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## STAGNANT WAGES AND THE SQUEEZE ON LIVING STANDARDS IN MALAYSIA: CONCEPTUAL INSIGHTS

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### Abstract:

This conceptual paper investigates the persistent challenge of wage stagnation in Malaysia's rapidly evolving economy. Despite achieving remarkable economic growth and structural transformation since the 1980s, Malaysia faces a critical disconnect between productivity gains and real wage growth. Our analysis reveals systemic barriers to equitable income distribution. Building on existing theory and evidence, we develop an integrated conceptual model of wage determination in Malaysia's context. The findings highlight the dual impact of Malaysia's heavy reliance on low-skilled foreign workers and its weak collective bargaining systems in suppressing wage growth, particularly in labor-intensive sectors. The paper further reveals how current economic policies favoring capital-intensive development have inadvertently created systemic barriers to equitable income distribution. Building on existing theoretical frameworks and empirical evidence, this study proposes an integrated conceptual model that captures the complex dynamics of wage determination in Malaysia's unique economic context and necessitate urgent policy reform—targeting skill mismatches, strengthening wage-setting mechanisms, and rebalancing capital-labor power dynamics—to break the stagnation cycle.



## Introduction

The analysis of wage growth dynamics is crucial for understanding macroeconomic stability and income inequality within an economy. In recent decades, numerous developed and developing nations have observed a concerning trend of wage stagnation, leading to significant implications for household welfare and overall economic development. This phenomenon is particularly pertinent in Malaysia, where despite sustained economic growth and structural transformation from an agriculture-driven to a services-driven economy since 1987, real wages have exhibited persistent sluggishness, raising questions about the equitability of growth benefits (Rahman & Schmitten, 2023). This persistent regime of low wages may have profound negative long-term consequences on the Malaysian economy, potentially impeding the nation's aspiration to transition into a high-income economy between 2024 and 2028 (Hassan et al., 2023; Fontanari & Palumbo, 2022).

Wage stagnation has emerged as a pressing economic issue in Malaysia, raising concerns about workers' living standards, income inequality, and long-term economic growth. Despite steady economic expansion and productivity gains over the past decade, real wage growth for many Malaysian workers has remained sluggish, failing to keep pace with rising living costs (Department of Statistics Malaysia [DOSM], 2023; Bank Negara Malaysia [BNM], 2022). This stagnation disproportionately affects middle- and lower-income earners, exacerbating financial strain and limiting upward mobility (Ministry of Economy, 2023; World Bank, 2021).

Several key indicators highlight the severity of stagnant wages in Malaysia. Official data reveal that median and mean wage growth has consistently lagged behind inflation, particularly in labor-intensive sectors such as manufacturing, agriculture, and low-skilled services (DOSM, 2023; Khazanah Research Institute [KRI], 2022). Additionally, Malaysia's wage-to-GDP ratio remains low compared to regional peers, indicating that workers are not fully benefiting from economic progress (International Labour Organization [ILO], 2022). Structural factors, including skill mismatches, reliance on low-cost labor, and weak collective bargaining power, further contribute to wage stagnation (BNM, 2022; Lee & Lee, 2021).

This study aims to investigate the determinants of wage growth in Malaysia, focusing on the factors contributing to this stagnation, including the role of foreign direct investment, the unemployment rate, and the presence of foreign workers. To accurately capture the nuances of wage dynamics, this study will proxy wage growth with the inflation rate, as it reflects the purchasing power of earnings and offers a more robust measure of real wage changes (Hii & Lau, 2025). Our conceptual framework enables a more precise examination of the economic conditions affecting the actual earnings of the workforce, thereby providing a comprehensive basis for evaluating the drivers of wage stagnation (World Bank, 2024).

## Literature Review

This section delineates the theoretical underpinnings of wage determination, beginning with an exploration of the Phillips Curve, which posits an inverse relationship between unemployment and inflation. Subsequently, an empirical review will delve into prior research examining the relationship between the dependent variable (wages, proxied by inflation) and the independent variables (unemployment rate, gross domestic product, foreign direct investment, and foreign workers) as specified in research model, providing a comprehensive overview of existing findings on wage determinants in Malaysia (Fung & Nga, 2023 ; Hii & Lau, 2025).

The theoretical discussion on the Phillips Curve will provide a foundational understanding of the macroeconomic trade-offs that influence wage dynamics, particularly in the context of inflationary pressures and employment levels. Conversely, the empirical review will synthesize the various quantitative findings that have explored how factors like foreign direct investment, unemployment rates, gross domestic product, and the influx of foreign workers collectively influence wage growth in Malaysia (World Bank, 2024). The integration of these theoretical and empirical perspectives will thus offer a robust framework for analyzing the complex interplay of factors shaping wage trajectories within the Malaysian economic landscape. Furthermore, this comprehensive framework will enable the identification of critical policy levers that could potentially alleviate wage stagnation and foster more equitable economic growth in Malaysia.

