THE ECONOMIC IMPACT OF IMMIGRATION ON PRODUCTIVITY IN MALAYSIA

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ABSTRACT

The main purpose of this study is to investigate the impact of immigration on productivity in major sector (construction sector and manufacturing sector) of Malaysia, using annual time series data covering the period from 1982 to 2012. Time series analysis applied in this study. In this study, Cobb-Douglas production function is used to derive the model specification. The conclusions are: first, the significance of the variables in first difference for both construction sector and manufacturing sector reveal that they are stationary in first difference. Second, the results show no-cointegration between the variables in both sectors, which indicates that there is no strong evidence for long term relationship. Third, through Granger causality test, the results reveal that there is bidirectional causality in manufacturing sector and no causality existing in construction sector. This means that there is a positive impact of migrant labors on labor productivity in manufacturing sector. On the other hand, construction sector is much more depending on domestic labors in Malaysia. Some policies have been recommended in this study that could be carried out by the government to support the sustainable economic development in the future.

Key words: Construction sector, manufacturing sector, Malaysia, migrant labor, domestic labor.
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1.0 Introduction

Due to absence of universally accepted definitions, the usage of migration terms is varies from country to country. However, there are numbers of people, including governments of both receiving and sending countries, border authorities and police, non-governmental and governmental organizations, even migrants themselves are concern with the issues of migration (Perruchoud, R., 2004). The history of migration can be trace back to the beginning of human civilization.


<table>
<thead>
<tr>
<th>Ethnic, %</th>
<th>1970</th>
<th>1991</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bumiputera</td>
<td>55.6</td>
<td>58.7</td>
<td>60.3</td>
</tr>
<tr>
<td>Chinese</td>
<td>33.9</td>
<td>26.3</td>
<td>22.9</td>
</tr>
<tr>
<td>Indians</td>
<td>9.0</td>
<td>7.5</td>
<td>6.8</td>
</tr>
<tr>
<td>Others¹</td>
<td>1.5</td>
<td>7.5</td>
<td>10.0</td>
</tr>
<tr>
<td><strong>Total (Million)</strong></td>
<td><strong>10.4</strong></td>
<td><strong>18.6</strong></td>
<td><strong>28.3</strong></td>
</tr>
</tbody>
</table>

Source: Department of Statistic
*¹ include non-Malaysian citizen

Recent years, immigration issues has been one of the most important topic in Malaysia (Athukorala, P. and Devadason, E. S., 2011). The most obvious evidence that can be seen in Malaysia is the multiracial population with more than 70 identified ethnic groups which was due
to the earlier immigration at the nineteenth and twentieth century (Mahari, Z., 2011). From the table 1, Bumiputera (inclusive of Malay and Indigenous) is the main ethnic in Malaysia, followed by Chinese and Indians. In the case of others (include non-Malaysian citizen), the increase of rate was due to the increase in foreign labors, which is from 1.5 % to 10%.

There are various reasons that cause people to migrate internally and externally such as pursue for better environment and employment opportunities, further study in advance countries, increase the living standard and etc. The top reasons for migration of population in Malaysia in year 2010-2011 is following family members, followed by work-related, environment, education and so on (Table 2).

Table 2: Reasons for Migration of Population in Malaysia in Year 2010–2011.

<table>
<thead>
<tr>
<th>Reasons for Migration</th>
<th>2010-2011</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number ('000)</td>
<td></td>
</tr>
<tr>
<td>Follow family member</td>
<td>258.2</td>
<td>41.8</td>
</tr>
<tr>
<td>Work-related:-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Job transfer/Start new job</td>
<td>108.2</td>
<td>17.5</td>
</tr>
<tr>
<td>Seeking Work</td>
<td>17.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Resign/Retire</td>
<td>9.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Environment</td>
<td>131.8</td>
<td>21.3</td>
</tr>
<tr>
<td>Education:-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Start Schooling</td>
<td>34.2</td>
<td>5.5</td>
</tr>
<tr>
<td>Complete Schooling</td>
<td>4.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Marriage and Divorce:-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marriage</td>
<td>33.3</td>
<td>5.4</td>
</tr>
<tr>
<td>Divorce</td>
<td>1.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Others</td>
<td>19.4</td>
<td>3.1</td>
</tr>
<tr>
<td>Total</td>
<td>618.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Immigration plays different roles and creates different impacts on countries. In the theory of development, labor migration is very important in supporting countries’ developmental activities such as the existence networks and maintenance of linkages between countries until social support of families and consumption needs (Dannecker, P., 2007). Skilled and professional migrants offer a comparative advantage in enriching a country’s position in the global political economy. Labor migration as critical ingredients is vital for the establishment and development of plural cultures (Idris, A., 2012). In general, there is a growing recognition that migration can improve the economy development of the country.

