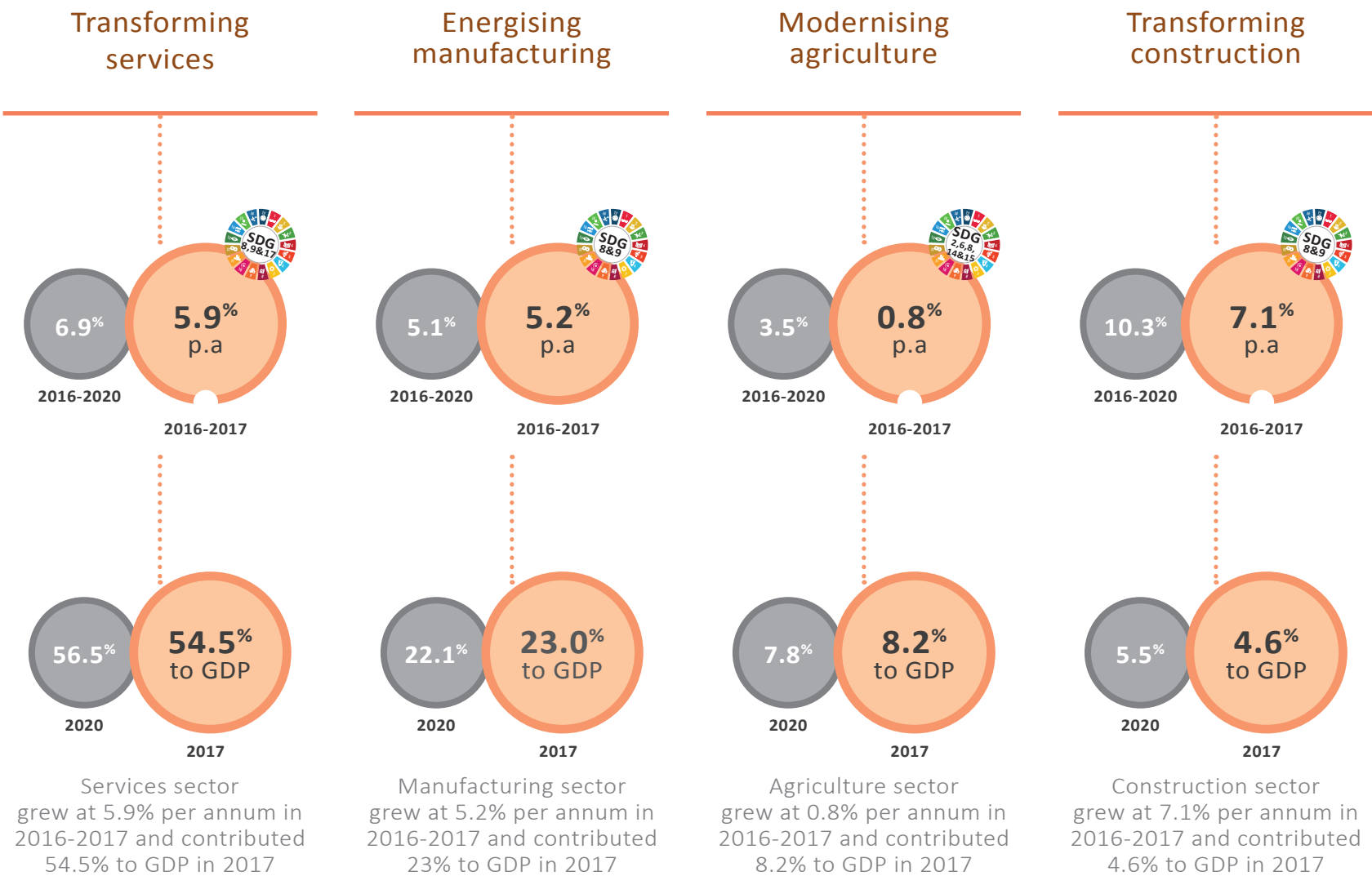
Performance of Selected Outcomes

Efforts to re-engineer economic growth were based on seven focus areas through the implementation of various strategies and initiatives, which were also aligned to meet the Sustainable