The current understanding of wage determinants is crucial, especially when considering the complex interplay between macroeconomic indicators and labor market conditions. This is particularly relevant for Malaysia, where understanding how variables like the unemployment rate, gross domestic product, foreign direct investment, and the presence of foreign workers impact wage growth (W) is essential for effective policy formulation, especially given the observed wage stagnation (Zulkefli et al., 2020). The persistent issue of graduate unemployment and labor market mismatches, despite relatively low overall unemployment, highlights the need for a more nuanced examination of how these factors influence wage development (Khoo et al., 2022 ; Kadir et al., 2020). Specifically, the relationship between inflation and unemployment, often described by the Phillips Curve, is a central tenet in understanding the macroeconomic forces shaping wage growth (Tanjung & Siswanto, 2022). In this regard, while the Phillips Curve suggests a trade-off between inflation and unemployment, its applicability and validity in the Malaysian context, particularly concerning wage growth, warrant rigorous empirical scrutiny given the observed disconnect between economic growth and real wage improvements (Kinuithia, 2022; Azam et al., 2022).

Moreover, the impact of labor market slack and institutional factors on wage dynamics necessitates a deeper analysis to explain the persistent decoupling between labor compensation and productivity observed in many economies, including potentially Malaysia (Meloni & Stirati, 2022). This study, therefore, seeks to bridge these gaps by empirically analyzing the determinants of wage growth in Malaysia, particularly focusing on the implications of the identified variables in research model, and drawing upon both theoretical models and empirical evidence to provide a comprehensive understanding of the factors contributing to stagnant wages. Such an investigation is paramount for informing evidence-based policy interventions aimed at fostering sustainable and inclusive economic development. Moreover, this research will contribute to a more comprehensive understanding of how specific economic indicators

interact to influence wage growth, thereby offering valuable insights for policymakers grappling with similar challenges in other developing nations.

## Methodology

### Source of Data

Secondary data was suggested to conduct this study following Hassan et al., 2023 and Autor et al (2003). Data on wages, unemployment rate, growth domestic product (GDP), foreign direct investment, and share of foreign worker, will be sourced from the Department of Statistics Malaysia and The World Bank Indicator. Time series data is used from 1994 to 2024, with the number of observations amounting to 30 years, based on data availability. The wages is proxied by real wages growth (%), sourced from DOSM wage surveys, to ensure direct measurement of labor compensation. unemployment rate is proxied by unemployment, total (% of the total labour force). GDP is proxied by GDP growth, foreign direct investment is proxied by foreign direct investment, net inflows (% of GDP), foreign worker is proxied by share of foreign workers (% of total employment).

### Model Specification

The models and their determinants are as below:

$$W_t = \beta_0 + \beta_1 W_{t-1} + \beta_2 UR_t + \beta_3 GDP_t + \beta_4 FDI_t + \beta_5 FW_t + \varepsilon_t \quad (1)$$

where;

W = wages, UR = unemployment rate, GDP = gross domestic product, FDI = foreign direct investment, FW = foreign worker,  $\beta$  = coefficient,  $\varepsilon$  = error term.

### Long-Run Cointegration Relationship

Autoregressive Distributed Lag (ARDL) bound test approaches were used to regress the data since ARDL can handle both I(0) and I(1). Developed by Pesaran et al. (2001), the ARDL bounds test identifies long-run and short-run relationships among variables. The model integrates an error correction mechanism (ECM), enabling direct estimation of the speed at which variables adjust to long-run equilibrium following a shock. This feature is particularly valuable in labor market studies, as it quantifies how quickly indicators like unemployment return to steady-state levels after short-term fluctuations. To test for cointegration, the computed F-statistic is compared against the critical values provided by Pesaran et al. (2001). The long-run relationship is assessed using the following hypothesis:

$H_0 = \lambda_1 = \lambda_2 = \lambda_3 = \lambda_4 = \lambda_5$  (no cointegration)

$H_1 = \lambda_1 \neq \lambda_2 \neq \lambda_3 \neq \lambda_4 \neq \lambda_5$  (cointegration exists)

If the calculated F-statistics exceed the upper bound critical value I (1), it shows evidence of the existence of a long-run relationship, thus rejecting the null hypothesis. If the F-statistics is smaller than the lower bound I (0), it shows no existence of a long-run relationship, thus failing to reject the null hypothesis. However, if the F-statistics lies in between the upper and lower bound, it results in inconclusive.