Migration is expected to influence the productivity of the country (Tadora, M. P., 1980). The difference in skill profiles of potential migrant labors will affect the level of productivity. The average level of productivity will tend to be lower if immigrants consist of individuals who are not professional compare to native labor. On the other hand, immigration on potential output will be smaller if immigrants tended to be more skillful. The contributions of the immigrants in difference industry will also have impact on the productivity growth. Hence, immigration had attracted the awareness of policy makers and researchers as they believed to be strongly affecting the demographic, social, and economic situation in both sending and receiving countries.

Labor productivity can be used as an indicator in measuring economic performance and labor productivity growth is likely to be affected by the immigrants. Immigration is often said to be able to increase the productivity and to enable the country to compete successfully internationally (Grady, P., 2010). Hence, productivity is the most important driver of living standards in the countries as high productivity growth means the country is able to meet the economic pressures connected with an aging population (Sharpe, A., 2010).
1.1 Productivity and Recent Immigration of Malaysia

The impact of immigration on productivity is depending on the skills level of labor and ability of labor to utilize the skills effectively. The contribution and innovation of immigrant labors may help in improving the productivity of a country. The impact of immigration measured productivity is depending on the occupations and industries where immigrant labors are employed. If the immigrant labors are mostly employed in lower productivity industries, this may reduce the productivity of the nation as it raise the number of labors in lower productivity industries. However, at the same time, this situation will increase the productivity of every individual in the economy if immigrants and native workers are complementary.

From many recent studies, most of the literatures are focused on wages and employment impacts on labors. Wages has long term been used as an indicator of labor productivity as they reflect the value added of workers. Differences of wage could be in part of reflecting labor demand and supply imbalances. Immigrant labors have created opportunities for industries because immigrant labors are usually paid less compare to native labors with similar characteristics and skills. Therefore, the cost-savings on immigrant labors act as an increase in productivity for industries (Peri. G., 2012).

During 1980s and early 1990s, rapid economic growth had resulted in high demand for labor which could not be met locally. Figure 1 had showed the increase demand for foreign labor in Malaysia during the earlier years. The shortage of labors especially in manufacturing, agriculture, service and construction sectors prompted the Malaysian government to introduce the policy on the employment of foreign labors as early as 1981.
During the year between 1980 and 1990, there was a shift in industrial transformation to become more export substitution industrialization and involved in foreign direct investment. The outcome of result had showed a high rate in employment growth and economic growth in the country which the labor markets could not offered (Jantan, N. and Nair, P.L., 2006). Due to the booming modern industries, native labors had taken up the opportunities of employment. This had also given the opportunity for migrant labors in penetrating the modern sector of the economy. The first industry that experience labor shortage was agriculture sector and followed with the manufacturing sector and construction sectors. Migrant labors from neighboring nations had come to Malaysia to search for employment in these industries. As a result, Malaysia has become the largest labor importer in Asia from late 1990s (Athukorala, P., 2006; Ducane, G. and Abella, M., 2008). Therefore, since the formation of Malaysia until today, migrant labor has played a major part in country’s development.
The immigrants in Malaysia are mostly originated from Asia, Africa and Eastern Europe (Agus, M.R., 2000). Initially, the immigrants are mainly from the neighboring country that is from Indonesia (Athukorala, P. and Devadason, E.S., 2011). However, over period of time, the recruitment network has expanded to other countries such as Bangladesh, Nepal, Philippines, Vietnam, India, Sri Lanka, Pakistan, Burma, Thailand, Timor Leste, Uzbekistan, Kazakhstan and Turkmenistan (Ramasamy, P., 2004). They either entered into Malaysia illegally or vice versa. Government had tried to manage the inflows due to several source-country composition of labor supply. Table 3 outlines the total numbers and percentages of immigrant labors in Malaysia by country of origin from 2004-2010.