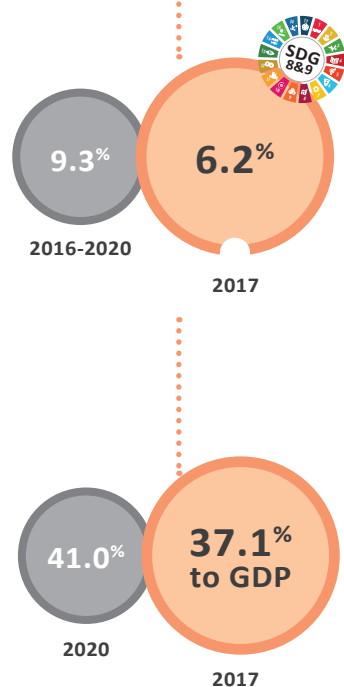
Development Goals (SDGs). The progress of the selected outcomes and performance are as shown in *Exhibit 7-1*.

Exhibit 7-1

Highlights
Eleventh Malaysia Plan: Selected Outcomes and Performance

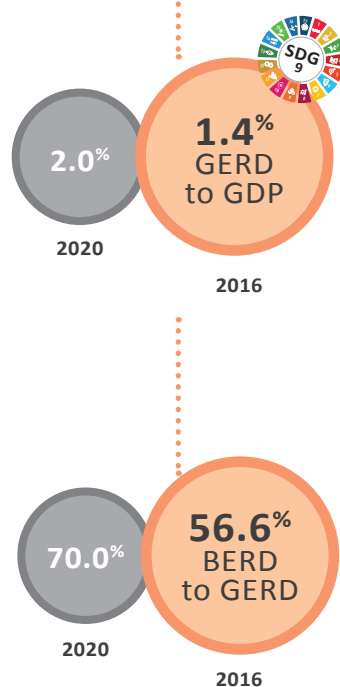


Growing dynamic SMEs



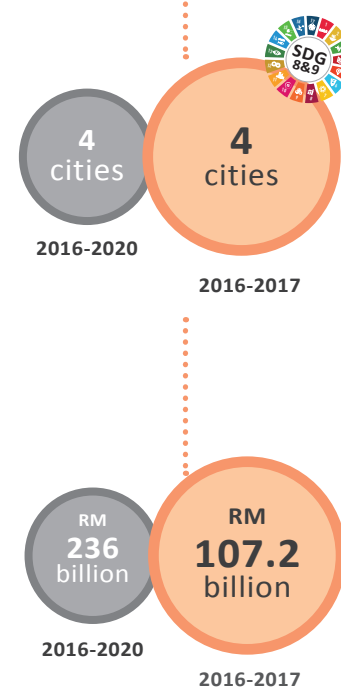
Value added of SMEs grew at 6.2% and contributed 37.1% to GDP across all sectors in 2017

Translating innovation to wealth



Gross expenditure on R&D (GERD) to GDP at 1.4% and business expenditure on R&D (BERD) to GERD at 56.6% in 2016


Investing in competitive cities and regional economic corridors



City Competitiveness Master Plan studies for the 4 major cities in progress and RM107.2 billion realised investment across 5 regional economic corridors

Performance of Focus Area and Game Changer

Various initiatives were implemented under the strategies outlined in the seven focus areas to re-engineer economic growth for greater prosperity. The highlight of key results by respective focus areas are as follows:


Focus Area	Key Result, 2016-2017
<div><p>Transforming Services</p></div>	<ul style="list-style-type: none">Cumulative value added of RM1,241.8 billionLabour productivity growth of 4.6% per annum compared with the targeted growth of 4.1% per annum in the Eleventh Plan8.8 million employed or 60.6% of the total employment in 2017Growth of services exports of 8.1% per annum compared with the targeted growth of 6.0% per annum in the Eleventh PlanContribution of knowledge-driven services subsectors to the total services sector value added was 31.8% in 2017 compared with 31.6% in 2015

The services sector recorded growth at 5.9% per annum during the review period, which is lower than the targeted growth of 6.9% per annum in the Eleventh Plan. The slow pace of growth was mainly due to low level of innovation and productivity improvement as well as the unfavourable oil market prices in 2016. Meanwhile, the share of the services sector to GDP increased from 53.6% in 2015 to 54.5% in 2017, which is on track to reach the target of 56.5% in 2020.

