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Energizing the Manufacturing Sector Can Malaysia Move Forward?

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The paper reviews and assesses the performance of the manufacturing sector in general, as well as the catalytic industries identified in the Eleventh Malaysia Plan (11MP), to ascertain whether the initiatives and targets proposed in the Plan are adequate to energize and move the sector forward. In doing so, the paper uses industrial policy arguments — market and government failures — to explain the slow progress of the sector. The findings suggest that market failures — in terms of lagging industrial capabilities and economies of scale, market frictions, lack of support for self-discovery by firms and diversification — require government intervention. Nevertheless, defying comparative advantage and identifying frontier products that show lacklustre performance to spearhead the sector under the Plan certainly require substantial improvements in institutional capabilities, coordination and institutional learning, while maintaining respect for markets and incentives. The paper concludes that lack of recognition to address government failures limited the success of policies implemented.

Keywords: Manufacturing, industrial policy, market failures, government failures, Malaysia.

1. Introduction

The Malaysian economy has witnessed significant transformation over the past half century. The manufacturing sector, more specifically, has historically played an important role in the economy, contributing prominently towards employment, exports and gross domestic product (GDP), as well as promoting positive structural change in Malaysia. Being a small open economy, the country has promoted manufacturing exports

with a range of policy measures to attract foreign direct investment (FDI) into the country, including export processing zones (EPZs) (Leinbach 1982; Johansson and Nilson 1997), initiated since 1971, and the Promotion of Investment Act (PIA 1986). This resulted in unprecedented growth of the manufacturing sector in the 1980s and 1990s (Tan and Ariff 2001). Nevertheless, things took a turn when the manufacturing sector began to show signs of slowdown in the late 1990s, following a decline in

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