### Table 3: Numbers of Migrant Labors in Malaysia by Country of Origin, 2004-2010.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>1,024,363</td>
<td>69.7</td>
<td>1,174,013</td>
<td>62.8</td>
<td>1,085,658</td>
<td>52.6</td>
<td>918,000</td>
<td>50.9</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>54,929</td>
<td>3.7</td>
<td>62,669</td>
<td>3.4</td>
<td>316,401</td>
<td>15.3</td>
<td>310,000</td>
<td>17.2</td>
</tr>
<tr>
<td>Thailand</td>
<td>5,463</td>
<td>0.4</td>
<td>13,811</td>
<td>0.7</td>
<td>21,065</td>
<td>1</td>
<td>15,000</td>
<td>0.8</td>
</tr>
<tr>
<td>Philippines</td>
<td>16,663</td>
<td>1.1</td>
<td>24,088</td>
<td>1.3</td>
<td>26,713</td>
<td>1.3</td>
<td>26,000</td>
<td>1.4</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1,156</td>
<td>0.1</td>
<td>11,551</td>
<td>0.6</td>
<td>21,278</td>
<td>1</td>
<td>21,000</td>
<td>1.2</td>
</tr>
<tr>
<td>Other</td>
<td>367,516</td>
<td>25</td>
<td>583,077</td>
<td>31.2</td>
<td>591,481</td>
<td>28.7</td>
<td>513,200</td>
<td>28.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,470,090</td>
<td>100</td>
<td>1,869,209</td>
<td>100</td>
<td>2,062,596</td>
<td>100</td>
<td>1,803,200</td>
<td>100</td>
</tr>
</tbody>
</table>


Economic Report 2010/2011 by the Finance Ministry had revealed that there were around 1.8 million of migrant labors registered in Malaysia. In manufacturing sector, 38.2% of migrant
labors were employed, followed by 16% in the construction sector and 14.2% in the plantation sectors. The highest number migrant labor that registered in Malaysia is from Indonesia which was 50.9%. Followed by migrant labors that coming from Bangladesh, which was 17% of the total migrant labors in Malaysia. The immigrant labors have undeniable in contributing to the Malaysia economic growth and improving the labor shortages in every sector.

Development inconsistency between Malaysia and its neighboring countries had become an attraction for migrant labors in seeking employment and go for better life (Aziz, A.R.A. et al., 1999). As the supply demand and labor markets for goods and products increase gradually, contribution for a larger workforce is essential. The gross domestic product (GDP) of Malaysia had improved more than 10% during the year 2010 due to influx of migrant labors (Talib, K.A. at. el., 2012). Lewis (2006) had stated that recognizing the cause of productivity to be higher or lower will lead to understanding of county’s economic performance. Evaluating the performance of individual industries is vital in order to as it is important to understand the productivity of the country (Lewis, 2006). As the domestic production constantly increases, there will be attraction of capitalists to bring in more low-priced labors into the industries. Consequently, the expansion of economic will increases the numbers of immigrant labors in Malaysia.

1.2 Major Sector in Malaysia

Malaysia, known as a middle-income country, has changed from a manufacturer of raw materials into an emerging multi-sector country since 1970s. Malaysia is striving to become high-income country by 2020 and attempt to boost the value-added production chain by attracting
more investors to invest in certain field such as Islamic finance, biotechnology, high technology industries and services.

Malaysia’s economy still constantly steps forward at a rate of 5.1% during the year 2012 as from 4.7% in 2011 without affected much by the global economic condition (Economic Report, 2012/2013). Strong private consumption and investment presently sustained the economy together with leading financial market conditions, stable prices and constructive labor market. Currently, Malaysia’s economy is determined by domestic demand. Private consumption grew in tandem with stable employment, income and lower inflation. Besides that, government policies such as the Tenth Malaysia Plan (2011-2015), Economic Transformation Programmed (ETP) and the 2013 National Budget had taken part in a vital role in sustaining the economic growth.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Change (%)</th>
<th>Share of GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>2.2 4.0 0.4 2.1 4.7 4.1</td>
<td>7.6 7.5 7.7 7.3 7.3 7.2</td>
</tr>
<tr>
<td>Mining</td>
<td>3.3 -0.8 -3.8 0.2 -2.4 2.5</td>
<td>8.4 8.1 7.7 7.0 6.5 6.2</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3.1 1.3 -9.4 11.4 4.5 4.5</td>
<td>30.1 29.1 26.6 27.6 27.5 27.2</td>
</tr>
<tr>
<td>Construction</td>
<td>4.6 2.1 5.8 5.1 3.4 7.0</td>
<td>3.0 3.0 3.3 3.3 3.2 3.2</td>
</tr>
<tr>
<td>Service</td>
<td>9.7 7.2 2.6 6.8 6.4 6.5</td>
<td>53.6 55.0 57.6 57.7 58.4 58.9</td>
</tr>
</tbody>
</table>

*e = estimate, f = forecast

Service sector follow by manufacturing sector playing a stronger role in supporting Malaysia's economy. Service sector has surpassed manufacturing sector and become the main contributor to the economy. The service sector had an estimate increase of 6.4% in 2011 with
of GDP 58.4% (Table 4). Government has targeted service sector in order to bring in new capital, technology and expertise, create employment and new opportunities for joint ventures between foreign and domestic services.