The performance of the services sector in 2017 was at 6.2% compared with 5.3% in 2015, driven by higher domestic consumption and exports of services. The wholesale and retail trade was the main contributor to the services sector value added, valued at RM211.3 billion in 2017 compared with RM185.3 billion in 2015 attributed to improved consumer sentiment and better labour market conditions. Meanwhile, the contribution of finance, insurance, real estate and business services subsector to


the services sector value added, stood at RM131.6 billion in 2017 compared with RM119.4 billion in 2015. This subsector benefitted from the strong pick-up in capital market activity, particularly from initial public offerings and corporate bond fundraising. In addition, the transport, storage and communication subsector contributed RM113.1 billion in 2017 to services sector value added compared with RM98.1 billion in 2015, supported by stronger trade, land and air passenger traffic growth as well as higher demand for data communication and computer services.

Malaysia received a total of 25.9 million international tourists in 2017, recording a 0.8% increase compared to 25.7 million in 2015, amidst stiff competition from other neighbouring countries in the ASEAN region. Tourist receipts grew 19.1% to RM82.3 billion in 2017 compared with RM69.1 billion in 2015. In addition, the average length of stay in 2017 for foreign tourists increased to 5.7 nights from 5.5 nights in 2015.

Focus Area	Key Result, 2016-2017
<div></div> <div>Energising Manufacturing</div>	<ul style="list-style-type: none">Cumulative value added of RM524.3 billionLabour productivity growth of 3.9% per annum compared with the targeted growth of 2.6% per annum in the Eleventh Plan2.4 million employed or 16.8% of the total employment in 2017Cumulative export of manufactured goods worth RM1,411.6 billionCumulative approved investment of RM122.2 billionTotal manufacturing value added at RM269.8 billion in 2017 compared with RM243.7 billion in 2015Trade surplus of manufactured exports at RM36.8 billion in 2017 compared with RM24.5 billion in 2015


The growth of the manufacturing sector at 5.2% per annum exceeded the targeted 5.1% per annum during the review period, supported by steady performance of exports and domestic-oriented industries. In 2017, the major contributors were the electrical and electronics (E&E) at 26.5%, chemical and chemical products 10.4% and transport equipment and other manufactures 11.8%, which collectively contributed 48.7% or RM131.4 billion of the manufacturing value added. Manufactured goods continued to register growth and dominated exports mainly as a result of

stronger external demand and partly due to the depreciation of the ringgit. In addition, domestic-oriented industries also expanded steadily due to robust construction activities and strong consumer demand. Meanwhile, total approved investment in the manufacturing sector remained resilient, driven by higher demand and improved business confidence among manufacturers. Higher labour productivity was recorded due to increased utilisation of new machineries and innovative technologies as well as improvements in the quality of the workforce and production processes.

Focus Area	Key Result, 2016-2017
<div><p>Modernising Agriculture</p></div>	<ul style="list-style-type: none">Cumulative value added of RM185.5 billionContribution of 8.4% to total exports in 2017 compared with 8.7% in 2015Growth of labour productivity declined by 1.8% per annum compared with the targeted growth of 3.6% per annum in the Eleventh PlanTotal value added of agro-based industry worth RM53.7 billion in 2017 compared with RM48.1 billion in 2015Share of industrial commodity subsector at 60.4% and agro-food subsector at 38.8% in 2017 compared with 61.8% and 37.4%, respectively, in 2015Food trade deficit increased to RM19 billion in 2017 compared with RM18 billion in 2015


Agriculture sector recorded a slower growth, 0.8% per annum compared with the target of 3.5% in the Eleventh Plan due to volatile commodity prices, major floods and the El-Nino phenomenon, which affected the yield and labour productivity during the review period. The share of agro-food subsector to the total agriculture value added increased marginally to 38.8% in 2017 and is unlikely to achieve the target of 42.4% in 2020. Investment in large-scale high value-added food crops was still relatively low due to the high-risk nature of investment in agriculture.