**Long Run And Short Run Coefficient**

If the result shows the presence of a long-run cointegration relationship between variables then the long-run cointegration model can be estimated as follows:

$$W_t = \beta_0 + \sum_{i=1}^k \alpha_1 W_{t-i} + \sum_{j=0}^l \alpha_2 \Delta UR + \sum_{j=0}^l \alpha_3 \Delta GDP_{t-j} + \sum_{j=0}^l \alpha_4 \Delta FDI_{t-j} + \sum_{j=0}^l \alpha_5 \Delta FW_{t-j} + \varepsilon_t \quad (2)$$

Once the long-run coefficient was estimated, to find the short-run coefficient and the speed of adjustment that drove the variables back to the long-run equilibrium, the Error Correction Model was regressed as below:

$$\Delta W_t = Y_0 + \lambda ect_{t-1} + \beta_1 W_{t-1} + \beta_2 UR_{t-1} + \beta_3 GDP_{t-1} + \beta_4 FDI_{t-1} + \beta_5 FW_{t-1} + \sum_{i=1}^k \alpha_1 W_{t-i} + \sum_{j=0}^l \alpha_2 \Delta UR_{t-j} + \sum_{j=0}^l \alpha_3 \Delta GDP_{t-j} + \sum_{j=0}^l \alpha_4 \Delta FDI_{t-j} + \sum_{j=0}^l \alpha_5 \Delta FW_{t-j} + \varepsilon_t \quad (3)$$

where  $l$  and  $j$  are the lag based on the selected lag length in the long-run equation and  $[ect]_{(t-1)}$  is the error correction term.  $\lambda$  is speed of adjustment that drives the variables back to the long-run equilibrium.  $\lambda$  also, should be negative and significant.

**Discussion**

The persistent issue of wage stagnation in Malaysia presents a complex challenge that intertwines economic growth, labor market dynamics, and structural inefficiencies. Despite the country's steady macroeconomic progress and transition toward a services-driven economy since the late 1980s (Rahman & Schmillen, 2023), real wages have remained sluggish, particularly for middle- and lower-income workers (DOSM, 2023; World Bank, 2021). This disconnect suggests that the benefits of economic expansion are not being equitably distributed, raising concerns about long-term social and economic sustainability (Ministry of Economy, 2023). The reliance on low-cost foreign labor, coupled with skill mismatches and weak wage-setting institutions, appears to have created a structural bottleneck that suppresses wage growth even as productivity improves (BNM, 2022; KRI, 2022).

Theoretical frameworks such as the Phillips Curve provide a foundational understanding of the trade-offs between inflation and unemployment (Tanjung & Siswanto, 2022), yet Malaysia's unique labor market conditions suggest that traditional models may not fully capture the nuances of wage stagnation. For instance, the influx of foreign workers has introduced segmented labor markets, where domestic wages in certain sectors remain depressed due to the availability of cheaper alternatives (Hii & Lau, 2025). Meanwhile, foreign direct investment (FDI), while driving productivity gains (Hassan et al., 2023), has not consistently translated into higher wages, particularly in industries dominated by capital-intensive rather than labor-intensive activities (ILO, 2022). These dynamics highlight the need for a more nuanced examination of how global and domestic factors interact to shape wage trends (Lee & Lee, 2021).

Furthermore, the decoupling of wages from productivity growth signals deeper institutional weaknesses (Fontanari & Palumbo, 2022). In advanced economies, strong labor protections and collective bargaining mechanisms often ensure that productivity gains are shared with workers (Meloni & Stirati, 2022). In contrast, Malaysia's labor market policies have yet to fully address these imbalances, leaving workers vulnerable to stagnating incomes despite their contributions to economic output (World Bank, 2024). Addressing these issues requires not only macroeconomic adjustments but also targeted interventions to enhance skills (Vinayan et al., 2020), reduce dependency on low-wage foreign labor (World Bank, 2024), and strengthen wage-setting institutions (Lee & Lee, 2021).

## Conclusion

Wage stagnation in Malaysia represents a critical challenge that threatens both economic equity and long-term development. The persistent gap between productivity gains and real wage growth reveals systemic weaknesses in how economic benefits are distributed across society. While Malaysia has achieved impressive macroeconomic growth, this progress has not translated into proportional improvements in workers' living standards, particularly for middle- and lower-income groups.

The analysis suggests that multiple interconnected factors contribute to this phenomenon. Structural issues in the labor market, including skill mismatches and heavy reliance on low-cost foreign workers, create downward pressure on wages. Institutional factors such as weak collective bargaining mechanisms further exacerbate the problem by limiting workers' ability to negotiate fair compensation. These challenges are compounded by economic policies that prioritize capital investment over labor welfare.

Addressing wage stagnation requires fundamental reforms across several dimensions. Labor market policies need reorientation to better align wages with productivity, while education and training systems must adapt to meet evolving skill demands. Reducing dependence on low-wage foreign labor and strengthening worker protections could help rebalance power dynamics in wage determination.

Future research should empirically test these relationships to provide policymakers with concrete evidence for reform. The conceptual framework presented here offers a starting point for understanding Malaysia's wage stagnation puzzle, but deeper investigation is needed to develop targeted solutions. Ultimately, breaking the cycle of wage stagnation is essential not just for improving living standards, but for ensuring Malaysia's transition to a more equitable and sustainable economic model.

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