Compare to service sector, manufacturing sector has an estimate increase of 4.5% with 27.5% share. Manufacturing sector is labor demanding and is a high yield investment opportunity in Malaysia. The development of Malaysia’s economic is determined by export orientated manufacturing sector which creates the best option for foreigners to take part in investment in the industry.

Besides manufacturing sector, agriculture sector is also labor intensive and reducing the unemployment rate in Malaysia. The major crops such as cocoa, rubber and oil palm are produced and exports which consequently contributes to national GDP in Malaysia. Based on statistic in table 3, agriculture sector had an estimated raise of 4.7% in GDP during 2011.

Construction sector is important in generating wealth for the country and civilizing the standard of living from socio-economic policies into social and economic infrastructure and buildings through the government’s transformation. It also provides job opportunities in Malaysia. Construction sector is known as a substantial economic driver for Malaysia due to the amount of sectors linked to it such as manufacturing, professional services, financial services and so on.

From table 5, manufacturing sector had the highest distribution of migrant labor followed by agriculture sector, construction sector and service sector. In this study, due to the limit of data in agriculture sector, construction sector and manufacturing sector were chose for investigation as most of the migrant labors are concentrated in these sectors. The research is constructed to
determine whether Malaysia is still depending on migrant labors to sustain economic growth in both sectors.

Table 5: Distribution of Migrant Labors by Sector in Malaysia.

<table>
<thead>
<tr>
<th>Year</th>
<th>Construction</th>
<th>Manufacturing</th>
<th>Agriculture</th>
<th>Service</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>25,100</td>
<td>23,700</td>
<td>115,800</td>
<td>76,000</td>
<td>172,200</td>
</tr>
<tr>
<td>1995</td>
<td>64,800</td>
<td>115,700</td>
<td>173,000</td>
<td>124,000</td>
<td>477,500</td>
</tr>
<tr>
<td>2000</td>
<td>68,603</td>
<td>307,504</td>
<td>200,160</td>
<td>54,075</td>
<td>630,342</td>
</tr>
<tr>
<td>2005</td>
<td>281,362</td>
<td>580,876</td>
<td>471,962</td>
<td>159,741</td>
<td>1,493,941</td>
</tr>
<tr>
<td>2008</td>
<td>307,327</td>
<td>728,096</td>
<td>521,837</td>
<td>212,447</td>
<td>1,769,707</td>
</tr>
</tbody>
</table>

Source: Department of Statistic and Department of Immigration

1.3 Malaysia Migration Policy

Malaysia’s migration policy is governed under the Immigration Regulation 1963 and Immigration Act 1959/63. There are some criteria and processes have to be observed under the Passports Act 1966 for entering into the Malaysia. Both two category of migrants, temporary migrants and permanent migrants have their own policy.

1.3.1 Temporary Migrants

A temporary migrant whose include students, tourists, business people, foreign labors as well as those who have the contribution to the development of international relations such as participants in exchange program and diplomatic personnel. Immigration facilitation will be given according the purpose of entry.
The category of passes will be issued to migrant according to Regulations 1963 for the purpose of providing permit for the migrant to enter and stay temporarily in Malaysia such as dependent’s pass, visit pass, employment pass, student pass, transit pass, landing pass and special pass. By focusing to the provisions of the regulations, the Controller (Immigration Officer) will judge for issuance of any pass.

1.3.2 Permanent Migrants

As for the permanent migrants, the Entry Permit is issued for those who wish to stay in Malaysia but are not a citizen of Malaysia. The Immigration Acts 1959/63 was governed in issuance of Entry Permit. There will be exemption for those who wants to apply for employment or other purposes as they already have been issued with Entry Permits. The permit will be issued with a Permanent Resident Status.

1.4 Problem Statement

The preference of the employers in choosing the migrant labors rather than local labors had become one of the problem that Malaysia facing. This is due to the willingness of immigrants to get a low wages compare to natives. Therefore, domestic labors will have to choose the job that had been offered with lower wages. Otherwise, they have to remain competitive with other labors or undergo higher unemployment. Moreover, the increase of immigration has increase the supply of labor. The basic economic theory has forecast that as immigration increase, the wages
of those in competition with immigrants will decline. This is because there will be numbers of workers competing for jobs.