However, with the rebound of commodity prices in 2017, the average income of oil palm and rubber smallholders increased within the range of 36.9% to 87.2%, compared with 2015. In 2017, the income of commercial fishermen increased by 229.6%, largely attributed to the use of advanced technologies and bigger vessels, compared with 2015. In contrast, the income of traditional fishermen declined by 19.7% due to depleting coastal fishery resources, while the income of paddy farmers dropped by 40.1% in 2017 as a result of lower yield caused by adverse weather conditions.

Focus Area	Key Result, 2016-2017
<div><p>Transforming Construction</p></div>	<ul style="list-style-type: none">Cumulative value added of RM103.8 billionLabour productivity growth of 6.1% per annum compared with the targeted growth of 9.6% per annum in the 11th Plan1.3 million employed or 9.2% of the total employment in 2017Growth of construction exports of 0.4% per annumCumulative export of construction services worth RM8.2 billion



The construction sector remained the fastest growing economic sector with a growth rate of 7.1% per annum during the review period. However, the performance was below the targeted growth of 10.3% in the Eleventh Plan. The performance of this sector was mainly driven by civil engineering, which increased by 31.8%, from RM12.9 billion in 2015 to RM17 billion in 2017, due to implementation of large petrochemical, transport and utility projects. Furthermore, residential buildings recorded an increase of 11.3%, advancing from RM12.4 billion in 2015 to RM13.8

billion in 2017, while non-residential buildings grew by 1.6%, from RM12.8 billion in 2015 to RM13 billion in 2017. The small increase was mainly due to oversupply of office space and commercial complexes. In addition, several large public infrastructure and transportation projects contributed to the growth of the sector. The value of construction works done recorded an expansion of 20.5%, amounting to RM138.4 billion in 2017 compared with RM114.9 billion in 2015.

Focus Area	Key Result, 2016-2017
<div></div> <div>Growing Dynamic SMEs</div>	<div><ul style="list-style-type: none">Cumulative value added of RM840.9 billionContribution of RM167.4 billion or 17.3% to total exports in 2017 compared with RM147.8 billion or 19.0% in 2015Contribution of 66.0% of the total employment in 2017 compared with 59.0% in 2015Labour productivity growth of 3.7% in 2017 compared with 2.8% in 2015</div>

The value added of SMEs recorded a moderate growth of 6.2% per annum during the review period, which remained below the targeted rate of 9.3% in the Eleventh Plan. However, the value added growth of SMEs exceeded GDP growth of 5.1%, mainly driven by wholesale and retail trade, food and beverages, as well as rubber, oil palm and livestock subsectors. In terms of exports, SMEs contributed 17.3% in 2017, which is on track to achieve the target of 23% by 2020. According to the Economic Census 2016, SMEs accounted for 98.5% of total establishments, totalling 907,065 establishments. Among these, 89.2% was in the services sector, followed by manufacturing at 5.3%, construction 4.3%,

agriculture 1.1% and mining and quarrying 0.1%. Micro enterprises, which were constrained by limited financing, human capital and production capacity, contributed 18.6% to SMEs value added despite forming 76.5% of total SME establishments. Meanwhile, the services sector contributed 59.7% of the total SME contribution to value added and 8.7% of total exports in 2017. In addition, SMEs in the manufacturing sector accounted for 21.5% of the total SME contribution to value added and 8.2% of total exports. The smaller contribution of SMEs to GDP and exports during the review period calls for more efforts to grow dynamic SMEs in contributing to sustainable economic growth.

Focus Area	Key Result, 2016-2017
<div><p>Translating Innovation to Wealth</p><p>Game Changer</p></div>	<ul style="list-style-type: none">○ Malaysia ranked 37th in the Global Innovation Index in 2017 compared with 32nd in 2015○ 74 scientists and research engineers per 10,000 labour force in 2016 compared with 62 in 2015○ 2,519 of 14,673 patents and utility innovations filed locally by Malaysians○ Completed the Social Progress Assessment study as part of the social financing model○ Enterprise innovation enhanced through demand-driven research:<ul style="list-style-type: none">○ Provision of Commercialisation of Research and Development Fund and Technology Acquisition Fund benefitted 74 companies to enhance innovation and competitiveness○ 1,196 companies benefitted from collaboration through intermediaries, namely PlaTCOM Ventures, SIRIM-Fraunhofer programme, Steinbeis Malaysia Foundation and the Public-Private Research Network○ 40 industry-academia collaborative projects undertaken through Collaborative Research in Engineering, Science and Technology Centre○ Social innovation promoted through the whole-society approach:<ul style="list-style-type: none">○ Relational capital in social service delivery strengthened through 8 social intervention projects under the social public-private partnership fund and the introduction of a social financing model○ Innovation at the grassroots level encouraged through the implementation of 164 MOSTI Social Innovation projects as well as the Mainstreaming Grassroots Innovation Programme which created 10 prototypes for commercialisation

The percentage of gross expenditure on R&D (GERD) to GDP increased marginally from 1.3% in 2015 to 1.44% in 2016. A significant portion of the GERD was spent on field of research related to information, computer and communication technology at 42.2%, followed by engineering and technology 15.2% and natural sciences 9%. The marginal increase was due to the low R&D expenditure among SMEs as a result of lack of funding, skills and capacity. Furthermore, business expenditure on R&D (BERD) to GERD remained low at 56.6% in 2016. Hence, Malaysia’s ranking in the Global Innovation Index fell from 32nd position in 2015 to

37th in 2017 due to lower score in the business sophistication component, especially for the indicators of BERD and research talent. In addition, the number of patents and utility innovations filed locally by Malaysians remained low at 16.5% of the total filings as compared to the Asian countries average of 90.1% in 2016. The low number of applications filed locally by Malaysians was largely due to the long duration and high cost involved in the filing of intellectual property (IP) as well as concerns on the effectiveness of IP enforcement.

Innovation at the enterprise level was focused on improving demand-driven research primarily through industry-academia collaboration and provision of incentive in the form of partial grants to assist local companies in enhancing innovation and competitiveness. These efforts included promoting the adoption of state-of-the-art technology, improving production processes and productivity levels, promoting knowledge creation as well as creating innovative and high-value products. Meanwhile, innovation at the societal level was encouraged by strengthening collaboration through a whole-society approach as well as developing a social

financing model. Nevertheless, the achievement of targeted outcomes in research, development, commercialisation and innovation were limited despite the implementation of various efforts. This was due to the gap in collaboration between industry and academia, especially in the early planning stages of R&D activities. This has resulted in public-funded R&D projects that were not in line with industry demand. In addition, minimal efforts to commercialise such R&D projects contributed to the low return on investment as researchers were more focused on publishing scientific journals.

Focus Area	Key Result, 2016-2017
<div></div> <div>Investing in Competitive Cities and Regional Economic Corridors</div>	<div>Regional economic corridor development</div> <div><ul style="list-style-type: none">○ Contribution of RM107.2 billion of realised investment by regional economic corridors:<ul style="list-style-type: none">○ Iskandar Malaysia: RM41.8 billion○ East Coast Economic Region: RM22.5 billion○ Northern Corridor Economic Region: RM17.3 billion○ Sarawak Corridor of Renewable Energy: RM15.9 billion○ Sabah Development Corridor: RM9.7 billion○ 147,627 jobs created in regional economic corridors:<ul style="list-style-type: none">○ Iskandar Malaysia: 64,288 jobs○ East Coast Economic Region: 32,032 jobs○ Northern Corridor Economic Region: 24,200 jobs○ Sarawak Corridor of Renewable Energy: 19,354 jobs○ Sabah Development Corridor: 7,753 jobs</div> <div>Competitive cities</div> <div><ul style="list-style-type: none">○ City Competitiveness Master Plan studies for the 4 major cities scheduled to be completed by end-2018○ Economic density<ul style="list-style-type: none">○ Optimise the built environment through dynamic planning guidelines: Kuala Lumpur Structure Plan 2020, Sabah Structure Plan 2033, Sarawak Socioeconomic Transformation Plan and <i>Rancangan Tempatan Daerah Johor Bahru dan Kulai 2025 (Penggantian)</i></div>
<div></div> <div>Game Changer: Investing in Competitive Cities</div>	