Brain drain or emerging of skilled labors and professionals has long been a subject of debate. Malaysia face severe brain drain in its labor force. Although Malaysia has already experienced brain drain in early 1960s, this situation are still rising in recent years. There is an alarming of the outflow of human capital for Malaysia as the outflow is at a higher rate compare to other countries. The high percentage of this outflow is skilled labors (Jauhar, J. and Yusoff, Y.M., 2011). According to a recent parliamentary report, there are more than 139 thousand Malaysians left the country in 2007. The figure is more than doubled to 304 million in between March 2008 and August 2009. The outflow of people have included an estimated of 50 thousand students who left the country to study abroad during that period (Kanapathy, V., 2010). The main reasons of the loss of quality and skilled labor forces was due to better education, career and business prospects that available in the overseas (Jauhar, J. and Yusoff, Y.M., 2011). In addition, the lack of education opportunities is one of the biggest reasons for Malaysia’s Brain Drain.

The rapid industrialization and strong growth in the economy had resulted in labor shortage in every sector. It is of little comfort that neighbor’s countries are able to attract some skilled talent labors through immigration-friendly policies, open environments and rewards. However, Malaysia is only able to attract low-skilled foreign labor. It is estimated that there are around 2.5 million foreign labors that are both legal and illegal in Malaysia during year 2011. They are all largely holding basic jobs in manufacturing sector, agriculture sector, construction sector and low-paying service sectors (Jauhar, J. and Yusoff, Y.M., 2011).
Illegal immigration issues presently have also become one of the serious problems in Malaysia. The illegal migrants are largely from Indonesia, Thailand and Philippines (Kassim, A., 1987). The illegal immigration had come across with lots of problem as the migrant labors are often paid in very low wages, their housing quarters are overcrowded and they hardly received any health care services. This had result in increasing in crime cases in Malaysia such as smuggling, human trafficking, raping and etc (Alice, H. L., 2012).

Besides that, substantial numbers of female migrants from Indonesia seeking employment in Malaysia to avoid poverty and to be able to support their families back home (Orange at. el., 2012). However, they had to face unpleasant working conditions with no freedom and long working hours. They have to work for sixteen or even eighteen hours a day, seven days a week (Alice, H. L., 2012). Moreover, they had found themselves in a situation of abuse. They had face mistreatment and violence while working in Malaysia.

The productivity challenge is interplay between human capital development issues (affecting the supply of skill) and broader investment climate issues (affecting firms' productivity and the demand for skill). The concern is that this interplay has caused the Malaysian economy to be stuck in undesirable low-skill low-productivity equilibrium, where the demand and supply deficiencies reinforce each other. The low level of productivity is due to the dependent on large number highly unskilled labor, low level of technological development and lack of R&D activities and innovation (Bardan, H.S., 2012).
1.5 Objective of the Study

1.5.1 General Objective

The general objective of this study is to investigate the impact of immigration on major sectors productivity in Malaysia.

1.5.2 Specific Objective

The specific objectives of this study include:

1. To investigate whether the productivity differences vary between industries: construction sector and manufacturing sector.

2. To examine the relationship between immigrants and native: complementary or substitute.

1.6 Significance of the Study

This paper has attempts to investigate the degree to which immigration has affected productivity growth over the 1980s, 1990s and 2000s. This study is determined whether immigration will lead to economic growth or vice versa. The data from this study can be used as reference for production planning. The results obtained from this study might provide a deeper insight for government to understand the impact of immigration on productivity in Malaysia.

This study will benefit the countries’ policy makers in decision making. A good management on immigration might result in economic growth rather than economic recession.
With the gradually increase in standard of living and productivity growth in Malaysia, government should reconsider of fully utilize the domestic labor instead of still depending on foreign labors. Malaysia had experience a massive capital flight with the sudden reversal of huge net portfolio capital inflows during 1992 and 1993 (Jomo, K. S., 2002). Through limiting the influx of foreign labor, this might enable governments to prevent further capital flight which is due to large capital outflow. Therefore, policy makers should improve the migration policy of the country in order to sustain or increase economic growth. The findings can straighten out the important light on issues toward economic growth which relating to the productivity. This can be very useful in implicating the policy for developing economy’s manpower.

This study will enhance the knowledge of relationship among immigrants, productivity and economic growth to assist policy makers in implementing new policy for Malaysia. Moreover, it also helps future researchers to conduct further studies which are related to the immigration issues and productivity for other countries.

1.7 Scope of Study

This study investigates the impact of immigration on productivity in Malaysia. The research is based on the theory which suggests that immigration occurs as a reaction to differences in standard of living and expected earnings between both areas. This has provides some of problems in the industries through the loss of productive members of the population. Therefore, improving the targeted policies that aimed at restraining the incidence of immigration
will set out a long way in increasing productivity in Malaysia. This study is based on a time series data covering the period from 1982 to 2012.