Focus Area	Key Result, 2016-2017
	<ul style="list-style-type: none">Urban form<ul style="list-style-type: none">Completion of the MRT 1 and LRT 2 in Klang ValleyDevelopment of MRT 2Preliminary study on the development of the Bus Rapid Transit Iskandar Malaysia and Malaysia-Singapore Rapid Transit SystemOngoing feasibility study on the Bus Rapid Transit System for Kota KinabaluResource usage<ul style="list-style-type: none">Launch of Malaysian Carbon Reduction and Environmental Sustainability Tool (MyCREST) in 2016 for new buildings to promote the development of green buildingsEnforcement of waste separation at source in 6 states, FT Kuala Lumpur and FT Putrajaya encouraged waste recycling and supported waste to wealth initiativesHousing<ul style="list-style-type: none">177,554 units of affordable houses constructed (FT Kuala Lumpur – 100,650 units; Johor Bahru – 54,370 units; Kuching – 12,841 units; and Kota Kinabalu – 9,693 units)Industry focus<ul style="list-style-type: none">Launch of <i>Tabung Ekonomi Gagasan Anak Bumiputera Sarawak</i> (TEGAS) Digital Innovation Hub in KuchingLaunch of Iskandar Malaysia Comprehensive Development Plan II, 2014-2025Establishment of shared services and outsourcing (SSO) centre in Kota Kinabalu Industrial Park, SabahUrban services<ul style="list-style-type: none">Establishment of Urban Transformation Centres (UTCs) in 4 major cities (FT Kuala Lumpur – 3; Johor Bahru – 1; Kuching – 1; and Kota Kinabalu – 1) for better service deliveryLaunch of Kota Kinabalu free wi-fi as platform to spur e-government initiativesLaunch of Sarawak Pay mobile application to promote cashless payment

During the review period, several efforts were undertaken to develop competitive cities. In improving economic density, the structure and local plans in four major cities were revised to optimise the built environment and maximise the usage of underutilised plots of land in stimulating growth. Meanwhile, the construction of major transport infrastructure such as the Mass Rapid Transit 1 (MRT 1) and Light Rail Transit 2 (LRT 2) was undertaken to enhance urban form, facilitate movement of people and improve connectivity. In addition, efforts to improve resource usage include the enforcement of waste separation at source for efficiency in waste management. Moreover, affordable and quality housing was provided to further improve liveability at the four cities.

In improving industry focus, the *Tabung Ekonomi Gagasan Anak Bumiputera Sarawak* (TEGAS) Digital Innovation Hub was launched in Kuching, which hosted incubator programmes to develop ideas for commercialisation. Meanwhile, the establishment of the shared services and outsourcing (SSO) centre in Kota Kinabalu assisted SMEs to improve business efficiency and encourage entrepreneurship in the city. In addition, urban services was improved with the launching of Kota Kinabalu free wi-fi and Sarawak Pay mobile application, which contributed towards better service delivery, improved connectivity and access to information.

Efforts to promote and maximise the contribution of the major cities as growth catalyst were intensified. In this regard, studies to develop City Competitiveness Master Plans (CCMPs) are being conducted to identify key drivers of growth in four major cities, namely Federal Territory (FT) of Kuala Lumpur, Johor Bahru, Kuching and Kota Kinabalu. The CCMPs address seven principles and are scheduled to be completed by end-2018. These principles are economic density, transit-oriented development, knowledge-based clusters, liveability, green-based development and practices and inclusivity. The last principle, digital infrastructure for smart cities was added to enhance digitalisation.

A total of RM107.2 billion of investment has been realised¹ in the regional economic corridors during the review period, which represented about 45.4% of the total RM236 billion targeted under the Eleventh Plan. The realised investment target is expected to be achieved at the end of the Plan period. The investment has contributed towards positive economic growth in the regions. The good performance of the investment was mainly contributed by better facilitation of investors, supportive investment ecosystem and appropriate incentives provided in creating a competitive business environment in the regions.

Issues and Challenges

Several issues and challenges faced by the main economic sectors continued to hamper efforts towards sustained growth and greater prosperity. The issues and challenges are mainly related to human capital, technology and innovation, financing, exports and food security and safety as well as competitiveness of cities.

The services, manufacturing, agriculture and construction sectors are affected by the shortage and mismatch of **skilled workforce**, which hindered the shift towards knowledge-intensive activities. The situation is further exacerbated with continued over-reliance on low-skilled workforce as well as foreign workers, particularly in the wholesale and retail; transportation and storage; food and beverages and accommodation; textile and apparel; and furniture industry subsectors as well as construction and agriculture sectors. At the same time, capital investment for automated machinery and equipment in the above industries remains relatively low.

The **advancement of emerging new technologies** including blockchain, autonomous vehicle, artificial intelligence, augmented reality and advanced robotics, are causing unprecedented rate of technological changes and rapid pace of innovation. As a result, industries are confronted with the constant pressure to

¹ East Coast Economic Region Development Council (ECERDC), Northern Corridor Implementation Authority (NCIA) and Regional Corridor Development Authority (RECODA) define realised investment as total value of investment that has been committed with the commencement of the project. Meanwhile, Iskandar Regional Development Authority (IRDA) and Sabah Economic Development and Investment Authority (SEDIA) define realised investment as the value invested in the project for the current year or based on work completed.

reinvest in new production processes to cope with technological advancements and meet fast-changing preferences of consumers. The current slow pace of adoption and implementation of digital technology, new business models, Industry 4.0 initiatives and cyber security measures are hampering efforts in re-engineering economic growth.

Access to financing continues to remain a challenge, particularly for SMEs and agriculture-based businesses due to the inability to comply with the terms and conditions imposed by conventional financing system. There is also a lack of alternative financing mechanisms such as angel investors and crowdfunding to support the growth and development of small businesses. As for services sector, **exports** at firm levels are constrained by lack of financial strength, multi-disciplinary expertise and awareness of regulations in host countries. Total exports by SMEs continues to be relatively small due to the low level of export capacity and readiness, limited market access, insufficient innovative products and services as well as products that are non-compliant with international standards.

The concern over **food security and safety** gives rise to the need to ensure self-sufficiency levels of major agro-food commodities. Therefore, there is a need to intensify food production capacity to reduce the food import bill while improving affordability and accessibility. Productivity improvement in the agriculture sector is still lagging owing to various factors including inefficient

management of infrastructure and low adoption of modern technology as well as ageing farmers due to low participation of youth. In addition, inadequate extension and support services, ineffective programmes and implementation models, broad-based subsidies and the existence of monopoly or oligopoly in certain industries have led to low productivity and market inefficiency. Other issues that hampered growth of the sector are volatile international commodities prices, high production cost and adverse environmental effects such as major floods and the El-Nino phenomenon.

In enhancing **competitiveness of cities**, challenges faced by some of the major cities include lack of affordable housing, insufficient connectivity of public transport and traffic congestion. The rapid rate of urbanisation spurred by vibrant economic growth also poses challenges in ensuring all segments of the society enjoy greater liveability and quality of life. Meanwhile, the regional economic corridors face stiff competition in attracting foreign direct investment and shortage of skilled workers. The shortage of skilled workers to meet the industry demand will impede growth of the industry, as it creates hurdles to move up the value chain and attract large capital investment. At the same time, there are elements of duplication, such as the duplication of incentives offered by the Malaysian Investment Development Authority (MIDA) and regional economic corridor authorities in attracting foreign investments.

